SEPTEMBER 2018

Q3 report

Looking ahead, we see positive economic data continuing, another quarter of significant corporate profit growth and a strong end to the year.

Throughout the summer, markets showed renewed strength. Now, as we enter the fall, a resolution to the lengthy NAFTA* negotiations – coupled with a strong U.S. economy – has set the stage for a promising end to the year.

For our clients, Barometer's investment themes have once again resumed market leadership, with sectors like healthcare and information technology benefiting from robust secular revenue growth and good corporate earnings growth.

The relative strength of the U.S. dollar placed added stress on overseas equity markets in recent months. Currency pressures eased in September, however, which reassured investors and added market stability – ultimately helping to lower volatility. As October began, three prevailing trends remained intact: emerging markets under pressure, strong energy markets and the U.S. market leading the world.

Historically, markets are nervous ahead of U.S. mid-term elections; however, over the past quarter, U.S. markets have rallied despite further trade concerns. Moreover, markets tend to rally after mid-term elections, traditionally posting the highest return (on average) over an election cycle. The pool's positioning is intended to take advantage of this scenario.

Regardless of what might happen on other fronts, trade rhetoric, negotiations and posturing between the U.S. and China show no sign of concluding any time soon. However, a resolution to NAFTA – now known as the USMCA (United States-Mexico-Canada) – has provided some clarity for Canadian companies. Despite this trade resolution, Canadian markets did not respond positively. In general, we still favour U.S. companies and Canadian companies that have U.S. exposure.

The USMCA will place further emphasis on the China front in terms of U.S. trade negotiations.

Market Highlights

Information technology, industrials and healthcare were the best performing sectors in the third quarter. During the first week of October these leading sectors also experienced a pullback, however, we still feel that information technology and healthcare are good opportunities.

For Barometer, the key is that the strength of the U.S. economy enables the U.S president to maintain a firm stance on trade. As long as the data is supportive, the trade skirmish will continue. We still believe that the market can continue to rally given this backdrop.

Sectors like retail have shrugged off these concerns, despite the impact that tariffs might have on costs. Even with a small pullback in early October, we still like stocks in the retail sector.

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At the same time that currency pressures eased late in the third quarter, bond yields globally resumed their climb. In the U.S., the 10-year yield has reached a high not seen since 2011, and utilities and real estate lagged as a result. While the consensus is that rates will move higher, there is disagreement on the impact that this will have on equity markets. One concern is that higher interest rates will negatively impact the multiples paid for growth. We view rising rates as a positive development, in part because of the negative perception that investors have regarding an inverted yield curve.

Portfolio Updates

The **Barometer Tactical Income Pool** maintained its focus on equities that offer compelling dividend growth prospects. We continue to find these companies primarily in the U.S.

Healthcare stocks contributed the most to returns in the third quarter, but returns were broadly distributed across sectors. HCA Healthcare Inc., an operator of U.S. hospitals and outpatient facilities, was the best performer. Tech giants Apple Inc., Microsoft Corporation and Amazon.com Inc. also contributed positively, as did railway companies. Payment networks Visa Inc. and Mastercard Inc. – sometimes called the digital railroads because of their lock on such a fundamental piece of economic infrastructure – were also positive. Stocks in the energy and materials sectors detracted from returns. During the quarter, the pool added to its healthcare and industrials weightings and reduced its exposure to energy. Information technology and industrials remain the largest exposures.

The **Barometer Equity Pool** benefited from an overweight in the technology, healthcare and consumer discretionary sectors in the third quarter.

The U.S. dollar depreciating against the Canadian dollar hurt

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performance in the Equity Pool – along with other mandates. Currency hedges placed on part of the portfolio helped to reduce the impact to approximately one per cent.

The Equity Pool continues to have significant exposure to information technology. Square Inc. contributed the most to returns in Q3. Illumina Inc., a healthcare company, and Cargojet Inc., a Canadian transportation company, were also positive contributors. After a good run in the first half of the year, poor returns from Bombardier Inc. hurt the portfolio in the third quarter and it was sold. Activision Blizzard Inc. and Spark Therapeutics also detracted from performance. During the quarter the Equity Pool increased exposure to consumer discretionary and reduced energy exposure. Healthcare was also reduced slightly.

The **Barometer Tactical Balanced Pool** benefited from overweights in information technology, industrials and energy. Apple Inc., Parkland Fuel Corporation, TFI International Inc. and Methanex Corporation helped returns, as did retail stocks such as Amazon Inc. and Lowe's Companies Inc. Poor performance from Bombardier Inc., Polaris Infrastructure and E-Trade Financial Corporation detracted from returns.

Market Highlights

During the quarter the Balanced Pool reduced energy exposure and added to industrials. Energy remains a significant exposure in the fund and the exposure to bonds remains at the mandated minimum weight of 25 per cent.

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The **Barometer Long Short Pool** is concentrated in the healthcare and information technology sectors. Square Inc., Parkland Fuel Corp, and Cargojet Inc. all had strong quarters and helped returns, while several small cap stocks and financial stocks hurt performance. A short position in Tesla also helped performance. During the quarter, the Long Short Pool added consumer discretionary names and reduced energy and financials exposure.

During the third quarter, the **Barometer Global Macro Pool** maintained its large exposures to the U.S. market and benefitted accordingly as the U.S. equity market continued to outperform.

Exposure to the information technology and healthcare sectors (as well as U.S. large cap stocks in general) had a positive impact on performance. These remained as large weights in the portfolio throughout the quarter.

The Global Macro Pool also experienced a positive contribution to returns by maintaining a short position in the volatility index, since the condition of the index deteriorated further. Over the course of the quarter, the pool

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decreased exposure to financials. The financial sector equities have lagged in performance relative to the market and have struggled to get going, despite tailwinds like a steepening yield curve and rising interest rates. The pool held short positions in various types of financials fixed income in September, which contributed positively to performance as the fixed income asset class continued to weaken.

Looking Forward

We continue to view equities as the most attractive asset class and are most positive on the U.S. market. We own very little fixed income outside of holdings in the Balanced Pool.

Looking ahead, we see positive economic data continuing, another quarter of significant corporate profit growth and a strong end to the year. Information technology and healthcare are the largest weights in the pools, but we continue to find quality companies with good growth prospects in other sectors as well.

The combination of increasing breadth, strong economic data and the historical precedence of post U.S. mid-term election rallies make us confident that we will see a strong end to the year. We remain fully committed to our disciplined risk management process and are prepared to protect our clients' capital if circumstances require us to act.

* NAFTA – North American Free Trade Agreement

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