THIRD QUARTER 2019

Matt's Market Update

IN THIS REPORT

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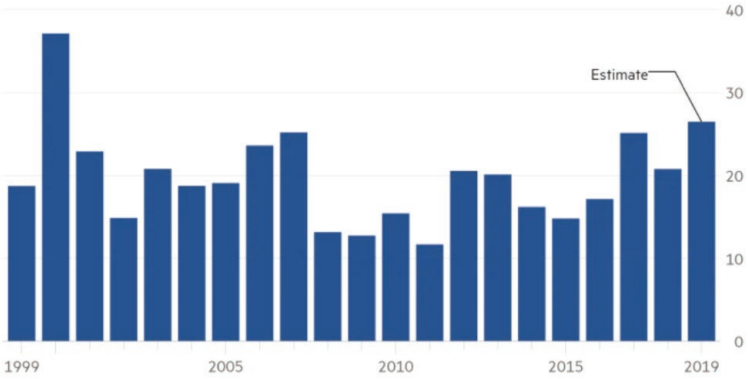
Market Review

Equities rallied in September to end the quarter on a positive note, but the major indexes posted either small positive or negative returns depending on the benchmark. Much of the stall in the market's upward progress in Q3 is due to the uncertain outlook for corporate earnings. As the quarter ended, equity analysts expect companies in the S&P 500 index to report a year-over-year earnings decline of approximately 4%. Despite the stalled upward progress for equity prices in Q3, the major averages have posted strong double-digit gains year-to-date. These returns don't look so rosy on a trailing 12-month basis, though. In fact, the NASDAQ and Russell 2000 indexes have negative returns over this time frame while the Dow Jones and S&P 500 are up just over 4%. This is another reminder for investors that the time frame through which we judge returns is so important. An investor focused solely on 2019 may feel like we're in the midst of a strong bull market while the investor looking at returns over the past year (or even 18 months) may view equities struggling to make progress while the key market averages hover near all-time highs. Corporate insiders certainly seem to be taking the "glass half empty" attitude in relation to the stock market. As you'll note from the chart on this page from the firm Smart Insider, company executives are selling shares at the fastest pace in two decades.

INSIDER SELLING ON PACE FOR TWO-DECADE HIGH
Value of shares sold by company insiders ($bn)



Source: Smart Insider, 2019

Based on returns for the Bloomberg Barclay's Aggregate Bond Index, bond investors have actually experienced equity type returns year-to-date (+8.52%) and for the trailing 12-month period (+10.30%). Declining interest rates across the Treasury yield curve drove these gains as markets are starting to price in the fact that the global economy is slowing down. The massive amount of global debt that needs to be serviced is weighing on markets and more recently the continuation of trade wars has had serious implications for growth. As expected, the Federal Reserve returned to their old habit of cutting interest rates in an attempt to stimulate growth. The cuts of 25 basis points in the Fed Funds rate came after both the July and September meetings. Market forecasters are expecting at least one more cut in rates prior to year-end.

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Hope Springs Eternal for a Trade Deal

While a large driver of optimism for equities in Q3 and early in October has been the continuing stories in the press (and a certain Twitter account) of potential breakthroughs on the trade front between the U.S. and China. The logical assumption is that if a substantial trade deal is agreed upon, the outlook for corporate earnings should improve, and thus stock prices will reflect the good news. While equity prices have improved recently, a case can't be made that it's based on substantial progress for a trade deal. The most recently celebrated "trade truce" seems to be more smoke than fire so far. The Chinese have supposedly agreed to buy more U.S. agricultural exports in return for the U.S. relaxing some of the trade tariffs expected to go into effect in Q4. However, we keep coming back to the fact that nothing (as we write this update) has been signed yet, and another $150 billion of tariffs are still scheduled to start in December on a variety of consumer oriented goods unless a deal is reached. Should these tariffs go into effect, the cumulative amount of the penalties imposed on China so far would be $360 billion along with the current $100 billion in retaliatory penalties placed on U.S. goods by China. The impacts of these are only now starting to appear in company earnings and outlooks, yet the market powers higher on every hint of progress. After more than a year of the trade war we would ask, where are the concrete details of progress? So far, we're not seeing any.

A fair scenario to consider is whether we've entered a new normal phase on ongoing trade wars that will be with us for years to come? At its core, the clash between the U.S. and China is a case study in two entirely different cultures, and it's hard to see a scenario where both sides feel justified in making a deal. Is China willing to completely surrender to U.S. demands for structural changes in how they view information technology? More importantly, do they feel any real pressure to do so? While their economy is clearly slowing down (and trade wars don't help matters), the growth rate is still superior to most developed nations in the world today. More importantly, the Chinese can afford to play a long game as they don't have elections to worry about. The current U.S. government doesn't have the luxury of time as the 2020 elections loom and our economy continues to grow at sub-par rates. We bring up these questions only as the narrative in the public domain seems focused on the impending trade deal with China as if it's a sure thing. But what if the sure thing really isn't? How do equity markets react to a further escalation of trade pressures? We'll be keeping an eye on answers to all of these questions for what will likely be some time to come.

Random Notes from Q3

In no particular order, here are some of the more interesting data points we came across in Q3:

- So far this year we've seen over 1500 basis points of rate cuts from the global central banks, with our own Fed contributing 50 basis points. In the past two months alone, one quarter of the world's monetary authorities have eased interest rates.[1]

- Investors pulled $60 billion out of stock funds in Q3. This amounted to the most money leaving stock funds since 2009 and was the largest percentage decline from one quarter to the next since 2011. The opposite happened in bond funds. They took in over $118 billion and this was double the net inflows from Q3 2018. U.S. money market funds took in $225 billion, the biggest quarterly inflow in the past decade.[2] The price of copper, considered by many as a key barometer of the global economy due to its widespread applications, is trading near a two-and-a-half-year low.

- The Russell 2000 index of small-cap stocks is roughly 14% off its high from early 2018 and no higher than it was in September 2017.[3]

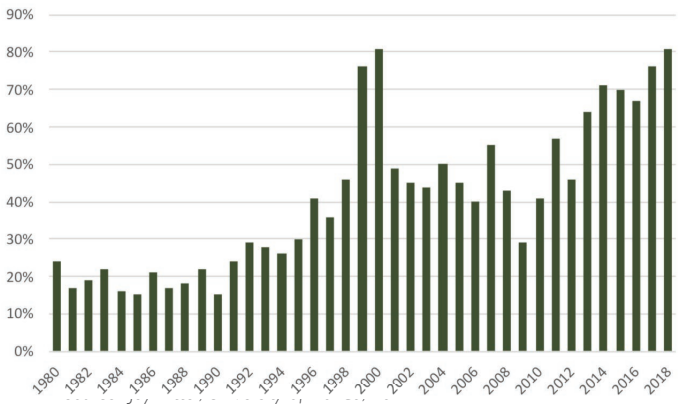
- U.S. consumers have a total of $1.3 trillion of auto debt on their books compared to $740 billion one decade ago. Roughly one-third of new vehicles sold in the first half of 2019 had loan terms greater than six years. A decade ago, that number was 10%.[4]

- Insider selling of stock by company executives in September totaled $14.2 billion This figure represents a 10-year high and the sixth month this year in which the people who know the best about

what's happening in their own companies sold at least $10 billion worth of stock.[5]

- In honor of the WeWork IPO disaster that has recently been in the news, we'll finish with the chart below on the % of IPOs with Negative Earnings. According to Jay Ritter, a finance professor from the University of Florida, more than 75% of the companies that went public in 2017-2018 were losing money. The only other time we've witnessed this was in the 1999-2000 period.[6]

% OF IPOS WITH NEGATIVE EARNINGS



Wealth Management Corner

Many financial experts consider life insurance to be the cornerstone of sound financial planning, however, most households have inadequate levels of life insurance or no life insurance at all. From major debt obligations such as a mortgage or saving for college for your children or loved ones, a lack of life insurance can be devastating to a family's financial well-being. Can your financial plan withstand the tragic loss of the primary income producing family member?

From its origins, life insurance has been utilized as a tool to replace the loss of financial resources that would occur in the event of premature death. Today, life insurance is still utilized for that purpose, but also for many other purposes as well, such as long-term care planning, retirement planning, estate planning, etc. Incorporating the appropriate policy to fit your situation is vital. A key question to ask yourself before considering any life insurance product is, "What am I trying to accomplish, and which product makes sense for my situation?" These questions should be explored with a qualified financial planner.

Your life insurance needs will depend on a number of factors, including whether you're married, the size of your family, the nature of your financial obligations, career stage, and your financial goals. For example, when you're young, you may not have a great need for life insurance. However, as you take on more responsibilities and your family grows, your need for life insurance increases dramatically. You may also find that your situation requires more than solely a death benefit and should include features and riders which can utilize death benefits while you are alive to address additional concerns such as long term care.

The two basic forms of life insurance are term life and permanent life (also known as cash value policies). Term policies provide life insurance protection for a specific period of time and generally contain liberal conversion features. If you pass away during the coverage period, your beneficiary will receive the policy death benefit. If you live to the end of the term, the policy would either increase in cost substantially and continue as term insurance or may be eligible for conversion to a form or permanent insurance, which would also drastically increase the premiums. Term policies are typically available for periods of 1 to 30 years and are generally the most affordable option. This form of protection is generally the most suitable when the insurance need is for a finite period of time, such as a mortgage obligation. Term coverage is popular in the workplace and many employers will provide group term life insurance to their active employees. It would be advisable to check your life insurance benefits with your employer as a starting point.

Permanent insurance is different from term life insurance as it provides protection for your entire life and may have a cash value benefit.

Due to the cash accumulation feature, premiums for these policies tend to be significantly higher. The most common and oldest form of permanent insurance is Whole Life insurance where you generally make guaranteed level premium payments for life. The death benefit and the minimum cash value are predetermined and guaranteed. Other forms of permanent insurance include Universal Life, Adjustable Life, Flexible Premium Life, Variable Life and Variable Universal Life. Depending on the type of policy, you can also have flexible premiums and death benefit. It is important to note that permanent insurance has more factors to consider and you want to review the details of the specific policy prior to purchasing. Permanent insurance is generally the only form of insurance used to address estate planning, retirement planning, legacy planning, charitable planning, etc. as the insurance must **be** in force at end of life.

Life insurance can be complicated, and it is always advisable to review any existing life insurance before purchasing a new policy. It is advisable to review your coverage periodically with your financial planner and take the necessary action steps to address any potential headwinds or life changes.

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Senior Investment Officer

Our Portfolio Strategy & Allocation Outlook

There were no changes made to our wealth management portfolios in Q3. While our equity managers were not immune from the volatility on display, they held up well. The quarter served as another reminder why having diversification with fixed-income holdings can help to steady the portfolio in the face of volatility. Nearly all asset classes have achieved gains through the first three quarters, yet the challenges we highlighted last quarter (trade tensions, slowing global growth and high equity valuations) remain firmly in place. We're often asked what our favorite sector of the equity market is and it's hard to have conviction in a reply based on these varied headwinds.

One theme we do like is that of increasing the quality of an investment portfolio. While the term quality can be defined in many ways, we generally define quality for equities as having lower debt levels, more sustainable earnings (especially in a downturn) and reliable dividend payouts. We should emphasize that a reliable dividend is more important to us than a high dividend yield. Remember, dividends are not guaranteed by a company and certainly can be cut during hard times. We like the managers who focus on companies that have historically had the ability to pay and grow those dividend payments over time. On the subject of dividends, over half of the S&P 500 constituents have a yield greater than the 10-year Treasury Note. Total dividends paid out to investors in Q3 amounted to approximately $128 billion, a 5% increase from one year ago. Exchange-traded funds (ETFs) that focus on dividends received $4.5 billion in inflows in Q3 while most other equity strategies continued to see outflows. If forced to pick one area of the stock market that **we** like right now, it would be strategies that focus on the themes of high quality and dividend income.

Please let us know if you'd like to discuss your personal investing and financial planning needs.

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Market Scoreboard

Index Returns (%)	Q3 2019	YTD	1 Year	3 Year	5 Year	10 Year
S&P 500	1.70	20.55	4.25	13.40	10.84	13.24
DJIA	1.83	17.51	4.21	16.45	12.28	13.56
NASDAQ	-0.09	20.56	-0.58	14.63	12.23	14.19
Russell 2000	-2.40	14.18	-8.89	8.23	8.19	11.20
MSCI ACWI Ex USA	-1.80	11.56	-1.23	6.34	2.90	4.46
Barclays Aggregate Bond	2.27	8.52	10.30	2.93	3.38	3.75

Source: Morningstar

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[1] Gluskin Sheff Research, 2019
[2] Kitco Metals, 2019
[3] Gluskin Sheff Research, 2019
[4] Wall Street Journal, 2019
[5] Gluskin Sheff Research, 2019
[6] Gluskin Sheff Research, 2019

S&P 500 TR: A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the large-cap segment of stock market.

Russell 2000 TR: Consists of the smallest 2000 companies in the Russell 3000 Index, representing approximately 7% of the Russell 3000 total market capitalization often used as a proxy for the small-cap segment of the stock market.

Barcap Aggregate Bond TR: The Barclays Capital Aggregate Bond Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most U.S. traded investment grade bonds are represented. The index includes Treasury securities, Government agency bonds, Mortgage-backed bonds, Corporate bonds, and a small amount of foreign bonds traded in U.S.

MSCI EAFE NR USD: Widely accepted as a benchmark for international stock performance, the EAFE Index is an aggregate of 21 individual country indexes that collectively represent many of the major markets of the world.

DJ US Industrials TR USD: Computed by summing the prices of the stocks of 30 U.S. companies and then dividing that total by an adjusted value--one which has been adjusted over the years to account for the effects of stock splits on the prices of the 30 companies.

NASDAQ: Measures the performance of all issues listed in the Nasdaq Stock Market and is often used as a proxy for the large-cap technology segment of the U.S. stock market.

DJ/UBS Commodity: The DJ-UBSCI is composed of futures contracts on physical commodities and is often used as a proxy for broad-based exposure to the commodity markets.

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