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Portfolio Management Report

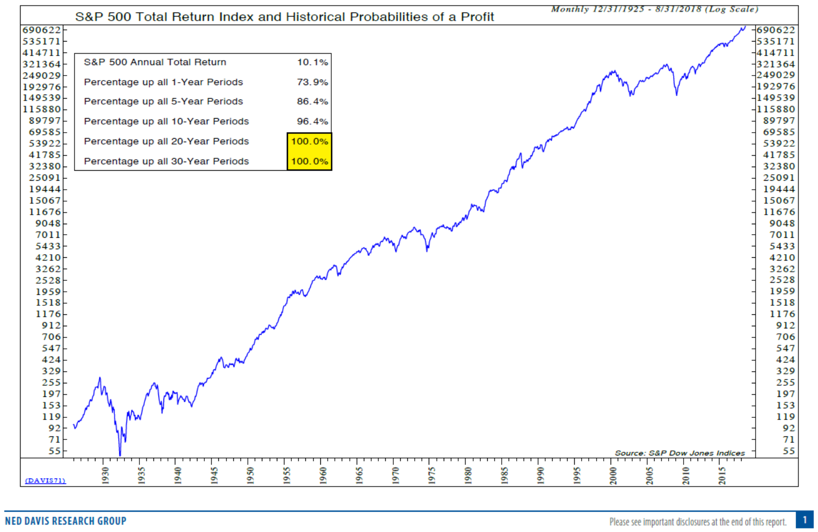
Third Quarter 2018

The Difference between Luck and Success is Duration…

The third quarter of the calendar year always marks an important date for all of us here at Raymond James. Unlike most Canadian financial institutions which end their fiscal year in October, Raymond James's fiscal year is September to September. Every year around this time we look back to reflect on some of the accomplishments across the fiscal year, as well as to uncover and discuss any missteps that may have occurred. Looking back, throughout the year we did welcome many new clients to the Raymond James "family" and as always we worked hard to maintain the confidence held with existing clients. As often mentioned in meetings, on conference calls and in print, the foundation upon which our business is built and at the core of every relationship is the trust our clients bestow in us. We can confidently say that we do not take this core principle lightly and we constantly challenge ourselves to ensure each client's goals, objectives and ambitions are met with an offering that they can view as "best in class". Each day we look to improve and enhance our business in areas such as client servicing, emerging trends, changes in technology, third party relationships, new opportunities in registration and licensing and of course portfolio management. This helps to ensure that our offering is at the forefront of the investment industry.

To stay on top of all of these requires diligence, attentiveness and commitment. These commitments are top priorities and will not change as we move forward. Another commitment that will not change is our conservative investment approach and our focus on protecting client's capital across the changing investment landscape. This conservative approach was instilled by the founders of Raymond James back in 1962 and has been adopted by all members of the team today. Most importantly, it is what our clients seek. In an environment that is so greatly impacted by the advancements in technology and communication (both negatively and positively) the constant burden and question of *"what to do with my money"* is persuasive and real. That is why we believe that now more than ever the relationship between an investment professional and an individual who looks for guidance is of utmost importance. Every client is different. Each circumstance is unique. Every conversation is exclusive. Everyone's experience is diverse. That said, what is widely common amongst the clients and investors we work with is the understanding that to achieve success and reach their objectives, a longer tem approach is essential. At times this can be demanding, but those with investment experience and tenure will acknowledge the benefits of using time or duration to one's advantage.

To us, the difference between luck and success is indeed duration. The context in which investors view success is certainly wide-ranging and comprehensive. To some it may be to protect their capital regardless of return potential, whereas some view success as "winning" by participating in a hot sector where momentum is strong and quick gains are the perceived outcome. Others view success as outperforming a benchmark or index, a strategy often referred to as relative performance. From our lens, success should be viewed in the context of the risk taken to achieve a desired outcome. These risks include market risk, inflation risk, interest rate risk, cost risk, longevity risk and opportunity risk to name a few. The management of these risks is critical to attaining the desired outcome, which for the majority of investors should be measured in years (duration) as noted above. As statistically proven, as duration increases so does one's success rate, with the probability of profits increasing to 86% after 5 years and 96% after 10 years for equity investors (see chart to the right by Ned Davis). Unfortunately, the ability for one to remain committed to duration is often challenged by short term aberrations and decisions are often reflective of this. As such,

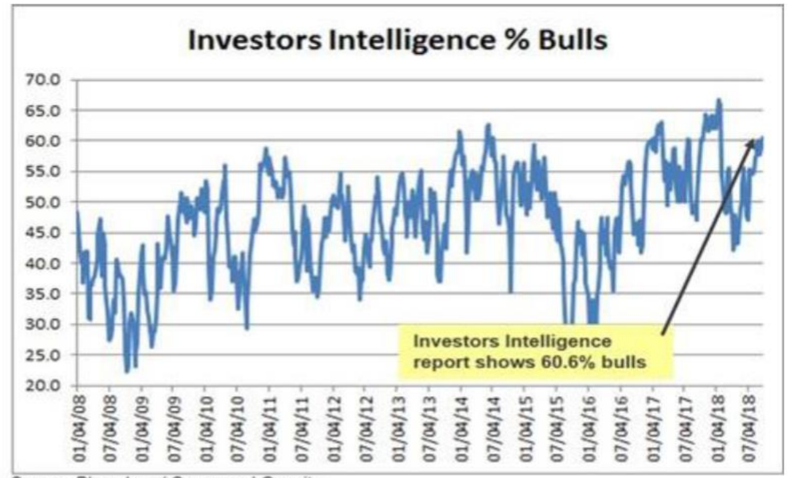


when duration is reduced to days or weeks so do the odds of success as "luck" and timing become critical. Good portfolio management is a process in which duration is used to one's advantage, while taking into consideration the above noted risks and the interconnected relationship of them. Technical and fundamental analysis is also required, in addition to the ability to remove personal biases and a knack to listen to the message of the market.

And certainly listening to the message of the market has been our chosen tact throughout the third quarter and the better part of 2018. While many have focused on the perpetual watershed of news and opinions, we have preferred to focus on the underlying fundamentals that drive the direction of markets; earnings, monetary policy & interest rates, valuations, sentiment and supporting economic data. To date, the majority have been relatively buoyant with the likes of earnings only improving and the path of monetary policy falling in line with expectations. Despite sentiment that appears to be elevated based on a select few measures, conversations amongst retail investors do appear to be cynical or hesitant at best. With equity markets once again probing all-time highs as of writing, baffled minds question the validity of such advance and calls for a "double-top" formation have once again emerged. Our work instead leads us to believe that what has parsed the lips of Main Street will inevitably be transitory and the catalysts that have allowed for new highs on Wall Street should only foster additional gains as we move forward.

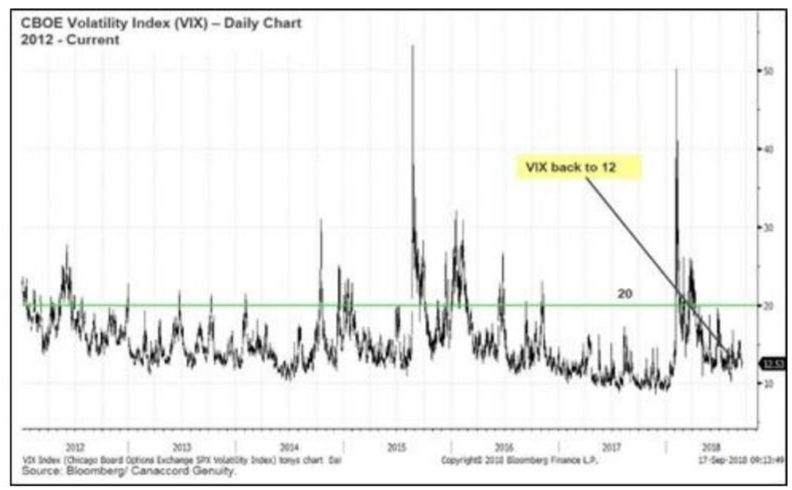
To reiterate this view, Tony Dwyer of Canaccord Genuity recently wrote, *"We have spent the better part of the past month on the road meeting with professional and individual investors alike from Europe, Canada and the US. We found the sentiment to be generally bullish, but nervous. The fear is that this long into an economic cycle, there has to be something scary around the corner, especially given the political theater in Washington, the eighth Federal Reserve interest rate increase since December 2015, and an increasingly likely "trade war." We do believe that these issues coupled with high Institutional Investors' Newsletter Writers optimism and a historically low CBOE Volatility Index (right) continue to create an environment that is ripe for volatility. We also continue to believe that any increased volatility should prove temporary as history shows positive earnings should drive the S&P 500 (SPX) to our 2018 and 2019 targets of 3200 and 3360, respectively, until an identifiable recession is in sight. Q3/18 EPS estimates look to be up over 21%. With the start of the third quarter*

Figure 1: Bullish Newsletter Writers are over 60% "bullish"



Source: Bloomberg/ Canaccord Genuity

Figure 2: The VIX is back toward the lower end of the range



2018 earnings season just around the corner, we thought it would be good to highlight that current SPX operating EPS estimates should again be up similar to the past two quarters.

• Q1 & Q2/18 EPS growth was up at least 25.0%. Growth was driven by the more cyclical sectors such as Energy, Materials, Info Tech, and Financials. Clearly, the 2017 tax cut legislation and more business-friendly regulatory backdrop opened the door for accelerated domestic economic growth and a jump in SPX EPS.

• Q3/18 EPS growth is estimated to be up 21.6% (Figure 3). Continued growth in the cyclical sectors is driving the upside in what likely should prove the third consecutive quarter of 20%+ EPS growth. Eight of the eleven SPX sectors look to be up double digits.

Figure 3: Current Q3/18 SPX growth estimate is up 21.6%

Sector	Today
Consumer Discretionary	12.8%
Consumer Staples	7.2%
Energy	97.0%
Financials	41.6%
Health Care	10.8%
Industrials	16.9%
Materials	30.9%
Real Estate	4.4%
Technology	20.2%
Communication Services	15.1%
Utilities	4.9%
S&P 500	**21.6%**

Source: Thomson Reuters I/B/E/S

Summary – We continue to believe the strength in EPS, coupled with strong business and consumer confidence should cause any market weakness to prove temporary until there is an identifiable recession in sight. Sustainably negative economic periods don't magically materialize because rates are going up; they are driven by credit stress that leads to a credit crisis strong enough to shut down money availability. History shows this happens more slowly than many fear, as proven by the lead time to recession of the initial inversion of the 2-10 year U.S. Treasury Yield Curve, and the cycle highs of the NFIB Small Business Optimism and ISM Manufacturing Surveys."

We find it difficult to disagree with Mr. Dwyer's outlook and note that the correlation between earnings and the direction of equity markets is 0.94 (a correlation of 1 refers to two data points that move identically in tandem). If earnings growth is anywhere near forecasts, than the next few quarters should be viewed with a bullish tilt. Trade tariffs, midterm elections and the possibility of a political "blow-up" inside Washington are certainly "risks" that cannot be discounted and have to be respected. We will also note though that 4th quarter mid-term seasonality has historically produced above average return as noted in the final chart below. Therefore, until these unknowns potentially become a clear and present danger, <u>we will use the duration of this secular bull market to our advantage and continue to allocate capital accordingly.</u>

As always, if you have any questions or comments please do not hesitate to contact any member of the team.

We will keep you updated as warranted.

With regards,

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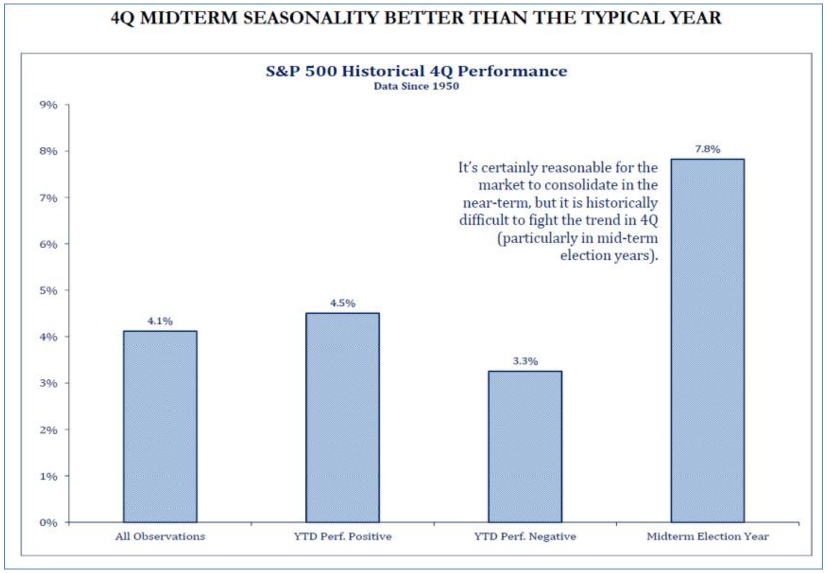

Additional Notes: With the gradual increase in interest rates here in Canada and the United States, we continue to see yields on Guaranteed Investment Certificates (GICs) and Money Market Funds follow suit. As noted in previous updates, current rates on 1 year locked in GICs are between 2.5%-2.8% depending on issuer and 1.6% to 1.85% for money market funds. (Note: these rates are subject to change). For clients looking to "park" cash in an option that generates more than most chequing or savings accounts, we strongly recommend these alternatives.

Also look for new forms of communication in the coming weeks as we look to offer WEBEX updates in place of our conference calls.