

## TD Wealth Asset Allocation Committee Overview

- Cautious outlook balances optimism about accelerating global growth against policy uncertainty and ongoing structural challenges
- Central banks transitioning policies from emergency to neutral, but expect lower for longer rate environment to continue
- Neutral rating in equities reflects strong corporate fundamentals offset by stretched valuations in the U.S.
- Preference for international equities driven by attractive valuations and potential for higher growth and inflation to boost earnings
- Potential sources of volatility include elevated global imbalances, particularly Canadian household debt, and friction between the U.S. and its trading partners

Up was the common theme running through 2017: economic growth, corporate earnings, equities, fixed income yields, jobs data and consumer confidence — all up, up, up. Economic growth wasn't quite firing on all cylinders, but it was strong amid a cyclical resurgence and was one of the key driving forces behind these other increases as we witnessed synchronised global growth for the first time in close to a decade.

For example, this solid economic growth helped to spur corporate earnings and equities notably higher. Equity indices in many regions boasted double-digit gains and reached all-time highs, with Europe, Australasia and Far East (EAFE) and emerging market equities outperforming their North American counterparts as they benefitted from both economic improvements and attractive valuations.

Economic growth also bolstered employment data, with unemployment in the U.S. reaching a 17-year low in October and Canada recording 11 straight months of job gains. All of this was enough to inspire consumer confidence, and the Conference Board Consumer Confidence Index reached its highest point since 2000.

### U.S. Unemployment Rate October 1997 - October 2017



Source: U.S. Bureau of Labor Statistics. As of October 31, 2017.

### The Conference Board U.S. Consumer Confidence Index October 31, 1998 - October 31, 2017



Source: Bloomberg Finance L.P. As of October 31, 2017.

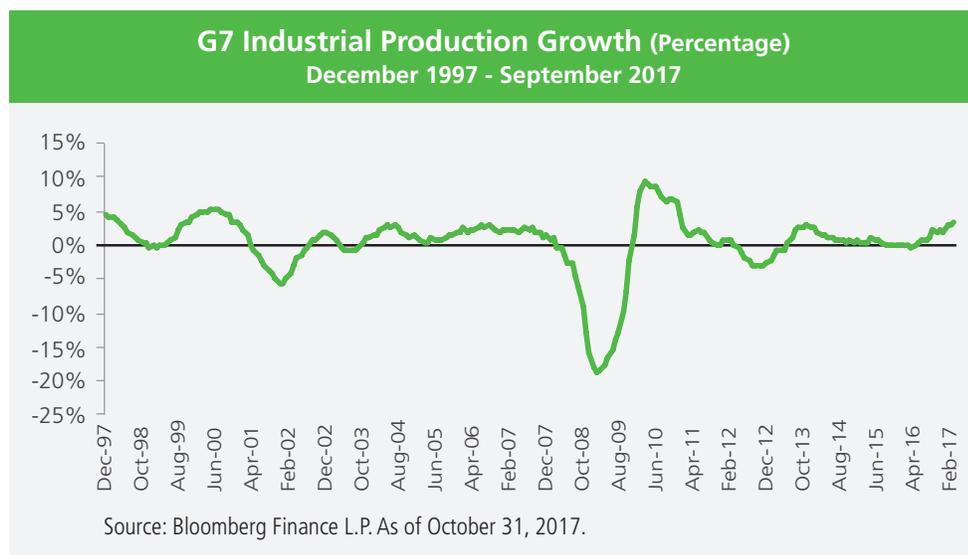


With this robust economic and employment landscape, we have begun to witness a monetary policy pivot. Almost a decade after the beginning of the financial crisis, these improved conditions have finally allowed some central banks to begin reducing their emergency levels of accommodation. The U.S. Federal Reserve (Fed) is leading the way toward a normalization of policy. It has been slowly moving toward neutral by modestly raising its key rate and carefully beginning to unwind its quantitative easing program. During 2017, the Bank of Canada (BoC) and Bank of England (BoE) also raised their key rates modestly, removing the stimulus related to extraordinary events that took place long after the financial crisis (the precipitous drop in the price of oil and Brexit, respectively). However, all three remain highly accommodative and plan to carefully consider developments in relevant data as they continue the journey toward neutral.

## Wealth Asset Allocation Committee (WAAC) Positioning

Moving into 2018, economic indicators continue to show strength, with trade, purchasing managers' indices, industrial production, job creation and construction activity all positive. This should further support solid economic growth in 2018; we anticipate it will be approximately 3.5% globally, which we refer to as Goldilocks growth — not too hot, but not too cold.

Given this, we expect central banks to stay on the road toward policy normalization. However, inflation has remained subdued in spite of improving economic growth and production, and this trend will probably continue in 2018, with elevated debt levels, demographic trends and technology all acting as price restraints. Subdued inflation should moderate the need for significantly higher rates, so we believe central banks will raise rates only modestly during next year, which will extend the low-yield environment for fixed income investors. Ongoing low interest rates should support



current equity valuation multiples, and solid economic growth is likely to drive corporate earnings growth. Both of these should contribute to a continuation of the upward trend for equities, although we do not anticipate gains will be as robust in 2018 as they were in 2017.

We are watching a number of risks as we head into 2018, including geopolitical developments, global imbalances, protectionism and central bank actions, all of which could have implications for financial markets. For example, if current protectionist sentiments result in a trade war, the associated reduction in global trade could dampen economic growth and result in higher inflation. It could also put

downward pressure on equity valuations. Additionally, it is possible that central banks will commit a policy error as they reduce their accommodation. While it is appropriate to reduce emergency measures as they are no longer required, tightening monetary policy to more normal levels while not adversely affecting economic growth or threatening financial stability will be a delicate balancing act. Given that current levels of accommodation are unprecedented, there is no roadmap for how central banks should move forward, therefore we expect them to proceed slowly and cautiously. However, a policy misstep remains a possibility and could create volatility and a difficult environment for investors.

With this backdrop, we maintain our broad asset class positioning, which is neutral equities and fixed income. While we expect equities to outperform fixed income in 2018, we do not believe investors will be appropriately rewarded for the risks associated with an overweight position at this time, and it may be useful to have some dry powder so that any pullback in markets can be used to increase positions. In terms of fixed income, while returns are likely to be low, bonds offer valuable diversification and stability benefits to portfolios. Therefore, we continue to believe a balanced approach is warranted and favour a diversified portfolio that includes:

1. High quality equities that have the ability to increase their earnings and dividends in a low growth environment and thereby protect the real value of investors' savings.
2. An allocation to cash to provide stability and safety of capital.
3. An allocation to high quality domestic government bonds and investment-grade corporate bonds to provide some income, diversification and stability.

**Below is our current positioning within these asset classes.**

## Equities

- Overweight international equities
- Neutral U.S. and emerging market equities
- Underweight Canadian equities

While equities were hot in 2017, we expect more modest returns for 2018. Overall, we anticipate that they'll deliver mid-single-digit returns. Our current geographic preference is for international equities as their valuations are attractive relative to those in North America and

European companies stand to benefit from improving economic growth, which lagged meaningfully following the financial crisis.

We are neutral U.S. and emerging market equities. In the U.S., free cash flow is strong and attractive versus fixed income yields. In addition, corporate tax cuts could add significantly to earnings, which does not appear to have been fully priced into the market. However, valuations are high. We believe that the ongoing low yield environment should support current valuations, but do not expect that they will expand significantly from here. In the emerging markets, equities are likely to benefit from positive global economic growth. Political risks in key regions have diminished and commodity prices appear to have stabilised, which should also be positive for emerging market equities, but our optimism is tempered by concern over high debt levels and a potential reduction in liquidity.

We are underweight Canadian equities. Economic growth in Canada was robust in 2017, but we believe the pace will slow in 2018. We have long cautioned about the side effects of high debt levels, and a recent Organisation for Economic Co-operation and Development (OECD) study notes that Canadian households are now the most indebted in the world. We anticipate this will lead to a reduction in personal consumption, especially amid tighter monetary conditions brought on by the BoC's 2017 interest rate increases and tighter mortgage lending rules. This is concerning as personal consumption has been a key driver of Canadian economic growth. Business investment could pick up some of the slack and contribute to growth; however, uncertainty about the outcome of North American Free Trade Agreement (NAFTA) negotiations appears to be restraining business investment. If economic growth does decelerate, it will be more difficult for companies to grow their earnings.

## Fixed Income

- Neutral cash, domestic government bonds, investment grade corporate bonds and inflation linked bonds
- Maximum underweight high yield and global bonds

As noted above, economic growth has been strong, and both the BoC and Fed have begun raising their key rates. While it is reasonable to anticipate that the BoC could raise its rate further if growth were to continue expanding in 2018, we expect increases will be modest. Key rate increases in the U.S. are also likely to be modest as inflation remains contained. While there will be a change in leadership at the Fed, with Jerome Powell taking over as Chairman, we believe the transition will be smooth and think he will follow the careful, data-dependant path laid out by the current Chair, Janet Yellen.

With central banks raising key rates cautiously, yields on short-term bonds are likely to remain low, and subdued inflation is likely to moderate the impact of positive economic growth on long-term bond yields, so we expect they will also remain low. Overall, our outlook is for bonds to generate coupon-like returns (in the low single digits). Although yields and returns are likely to be low, we still consider fixed income an important portfolio component.

We are neutral domestic government bonds as they offer diversification, stability and modest income. We are also neutral investment grade corporate bonds. Spreads have narrowed, but they still offer a yield advantage over government bonds and the economic backdrop is supportive for corporate health. Break-evens have been gradually rising, but are still reasonable from a historical perspective, so we maintain our neutral rating for inflation linked bonds.

We are maximum underweight high yield bonds as they are quite expensive and

narrow spreads make the risk/reward dynamic unattractive. Within the global bond space, we are currently maximum underweight. Very low nominal and real yields in Europe and Japan are not compelling, and while there are discrete opportunities in some emerging markets, they are associated with asymmetric risks.

### Canadian/U.S. currency exposure

- Underweight the Canadian dollar
- Overweight the U.S. dollar

While the Canadian dollar was strong in 2017, we believe it is close to the top of its range. We expect it to underperform the U.S. dollar in 2018, driven primarily by differences in central bank policy rates and economic growth prospects.

### Gold

- Neutral gold

We believe an allocation to gold may provide insurance against the risk of extreme outcomes. While there are still meaningful risks globally due to imbalances in the global economy, near-term political risks appear to have lessened.

As we head into the new year, all of us extend our best wishes to you for a happy, healthy and prosperous 2018!

## TD Wealth Asset Allocation Committee

The TD Wealth Asset Allocation Committee (WAAC) was established to deliver a consistent asset allocation message and be the originating source for active asset allocation advice across TD Wealth. The committee has three prime objectives: articulate broad market themes, provide macro-level asset allocation and identify the major risks on the horizon.

### Committee Members:

**Chair: Bruce Cooper, CFA**  
CEO & CIO, TD Asset Management Inc. and SVP, TD Bank Group

**Michael Craig, CFA**  
Vice President & Director, TD Asset Management Inc.

**Glenn Davis, CFA**  
Managing Director, TDAM USA Inc.

**Kevin Hebner, PhD**  
Managing Director, Epoch Investment Partners, Inc.

**David McCulla, CFA**  
Vice President & Director, TD Asset Management Inc.

**Robert Pemberton, CFA**  
Managing Director, TD Asset Management Inc.

**Brad Simpson, CIM, FCSI**  
Chief Wealth Strategist, TD Wealth

**David Sykes, CFA**  
Managing Director, TD Asset Management Inc.

**Sid Vaidya, CFA, CAIA**  
U.S. Wealth Investment Strategist, TD Wealth

**Geoff Wilson, CFA**  
Managing Director, TD Asset Management Inc.



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