WAAC Perspectives

TD Wealth Asset Allocation Committee (WAAC)

AUG 2019

At a glance

1. **Overweight equities, and underweight fixed income**
2. **Expect lower for longer** rate environment to continue with inflation low and central banks accommodative
3. **Corporate credit** benefiting from strong free cash flow and low default risk
4. **Protracted conflict** between China and the U.S. on issues of trade and technology leadership
5. **Episodes of volatility** may be driven by trade frictions and slowing global growth

Positioning Changes

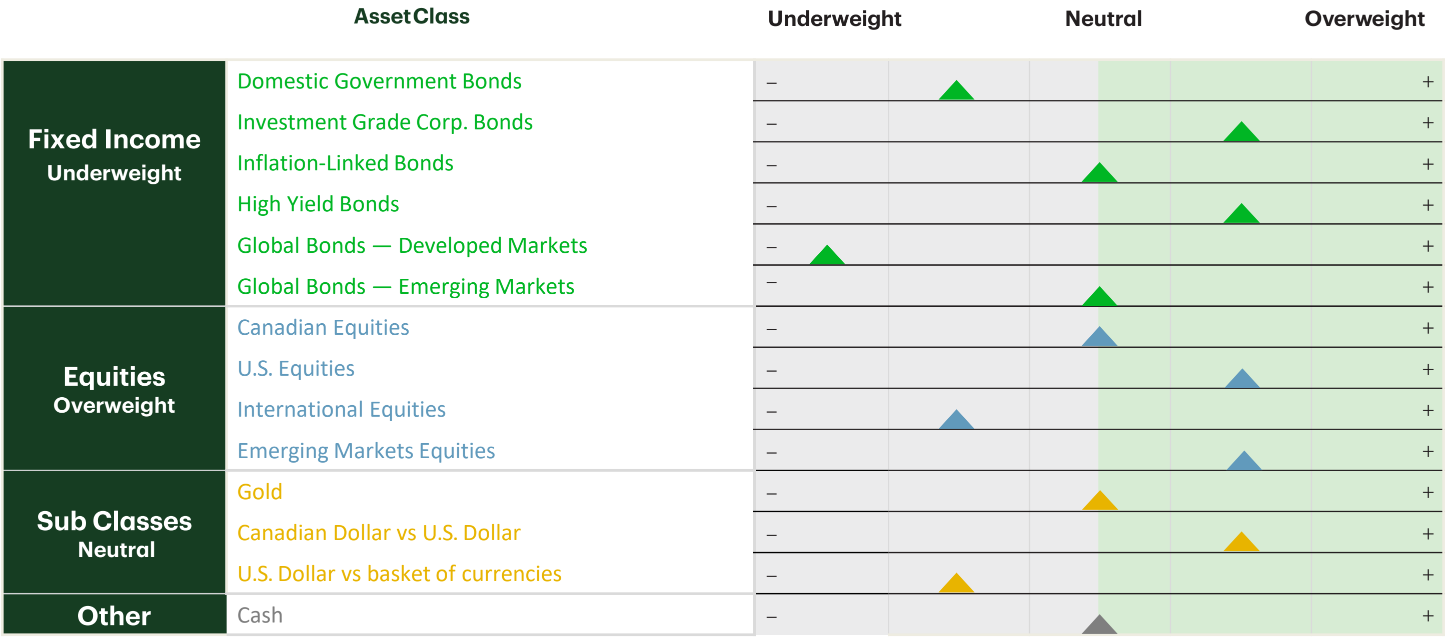
No positioning changes for August 2019

> We expect trade frictions between the U.S. and China to persist for some time, but do not anticipate a total collapse in the relationship. In the short term the dispute will likely create volatility, however continued strength in the U.S. economy and labour markets, combined with low interest rates, should minimize downside risk.

	WAAC is Watching	Potential Implications
Canada Neutral	**Corporate earnings coming in solid; economy remains relatively healthy**	About 50% of Canadian companies have reported quarterly results, and most have been solid. The reporting companies beat estimates by an average of roughly 8%, with Energy stocks leading the way. The Energy sector has demonstrated improved fundamental trends in revenue growth, cash flows, earnings and margins, however this has not contributed materially to higher share valuations. On the economy: Gross Domestic Product data showed a third straight month of growth, driven by strength in manufacturing and construction. Housing starts were higher, the unemployment rate continues to trend lower, however retail sales were a bit soft. Canada's core inflation measure came in at around 2% in June, which is within the Bank of Canada's ideal range. Canadian equities continue to trade at a discount relative to U.S. stocks (approx. 14x vs. 17x forward earnings). However, we maintain a preference for U.S. equities due to continued Energy Sector structural challenges, (despite evidence of corporate strength) and over-leveraged Canadian household balance sheets.
U.S. Modest Overweight	**Quarterly earnings slightly higher, while U.S. corporate health remains strong**	Most U.S. companies have reported Q2 results. Revenues have increased around 2%, while Earning Per Share (EPS) rose roughly 3%, versus the same period a year ago. Margins are down slightly but remain at solid levels as companies continue to manage cost structures effectively. Additionally, share buy-backs have added about 2% to growth. We feel U.S. equity valuations remain reasonable in light of historically low fixed income yields and strong corporate health. We consider the quality of corporate earnings to be high and as companies continue to generate substantial free cash flow, we expect them to continue boosting dividends and share buy backs.
	President Trump threatens more tariffs, jolts markets, but U.S. economy steady	Following fresh all-time highs in July for the S&P 500 Index, August introduced a volatility spike and sharp market declines. The main culprits: less dovish messaging from the U.S. Federal Reserve (Fed) and threats of new tariffs on $300 billion worth of Chinese imports. In the wake of the tariff announcement, U.S. 10 and 30-year treasury yields fell to multi-year lows as investors fled riskier assets for the safety of government bonds. In July, the Fed cut its policy rate by 25 basis points. In its comments, the Fed suggested that the move did not signal the start of a "lengthy cutting cycle" dashing hopes that rates would be cut more aggressively. We expect trade frictions between the U.S. and 3China to persist for some time, but do not anticipate a total collapse in the relationship. In the short term the dispute will likely create volatility, however continued strength in the U.S. economy and labour markets, combined with low interest rates, should minimize downside risk.
International Modest Underweight	**ECB and BOJ hold rates steady, indicate further easing measures if warranted. Brexit uncertainty remains an overhang.**	The European Central Bank and Bank of Japan kept rates on hold in July, however they both stated a commitment to providing further stimulus if warranted. New UK pro-Brexit Prime Minister Boris Johnson has pledged to leave the European Union on October 31—with or without a deal. The British pound has weakened sharply against the U.S. dollar and euro, as markets have become increasingly worried about the possibility of a no-deal Brexit. Developed markets have shown weakening trends in corporate revenues, slightly up 2.2%, however margin compression, particularly in cyclical industries, resulted in negative earnings growth. We continue to prefer North American equities over International due to Brexit uncertainty, and weak overall European growth expectations. Additionally, the economic backdrop and corporate fundamentals remain superior in North America.
Emerging Markets Modest Overweight	**Chinese economy decelerating amid escalating trade frictions**	China's economy continues to be lackluster. Second-quarter GDP data highlighted the slowdown, however retail sales and industrial production data showed some tentative signs of stabilizing. Beijing continues to demonstrate that it's determined to keep its economy stable through fiscal stimulus measures. Additionally, China recently allowed its yuan to weaken to an 11-year low against the U.S. dollar making Chinese goods less expensive abroad, which could help cushion the effects of U.S tariffs. We continue to cite a deterioration in the U.S./China trade relationship as a primary risk to the economy and markets. The heightened frictions have become amplified recently with the global economy decelerating and China experiencing softer GDP growth relative to recent years. Despite ongoing trade concerns, we remain modestly overweight Emerging Markets equities, on a valuation basis, and a resolution, or partial resolution to the trade dispute could act as a tailwind for China and other Emerging Markets.

Strategic Positioning

At a Glance



We continue to monitor the above economic and market themes, and in our view, believe that maintaining a portfolio of high-quality assets is critical to long-term investment success. While there is always potential for market volatility, we encourage investors to remain focused on the long-term. We consider periods of higher volatility to be normal market behavior that can help clear excesses, and often creates investment opportunities.