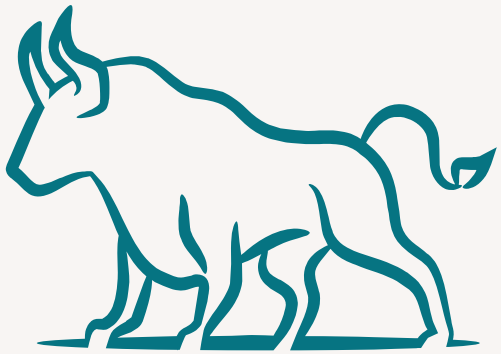
Market Outlook 2019.

Is This The Year of Investing Dangerously?

We're entering a tumultuous time for financial markets. A key driver of recent volatility has been political risk from unusual places. Political risk tends to be more associated with frontier and emerging markets. But today, developed regions like the U.S. and Europe have investors spooked about the policies being introduced by non-traditional political leaders, and the impact of these policies on bond and equity markets, as well as on overall investor sentiment.

Other areas of market uncertainty include the inevitable end to the record-breaking bull market in equities. On the positive side, the potential impact of U.S. corporate tax cuts have underpinned equity market strength over much of 2018.

There's more to the story … so read on and find out what we think will happen in 2019 in global financial markets.



It doesn't take a market prognosticator to see that this bull run is giving way to more uncertainty.

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The United States.

How can the U.S. economy be so strong when there's so much uncertainty? Maybe this was always the case, but it seems more obvious now that we live in a social-media-driven world. There are big changes afoot in markets, and 2019 might be an event-driven year.

The President vs. the U.S. Federal Reserve Board – Parts I, II and III. Based on economic data and its outlook for their future, the U.S. Federal Reserve Board ("Fed") has found it prudent to remove monetary stimulus at a fairly brisk rate. However, the President disagrees. His roaring equity markets have turned volatile and enemy number one is the Fed. We don't expect this battle to stop in 2019. To keep tabs on all things President vs. the Fed, take a scroll through Twitter in the early morning hours.

Up, up and away! The Fed's target range for its key interest rate stood at 2.00%-2.25% in November 2018, up from 1.25%-1.50% at the beginning of the year. We expect the Fed to keep raising interest rates in 2019. Risks, political and otherwise, remain, but three rate hikes next year would not surprise.

The past 10 years have been a blast. But what goes up, must come down. That includes equity markets. It's been a decade-long bull market that's getting a little long in the tooth. With interest rates rising, geopolitical uncertainty growing, global economic growth slowing and valuations at the higher end of the spectrum, equities are due for a sustained pullback. How much? 10%? 20%? 30%? Nobody knows for sure, but we can be certain a pullback isn't too far off. Get ready to deploy your idle cash.

Trade wars: the U.S. perspective. Trade disputes, disruptions and tariffs have been enacted to support American businesses. However, American businesses also rely on trade with other countries to aid their performance. Other countries have been quick to put up tariffs of their own in response to those imposed by the U.S., hurting some American businesses. However, the threats have resulted in one completed deal already between the U.S., Canada and Mexico. Unfortunately, the biggest loser in all of this could be the American consumer. Imports now cost more and, eventually, those rising costs will be passed along to the consumer.

We'll keep the Senate, you take the house. In the mid-term elections, Democrats took control of the house of representatives. Republicans, meanwhile, maintained control of the Senate. Now the predictions of how it will all work together and what major initiatives will, or won't, get passed begins. How will the results impact the economy? How will financial markets react to the results? Some sectors will get a boost, while others may not be so lucky. Either way, it'll be another combative two years in federal politics.

Consumers may curb their discretionary spending. The consumer discretionary sector has experienced sensational growth over the past year, driven by the robust spending of the American consumer. However, higher interest rates could curb these spending patterns, especially on non-core items.

Some exposure to cryptocurrencies, please. Will any company be able to slip a bitcoin exchange-traded fund ("ETF") application by the Securities and Exchange Commission ("SEC")? Time will tell. It would appear that the demand is there, it's just a matter of fundamentals, risk and regulations. The SEC was concerned that there is the potential for manipulation and fraud in this market, while the futures markets tracking these crypto assets are not yet large enough. As regulators around the world look to put rules and regulations around cryptocurrencies, it is only a matter of time until they become even more mainstream and warrant a listed ETF.

Canada.

When will Canada break free? Equity markets have stalled, and some kind of economic change is required for the country to be what it can truly be. We believe there are very few reasons why the Canadian health care, tech and financials sectors cannot be among the world's leaders.

Expect more available parking spots at the mall. Consumer spending falls drastically. Economics 101. When a rational human is presented with the option of spending their money or saving at higher interest rates, they will delay satisfaction now for happiness later. Rising interest rates should encourage saving. However, add on all-time record highs for consumer debt, and the name of the game may instead be debt repayment. Further rate hikes by the Bank of Canada ("BoC") are likely to put the squeeze on indebted Canadians. Disposable income will fall, spending will decline, Canadian economic growth could stall further, and consumer stocks may feel the pinch.

The Bank of Canada's thumb is on the pause button. While Canada's neighbour to the south has a booming economy, it's harder to predict where Canada is going. Some things seem wonderful, others seem terrible. We expect more economic challenges to bubble to the surface this year, forcing the BoC to halt or drastically slow its interest rate increases.

To change or not to change? That is the question facing the advisory business. Fiduciary duty? Trailer fees? Title changes? Big changes are coming to the advisory business, but determining when these changes will be introduced and how extensive they are going to be is anyone's guess. Let's take a shot. Changes to fiduciary duty and trailer fees may have to wait another year, but title reform is sorely lacking and changes will impact the industry very soon. Financial planners, financial advisors or financial consultants? No doubt the securities administrators will look to clarify the different roles and responsibilities to ensure clients are well represented and understand the exact role of their financial representative.

What's the alternative? No longer just the domain of accredited investors, alternative investment strategies, known as liquid alts, got the green light by the Canadian Securities Administrators in 2018. Industry players are clearly chomping at the bit to launch their own liquid alt offerings. Given recent volatility in the markets, this may just be the perfect time to launch these types of mandates. Expect to see liquid alts being offered by many different manufacturers across retail investors' portfolios by the end of 2019.

Can energy and materials stocks get back to black? Energy and materials stocks have had a rough couple of years, and trade disputes aren't helping these sectors at all. Political rhetoric, as well as misaligned supply and demand fundamentals, are pushing prices all over the map. If trade uncertainty between the U.S. and China persists, a decline in manufacturing activity in China will impact demand for commodities and add further pressure on prices. Worldwide tariffs on aluminum and steel could also affect demand and pricing. All this means 2019 could be another difficult year for commodity stocks.

Cannabis valuations are high. Luckily, so are many Canadians these days. Despite being massively unprepared (we're looking at you, Ontario), the 2018 legalization of cannabis went relatively smoothly. We'll see the launch of many new cannabis products, including beverages, in 2019, which should help keep the market growing. Where's the weakness in this industry? Probably the growers and producers, as price competition will drive a race to the bottom. Enter the cannabis lobbyist.

Boring, profitable banks will stay boring and really profitable. Cynical commentators have been waiting for one of Canada's banks to make a big mistake. But it hasn't happened in a long time. Will 2019 see a return to drama within the banking behemoths? Don't hold your breath.

Europe.

Europe has made huge gains over the past decade. We hope that the region can overcome all the political disruption taking place and keep moving forward with stronger economies, higher employment, greater earnings, as well as forward-thinking tech and industrial development. But everyone knows there are large roadblocks.

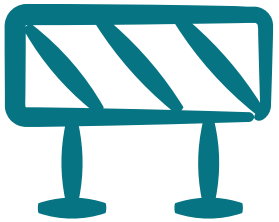
Messy Brexit. In retrospect, there was no way that Brexit would go smoothly. It's just too big of a change, and there are competing interests between and within the parties involved. Will there be a no-deal Brexit? Will there be another referendum? One certainty is that Teresa May's run as Prime Minister won't be a long one. She was thrown into a lose-lose situation from which she cannot escape.

Let's try letting it stand on its own two feet. While the European Central Bank ("ECB") has maintained its benchmark refinancing rate at 0%, it plans to conclude its asset purchase program at the end of 2018. This could hurt the economy, which has been boosted by monetary stimulus – meaning low interest rates and asset purchases – over the past few years. The removal of stimulus, combined with so much political change, could disrupt the region's economic and financial market progress.

***Che succede* Italy?** Europe has always been on the vanguard of "isms." This year will be no different as globalism, nationalism and populism fill the headlines, while the media and politicians vie for our attention. But really, what's going on in Italy? Is the political disruption (led by a comedian) really as impactful as it's made out to be?

The Merkel era comes to an end. Europe's most powerful politician – Angela Dorothea Merkel, who has been Chancellor of Germany since 2005 – is retiring at a turbulent time for Europe. Europe has changed a lot under her leadership. Whether you agree with her policies or not, you can't argue that she is leaving a vacuum at the top, and someone with serious political integrity will have to fill that spot and help Europe succeed.

You can't bank on it. It's been a tough year for banks in Europe. Political turmoil and Brexit are wreaking havoc on their share prices. Furthermore, there is no end in sight for the ECB's historically low interest rates. European banks are facing significant headwinds – related to politics, policy and the economy – and there might not be any relief for these banks in 2019.



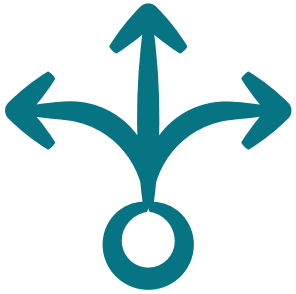
Asia.

Recently introduced tariffs out of the U.S. and elsewhere haven't had much of an impact yet, but they will in 2019 as things play out … or escalate. Gross domestic product ("GDP") increases in Asia over the past 10 years have been staggering, and it is fascinating to watch new economic realities form in front of our eyes.

Roaring like a tiger! India is often forgotten as an emerging markets powerhouse out of Asia. Make no mistake, it is. And India's economic might appears to be increasing. Domestic consumption is a strong driver of economic growth, as India's middle class continues to accumulate and spend their money. Improvements in that country's manufacturing and services industries will have a meaningful impact on its growth, giving India's economy a lot of runway. Should a slowdown in global economic activity persist, India will no doubt feel the pinch. Nevertheless, the country could continue to experience tremendous growth in 2019, as it cements itself as one of the world's economic leaders.

Trade wars: China's perspective. We saw a slight pullback in China's economic growth in the third quarter of 2018. While exports did not drag down the country's wider economic performance, tariffs imposed by the U.S. will result in softening exports in the near term. The Chinese economy is heavily impacted by its robust exports to other countries, especially the U.S. Prolonged tariffs and/or trade disruptions could have a meaningful impact on Chinese economic growth.

Calling all citizens: PLEASE SPEND! Trade uncertainty doesn't appear to be going away anytime soon. How can the Chinese government ratchet up other parts of its economy? Easy! Encourage consumer spending. This isn't a new idea. The government has been looking to make significant inroads in domestic consumption for years. Recently, the government has looked at implementing new policies to increase spending by its citizens to counterbalance any loss from decreased trade with China's historical trading partners.



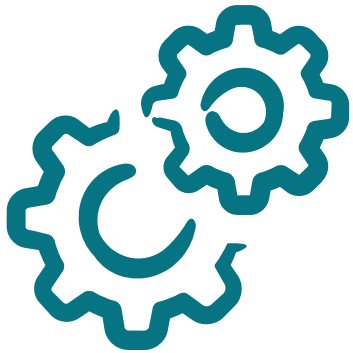
Fixed income.

Going into 2019, fixed income markets are a bit of a mystery to us. And so are the actions of central banks, which often seem to do the wrong thing. But we do have a few thoughts about the next 12 months.

Yes, yes, no, yes and no. "What is: did the Fed, BoC, ECB, Bank of England and Bank of Japan raise interest rates, Alex." Monetary tightening has begun and will continue in 2019. Some central banks are looking to get their interest rates back to "normal," while also moving their countries' inflation rates closer to their targets. Other central banks are struggling to make the jump, given soft spots in their respective economies. Will we see some convergence in 2019? Loose monetary conditions must end eventually, right?

Topsy-turvy curvy? The good old yield curve. Much has been discussed and documented about its pending inversion. Will it? Won't it? And what will happen if it does? Everyone has an opinion, making for some heated discussions around the water cooler. What we do know is that interest rates at the short-end of the curve have risen faster than their longer-term counterparts, flattening the yield curve at the tail end of 2018. We expect short-term rates to rise even further, most likely at a steady pace. The ball is in your court, long-term yields.

Easy money triggered increased borrowing. Is the party over? In response to ultra-low interest rates, corporations turned to debt markets to finance their needs. Going into 2019, corporate debt is at extremely high levels, meaning even small rate increases can have a meaningful impact on many companies' ability to carry that debt. We expect significant pressure on heavily indebted companies, sending some of the more poorly managed players into distress.



Final thoughts on 2019.

As we said last year, we're not prognosticators and we warn you against taking anyone who professes to be one seriously. But it is constructive to think about what events might happen, the likelihood of those events happening and how markets may react to them.

Our final thought? Expect politically driven financial market volatility as investors get more frazzled by conflicting messages. Have some cash ready for when opportunity strikes, which it most probably will. And don't forget to tighten your seatbelts. We're in for a bumpy ride in 2019.

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