

Quarterly Commentary

Architect Program

Jarislowsky Fraser – North American Equity

This commentary has been prepared by Jarislowsky Fraser.

Economic Review

The global economy appears to be moving along relatively smoothly as we take stock of the situation year-to-date. Recent data releases suggest that GDP growth rates are steady, if not robust, and that inflation is under control despite nine years of generally coordinated stimulus from the world's major central banks. The result has been a continuation of the long bull market that has seen many of the world's equity markets reach all-time highs. In the last few weeks of the second quarter, sentiment appeared to change. Despite no indication of rising inflation, the world's central bankers have suddenly become almost universally hawkish, with the governors of the Bank of Canada, the U.S. Federal Reserve, the European Central Bank and the Bank of England all making statements that suggest either a reduction in stimulus or a rise in interest rates. Arguably this should have been taken as good news by the world's markets, as bankers clearly have confidence in the strength of their economies. However, the opposite reaction occurred, with both stock and bond markets selling off quite sharply in the last few days of the quarter.

Canadian Equity

The Canadian portion of the portfolio slightly underperformed in the second quarter. The main reason for the underperformance was a result of the broad-based decline in the Energy sector due to the lower price of oil. The main detractor was **Cenovus Energy Inc.** following the recently announced acquisition of assets from Conoco Phillips. We are disappointed that the acquisition has negatively affected the strength of the company's balance

sheet and brings into question the strength of the company's board and management team. **Open Text Corp.** also detracted performance, showing some volatility in a stock that has done very well over time. This was only partially offset by our underweight in the weak-performing Materials sector and good performance from **Gildan Activewear Inc.** along with **SNC Group Inc.** This quarter we initiated a position in **Saputo Inc.** and exited our position in **Corus Entertainment Inc.** We also trimmed our positions in **CAE Inc.** and **Canadian Tire Corporation, Limited.**

U.S. Equity

The U.S. equity portfolio slightly lagged the market in the second quarter. Returns in USD terms were better; however, the stronger Canadian dollar eroded most of the gain for Canadian investors. Growth sectors led the market, with the Healthcare, Industrials, Financials and Information Technology ("IT") sectors outperforming. Stock selection in the IT sector was the strongest positive contributor to performance, as our balance of growth and value helped to side-step some of the volatility in the actively followed mega-cap names which were not held. **Oracle Corp.** was a solid performer on strong earnings results, which reflect continued success as the company transitions from a legacy on-premise to cloud-based "as a service" delivery models. Our bank holdings rallied on the strong results from the Fed's Comprehensive Capital Analysis and Review ("CCAR") capital stress tests and subsequent increases in dividends. **Bank of New York Mellon** and **JPMorgan Chase & Co.** were top performers. No trades were made during the quarter.

Investment Outlook

In Canada, investors will be looking at the effect of interest rate increases on the housing market in Vancouver and Toronto, but will also consider how the large amount of consumer debt, most of which is at variable rates, affects consumer spending. The banks are well provisioned, but there will undoubtedly be some effect on their consumer loan portfolios. In addition, commodity prices, especially oil and natural gas, will have an outsized influence on the performance of Canadian markets.

In the U.S., the Information Technology sector has led the markets in 2017. While this is unlikely to carry on, at least at this pace, we continue to maintain a meaningful weight in the sector. How the economy performs in the face of rising interest rates is obviously an important factor to watch, but President Trump's policies and unpredictability will ensure that markets remain fairly volatile.

Allocations to equities, especially foreign, have been near the high end of allowable ranges for a number of years. We have occasionally made slight reductions to lower risk but these have generally been somewhat masked by the relatively strong performance of stocks over subsequent periods. Looking forward, not only are the markets nine years into this bullish phase, but there is also an increasing list of potential challenges that could potentially derail them. Some are fundamental, such as high valuations and rising interest rates, while some are broader in scope and less obvious as to their impact, such as terrorism, travel bans, trade negotiations, geopolitics and elections. Risk or volatility, therefore, is on the rise.



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