Dear Client,

Never a dull moment. This phrase seems to sum up investment markets of late. To the surprise of many, and contrary to polls and financial market sentiment, Britain voted to leave the European Union on June 23, 2016 by a margin of 51.9% in favour, with 72.2% voter turnout. Immediate reaction was very negative, from the high in June to the bottom of June, the S&P/TSX was down 4.7%, the S&P 500 was down 5.6% and the Euro Stoxx 600 fell 10.9%. By June 30, all three markets had bounced back by 2.7%, 5.1%, and 7.6% respectively. Canada and the United States have almost fully recovered any lost ground, while Europe remains slightly behind.

Brexit, what next?

The immediate impact to the markets was driven more by sentiment than economics, as Brexit will likely be a long, drawn-out process. Once a new Prime Minister is selected and article 50 invoked, there will be an initial two-year negotiation period to determine the terms of exit. It will not likely be a clear break and changes are likely during the course of the negotiations. Given this uncertainty, it remains to be seen if Brexit will be followed by Grexit, Departugal, Italeave, Czechout, Oustria, Finish, Slovakout or Byegium with only Germaining left behind.

In Canada

The Canadian equity market performed very well in the first half of the year, buoyed by an increase in gold and oil prices. The S&P / TSX gained approximately 9.8% when factoring dividends during the first half of the year. The price of gold increased approximately 25% since the start of the year with the improvement in both gold and oil prices contributing to roughly three quarters of the Canadian index returns in the first half of the year. We have seen the price for "Texas Tea" gain about 88% since it hit a 14-year low of U.S. $26 per barrel in February. The rise in the price of oil would mark the best quarter since 2009. A meaningful decrease in U.S. shale oil production and other disruptions including massive forest fires in Fort McMurray and militant attacks on pipelines in Nigeria has helped reduce the excess global oil supply. As the fundamentals for oil improve going into 2017, this should bode well for energy-related stocks and the S&P/TSX overall.

Central Bank Policy

Global economic uncertainties kept global economic activity modest in the first half of 2016. As such, the chance of a 2016 U.S. Federal Reserve or Bank of Canada rate increase has virtually disappeared. The level of negative yielding global debt continues to climb as a result of an uncertain environment with low interest rates and the lure for the safety of government bonds has caused the amount of negative yielding bonds to jump to $11.7 trillion – a 12.5 percent increase since the end of May. The search for safe havens has driven investors buying sovereign debt to accept the negative yields in countries including Japan, Germany, Switzerland and France.

The United States

In the U.S., the S&P 500 Index gained 3.8% when factoring in dividends in U.S. dollars. Adjusting for the Canadian dollar, U.S. equities were down -2.4%. Despite a strong labour and housing market, the U.S. market continues to be volatile as companies struggle to grow profits. We anticipate this volatility will continue throughout 2016 as we approach the U.S. presidential elections in November. Since our last note, Donald Trump is the presumptive Republican nominee while on the Democrat side, former Senator and Secretary of State, Hillary Clinton is the presumptive Democratic Party nominee. While it's too soon to tell who would be better for markets, the debate will make for some great television and discussion.

Overseas

Europe and Japan continue to struggle with weak economic growth with their central bankers introducing a new paradigm of negative interest rates. Imagine lending governments your money and not receiving interest payments and then paying them for holding your money as well! It remains to be seen if a negative interest rate policy will prove effective for an anemic economy. The CEO of Japan's largest bank *Bank of Tokyo-Mitsubishi UFJ,* said negative interest rates had actually caused households and businesses to rein in spending by creating a sense of uncertainty about the future. In the meantime, equity investors have voted with their cash. As measured by the MSCI Indices, European stocks fell -4.6% and Japanese stocks fell -5.4% in U.S. dollar terms. In Canadian dollar

terms, the declines magnified to -10.3% and -11.1% respectively. The broader MSCI EAFE Index, a gage of collective international stock markets, fell -4.4% or -10.2% in Canadian dollar terms.

Bonds

Bonds continue to be a steady if not unspectacular performer in client portfolios. Canadian bonds gained 2.6% in the quarter as measured by the FTSE/TSX Universe Bond Index. With the Bank of Canada holding its key rate firm at 0.50% for now, an attractive interest rate continues to be an endangered species. From an income perspective, traditional fixed income continues to fall short of investors' needs, especially after factoring the impact of inflation and taxation.

Looking forward

Market volatility is likely to remain through the second half of 2016 if the start of the first half is any indication. Yet, despite the current malaise, the investment environment is looking up. Misplaced fears of an imminent global recession caused by the 'Brexit' vote are subsiding and U.S. business is improving. Oil has likely bottomed in February alongside the TSX. If anything, volatility enables us to take advantage of market lows; adding to our positions on the dips through a regular investment plan. I continue to encourage balance among many asset classes – Canadian equities, U.S. and foreign equities, bonds and cash – as a diversified approach will help mitigate volatility while working toward our objectives.

As always, if you have any questions about the markets or your investments, I'm here to talk.

Regards,

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