March 31, 2017

MARKET COMMENTARY

Q1 IN REVIEW

Canadian equities have benefitted from an improving market outlook. The S&P/TSX Composite Index increased 2.4% on a total-return basis during the first three months of 2017. A strong performance in Financials offset the recent lag in Energy prices. However, nine of the eleven sectors generated positive returns, with the best performers being Utilities, Information Technology and Consumer Discretionary returning 7.3%, 7.0% and 7.0% respectively. Also making a significant contribution during the first quarter was the gold sub-sector, with share prices once again rising after a correction period during the latter part of 2016, with recent softness in the U.S. dollar being the main driver of returns in the sub-sector and its underlying commodity. Shares of the more cyclical lumber, diversified metals and mining companies also performed well, as did their underlying commodities, specifically, copper, iron ore and zinc, as supply–demand fundamentals showed signs of possible further tightening.

The U.S. stock market continued to push higher during the quarter. The S&P 500 Index increased 6.1% (in USD) on a total-return basis during the first quarter with U.S. large-capitalization stocks outperforming mid- and small-cap stocks. Heavy sector rotation was a feature as investors weighed the likelihood of whether certain aspects of U.S. President Trump's legislative and policy agenda would be enacted. In late March, this uncertainty increased when U.S. House Republicans failed to repeal and replace the Affordable Care Act ("ACA"). With the exception of Energy and Telecommunication Services, all sectors generated positive returns during the period with strong contributions from Health Care (in anticipation that the ACA would be repealed and replaced), and Information Technology (thanks to positive results from Apple Inc., Facebook, Inc. and Microsoft Corporation).

International equity markets also recorded gains during the first quarter with Information Technology, Industrials, Health Care, Consumer Staples, Utilities and Materials sectors leading the way. For the quarter ending March 31st, the MSCI EAFE Index generated a total return of 6.6% (in CAD). Similar to Canada, Energy was the worst-performing sector internationally and experienced declines during the quarter following a small correction in oil prices during the month of March as a result of reports of a ramp-up in production activity and rig utilization with U.S. shale producers.

Developed foreign markets, which struggled as compared to emerging markets last year, moved ahead during the quarter. In Europe and Asia, markets finished the period at close to 52-week highs, with ongoing accommodative monetary policy in Japan and Europe appearing to have a positive impact on demand from market participants. With European banks increasing late in 2016 after the U.K. voted to exit the European Union ("Brexit"), broader markets have effectively increased, helped in part by stronger commodity prices.

Leading economic indicators look healthier than they have in several years, economic surprises have begun shifting to the positive side and corporate earnings both in the U.S. and Canada continue to recover. While there is a great deal of uncertainty around just how U.S. public policy will play out and what the long-term impacts might be for the economy, optimists continue to outweigh pessimists in North American markets. As a result, equities have performed well, enjoying relatively little volatility during their recent ascent outside the more cyclical (and volatile) commodity sectors.

Source: Brown Advisory, Louisbourg Investments, Manulife Asset Management

Market Snapshot	3 mth (%)	YTD (%)	1 yr (%)	3 yr (%)	5 yr (%)
S&P/TSX Total Return	2.4	2.4	18.6	5.8	7.8
S&P 500 Composite Total Return ($ Cdn)	5.2	5.2	20.4	17.5	20.0
MSCI EAFE ($ Cdn)	6.6	6.6	15.3	7.4	12.6
MSCI Emerging Markets Free ($ Cdn)	10.6	10.6	20.8	8.1	7.2
FTSE TMX Canada Bond Universe Total Return	1.2	1.2	1.5	4.1	3.5

Source: Manulife Asset Management
*Performance histories are not indicative of future performance. An index cannot be purchased directly by investors.

Tortoise vs. Hare: Slow and Steady wins the Race?

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For long-suffering Toronto Maple Leafs' fans, Auston Matthews is the new hockey god. The 19 year-old phenom has now set the record for the most goals by a U.S.-born rookie. With this momentum, many Leafs' fans, including some in my office, think that the 2017 Stanley Cup champions will be the Maple Leafs. For the record, I have been a long-time Canadiens fan and I know this is our year!

But, is it possible that the Leafs can win the Stanley Cup this year? Sure. Is it probable? No. Consider the facts. Matthews also has scored the most goals as a rookie since Alexander Ovechkin did for the Washington Capitals in 2005 – 06. How many Stanley Cups have the Capitals won? Exactly. Zero.

The point is not that Ovechkin is not a great player. He is. The point is not that Matthews will not become a great player. I think he will be. It is that people take a small sample – 82 games in a season or, worse, the last ten games – and project on that basis. This is what Nobel-prize winner Daniel Kahneman and his late collaborator, Amos Tversky, called the "Law of Small Numbers"[1] – people's belief that a small sample (i.e. one season) is representative of the population (i.e. the next ten seasons). People forget that opposing teams learned how to play and defend against Ovechkin just as they will learn how to play and defend against Matthews. So Ovechkin and Matthews will have to continue to up their game, perhaps focus more on assists than goals, stay healthy, etc.

The belief in the Law of Small Numbers is rampant in the investment world. People piled into dotcom stocks prior to the Tech Bubble based on stellar returns in 1999 only to have their holdings crash in 2000 and 2001. In the Toronto area, people are now entering bidding wars for houses based on beliefs that the returns of the last couple of years will continue unabated for the next

[1] Tversky, Amos and Kahneman, Daniel, "Belief in the Law of Small Numbers"

five to ten years. Similarly, people avoided the markets and stayed in cash after the Great Recession in 2008 despite the fact that some of the equities bounced back quickly.

CPPIB, the Canadian pension plan, and OTTP, the Ontario Teachers' Pension Plan, two of the leading institutional investors in Canada (and the world) reported fiscal 2016 performance of 3.4% and 4.2% respectively. Not particularly impressive if one were to judge the investment smarts of these "smart" investors by fiscal 2016 returns. More importantly, however, consider that in fiscal 2015, CPPIB returned 18.3% and OTTP returned 13% and their five-year annualized returns are 10.5% and 10.5% respectively. That's impressive and that is why they are both considered the "Smart Money" in Canada.[2]

Can CPPIB or OTTP have a bad year? Sure. Would I bet against them? Not on your life. As CPPIB says, they invest not for the quarter but for the quarter century. In this context, process, people and philosophy matter – that is why CPPIB and OTTP have great long term track records. And that is why we at Manulife Private Wealth have designed our investment process to provide the same type of philosophy and process as the big successful institutional players.

And will Matthews bring Leafs' Nation a Stanley Cup? Time will tell – but, as a professional investor and not, repeat not, as a Canadiens' fan, I wouldn't bet against it.

[2] CPPIB returns from their website http://www.cppib.com/en/our-performance/; OTTP returns from their website https://www.otpp.com/investments/performance;jsessionid=ZtJPDaooHkdTUM7JCjSQbkQd.undefined

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