EXECUTIVE SUMMARY

Economic Review

- *Record lows for global interest rates was the theme for bond markets globally.*
- *Stock markets continued their recovery after the first quarter's weakness.*
- *The Brexit vote derailed this recovery but, so far, it has proven to be short-lived, influenced by the expectation that central banks will ramp up their support.*

Investment Outlook

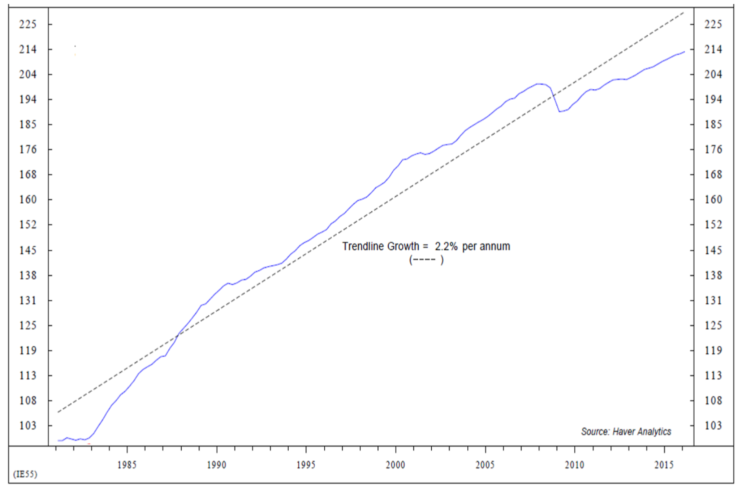
- *Uncertainty and volatility have increased, provoked by Brexit and the upcoming U.S. election.*
- *This looming uncertainty plays into our firm's strengths as quality portfolios should fare better in this environment.*
- *The trend for global economic growth will continue on its modest path.*

ECONOMIC OUTLOOK

Financial markets started the second quarter positively as expectations for rising interest rates were put on the backburner by the U.S. Federal Reserve (the Fed). Bond markets have for a long time now viewed any attempts to raise interest rates as inappropriate given the sluggish global growth backdrop and the unsettled condition of financial markets. Ultimately, the Fed acquiesced to that view and markets rallied before being dealt a blow by the United Kingdom's vote to leave the European Union. While the result of the vote was indeed a shock, it is debatable to what extent it will change the long run trend for economic growth; trade agreements will be re-signed and consumers will continue to consume. Uncertainty has, however, increased – if only because the appetite for free trade may have crested – which may shake the core of the market's confidence in the outlook for the economy. Increased uncertainty is a double edged sword, investors have less confidence about the potential long-term returns for their capital but valuations that may become more attractive make investments more appealing. What markets have taken comfort in is that central bankers will provide even more liquidity and support should the environment deteriorate dramatically.

The trend for global economic growth continued on the modest path of the last few years. After a disappointing first quarter GDP growth of 1%, U.S. growth will likely be close to 2.5% in the second quarter. The housing market has much room to expand and wages are starting to increase at more rapid levels after a number of years below trend. Business investment is relatively weak but the right fiscal spending could be an important offset. Currency fluctuations have had a significant impact on foreign profits and export activity. The outlook for the USD is contingent on foreign currency movements which have been and will continue to be heavily influenced by central bank policy. While the USD looks somewhat overvalued based on its historical average, it may still appreciate as a result of aggressive actions by the Bank of Japan to weaken the yen and the European Central Bank's (ECB) potential increased easing in response to political uncertainty. The Canadian economy continued to exhibit a relatively strong but overextended consumer sector. The business sector continues to recover and export growth was somewhat softer as a result of weaker U.S. economic growth.

G7 Real GDP Trendline Growth



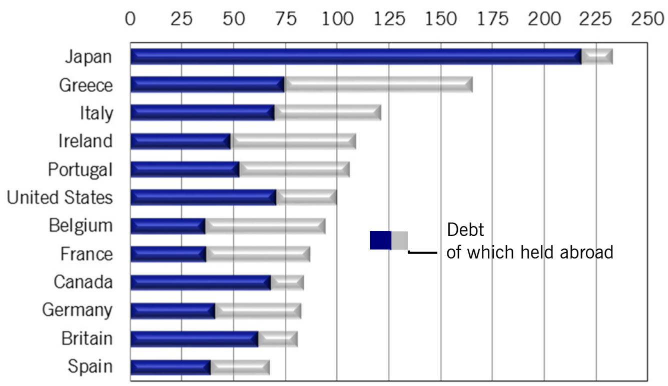
Trendline based on linear regression = average growth weighted for extreme observations.
Quarterly Data 3/31/1981 – 3/31/2016 (Log Scale)
Source: Ned Davis Research Inc, Haver Analytics

BOND MARKETS

Record low interest rates was the theme for bond markets globally. At one point there was over $10 trillion of sovereign debt yielding negative rates of return, i.e. the lender/investor pays the borrower/issuer to invest in their bonds. Obviously there are not many investors that would sign up for that type of deal but there are institutions that have considerations that are more important than the rate of return. Much of the negative yielding debt is in Japan where the central bank is buying bonds in order to drive down interest rates in the hopes that it will spur borrowing and reduce foreign appetite for the yen. Some banks may hold sovereign debt for liquidity purposes as well. The aggressiveness of central bank intervention means that interest rates will stay low for a long period of time. The typical increase in lending that comes with low interest rates has been somewhat neutralized by the more stringent capital requirements for lending institutions. This also adds to the argument that interest rates will stay low for the foreseeable future.

Corporate bonds produced slightly better returns than government bonds this past quarter. The outperformance was partly driven by the ECB's purchase of corporate bonds which has made investors seek higher-yielding bonds in North America. Demand for new corporate bond issues was robust with some multi-billion dollar deals being six times oversubscribed. The extra yield provided by high quality corporate bonds is still historically attractive but we are tempering our enthusiasm due to deteriorating quality and liquidity for the market in general.

Gross Government Debt
As % of GDP, 2017 Forecast

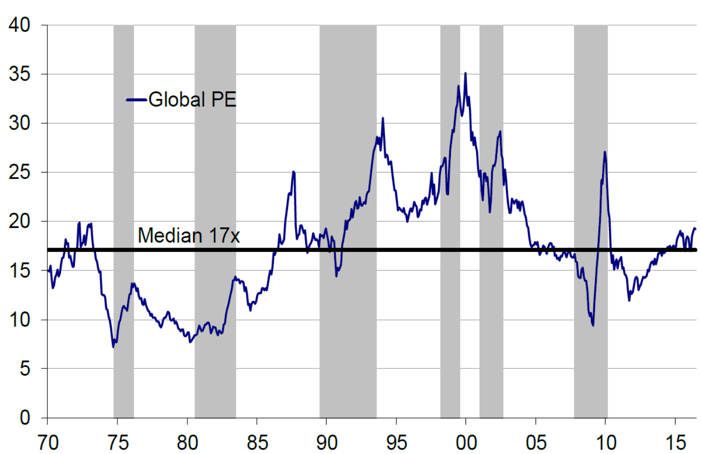


Source: IMF, World Economic Outlook Database, October 2015

EQUITY MARKETS

Most of the quarter saw a continued recovery in stock markets after the weakness experienced in the first three months of 2016. The Brexit vote certainly derailed the recovery but, so far, has proven to be short-lived as markets are comforted by the expectation that central banks will ramp up their support. The materials sector continued to be the best performer, with particular strength in metals and gold. Much of the strength is really a recovery from very weak performance over the last few years. The energy sector found a bottom in the first quarter as well and posted strong returns as the price of oil touched $52/bbl, up $20/bbl from its lows in January.

MSCI All Country World Trailing PE



Grey bars are EPS recessions
Source: MSCI, DataStream, Citi Research.

Banks and insurance companies continued to underperform the market as the prospect of low or even negative interest rates, for a longer period than expected, caused investors to readjust their future profit estimates. The Canadian market outperformed due to its heavier exposure to materials and energy sectors. The European markets underperformed with the U.K. vote to leave the European Union impacting most heavily on euro-centric companies.

Market Returns (as at June 30, 2016)

(%)	3M	1 Yr	5 Yrs	10 Yrs	15 Yrs
S&P/TSX	5.1	-0.2	4.2	4.9	6.8
S&P 500 (C$)	2.9	8.2	19.0	9.1	4.7
S&P 500 (US$)	2.5	4.0	12.1	7.4	5.8
Russell 2000 (US$)	3.8	-6.7	8.4	6.2	7.0
DJIA (C$)	1.8	5.9	14.2	6.5	2.6
DJIA (US$)	1.4	1.8	7.6	4.9	3.6
MSCI EAFE Net (C$)	-1.1	-6.5	7.9	3.2	3.2
MSCI EAFE Net (US$)	-1.5	-10.2	1.7	1.6	4.3
Nikkei 225 (US$) Japan	1.4	-7.2	6.3	2.9	4.1
Shanghai (US$) China	-4.6	-34.9	3.0	9.8	5.3
BSE Sensex (US$) India	5.0	-7.0	0.4	7.2	13.8
EAFE Emerging Mkts (US$)	0.8	-11.7	-3.4	3.9	9.5
FTSE TMX Canada Universe	2.6	5.2	5.2	5.6	6.0
FTSE TMX Canada 91 Day T-Bills	0.1	0.5	0.9	1.6	2.0
C$/US$	-0.4	-3.9	-5.8	-1.3	1.0

Converted to Canadian funds using London 4PM rates.
Returns are annualized for periods greater than 1 year.

INVESTMENT STRATEGY

Our underlying theme continues to be an economic environment where GDP growth is modest. The Basel III banking regulations will soon be implemented which will result in a continued reluctance by banks to lend, particularly with the spread between borrowing and lending rates being historically low. As a result, even if there were a surge in borrowing demand, we doubt the response from the banking sector would be enthusiastic. Fiat currency countries rely on credit to stimulate and if credit is reduced, it will result in lower growth. That dynamic is still ongoing even with a negative cost of credit. In this environment, investors should continue to seek higher quality companies for their more predictable earnings growth and stability. The markets will eventually turn and favour the more aggressive and lower quality companies but those periods tend to be brief and, we believe, are still far from today's reality.

Short term, we believe the Brexit outcome is a political crisis rather than a financial one. Long term, we recognize that there is an anti-globalization element to the vote which is shared by voters in many developed economies, including the United States. Expanding free trade over the past few decades has lifted millions out of poverty in emerging markets and has helped contribute to the unprecedented decline in interest rates. The benefits have not been shared equally in developed economies and that is now manifesting itself at the ballot box and in polls. This is a development that bears watching in the years to come as there will be winners and losers from this seeming reversal in the globalization trend.

Sources: TD Securities, IMF, Ned Davis Research, S&P, BIS and Bloomberg. The yen and euro currency conversion are based on Bank of Canada noon rates.