IN FOCUS

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Independent Accountants' Investment Counsel Inc.™

The Quarterly Commentary

While economic data continued to show strength in the U.S. economy, concerns about slowing global growth, tightening monetary policy and increasing trade tensions weighed on markets during the final quarter of 2018. As a result of these factors, North American and global stock indices posted net losses to end the year. Most of the damage was inflicted in the fourth quarter, when the DOW Jones Industrial Average (“DOW”) fell more than 20.0% from peak to trough. However, after hitting lows on December 24th, stocks rallied in the last week of the year. U.S. stock markets led with 7.0% gains, which mitigated and contained full-year losses to approximately 3.5% for the DOW and 4.4% for the S&P 500 Index (“S&P 500"). The volatility of the fourth quarter, with triple-digit swings for the DOW throughout daily trading sessions, certainly tested the resolve of many investors.

The first quarter of 2019 provided investors further relief, despite the same underlying economic pressures persisting, downward revisions regarding growth in the U.S. gross domestic product (“GDP”), and weakening confidence among purchasing managers and consumers. Even with earnings misses and some reduced earnings guidance, markets responded positively, while further interest rate increases in 2019 by the U.S. Federal Reserve Board (“Fed”) are no longer expected in the near-term.

The question on the minds of most analysts now is whether we are heading into, or towards, a recession. A recession is defined as two back-to-back quarters of economic contractions. Technically, we cannot determine whether the economy is in a recession until after the data has been gathered (i.e. after the fact). So instead of trying to predict a recession, we focus on changes in the rate of economic growth from quarter-to-quarter and how those changes translate into market expectations.

Cycles of economic expansion and contraction vary in both intensity and duration. Investors price future expectations into asset prices. The sharp downturn in stock prices in the last quarter of 2018 and rapid market recovery in the first quarter are textbook examples of this phenomenon. Fourth quarter economic data indicated that global growth was not materializing as expected from the outset of the year. Despite relative strength in the U.S. economy, the outlook pointed to increasing risks. At the same time, the Fed remained focused on inflation and pushing short-term interest rates higher to offset a potential “boom.” In 2018, investors began to fear overreaction by the Fed, which in turn could have precipitated a recession or compounded the negative impact of an economic contraction. Since the last increase of the federal funds rate on December 5th, the Fed has tempered its outlook, taking note of indicators suggesting slower economic growth. For example, the inflation rate is now trending below 2%, suggesting that the Fed’s concerns that continued positive employment gains would put upward pressure on wages and prices are, for now at least, largely unfounded.

The expectations for rate increases in 2019 have diminished and some forecasts beyond 2019 suggest that interest rates will remain low, as reflected in the yield curve, which has demonstrated a trend towards flattening and even a slight inversion. Having discounted the probability of the Fed continuing to tighten monetary policy, positive investor sentiment contributed to the first quarter rally in stocks despite leading economic indicators pointing to slowing growth. There is a risk that the Fed will revert to tightening again if unexpected inflation occurs or global uncertainty eases.

We continue to closely monitor those leading indicators, particularly the yield curve, which shows the yield on government bills and bonds over various durations. When long-term yields are lower than short-term yields, the curve takes on an “inverted shape.” Economists pay particular attention to the spread between the two-year and the 10-year yields (i.e., 10 minus 2). If this is negative, the yield curve is said to be inverted. Why do they monitor this? It has proven to be an accurate leading indicator of past recessions. The yield curve did in fact turn negative briefly this past

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quarter and is currently slightly positive. This is a clear signal that risks to the economy are rising. An inverted yield curve, however, has not been a useful tool for pinpointing when a recession will occur with the gap between the inversion and the onset of the recession being as far out as 23 months.

Canadian rates are following a similar path. To counter concerns, the Bank of Canada ("BoC") Governor Stephen Poloz recently downplayed the threat of the inversion. He cited that, in general, interest rates are much lower than in the past and thus more prone to inversion. Furthermore, the conditions accompanying the inversion are positive: stock markets continue to exhibit momentum and corporate debt continues to be adequately funded.

At this point, our concern is more focused on the possibility that investors have been lulled into a false sense of security. Markets were strong in the first quarter and generally made up for the losses of the previous quarter. The DOW rose over 11.0% and both the S&P 500 and S&P/TSX Composite Index ("S&P/TSX") rose over 12.0%. For Canadian investors, the strengthening Canadian dollar relative to the U.S. dollar had a drag of 2.0% on the value of U.S. holdings. Still, equities had a very strong overall performance in the first quarter. Even income-producing assets with fixed distributions benefited from falling interest rates.

Against the backdrop of these recent positive market gains, declining growth in auto sales, railroad traffic, consumer confidence and purchasing managers' indices point towards a slowdown in economic growth. Forecasts for both U.S. and global growth are 0.5%-1.0% lower in 2019 than in 2018. The current economic expansion has been one of the longest on record. While year-over-year growth has been relatively moderate when compared to past recoveries, capacity utilization and record-low unemployment suggest that the U.S. economy is due to pull back. Clearly, the Fed is factoring all of this into its outlook. At the same time, the Chinese economy's positive growth and easing trade tensions between the U.S. and China balanced some of the headwinds and provided additional stimulus to the global economy.

In conclusion, we advocate caution given the likelihood of slowing economic growth. Central banks, led by the Fed, seem to have retreated from their previous objectives of increasing short-term rates throughout 2019 to battle inflation and cool expanding economies. These factors have provided the markets with some confidence, given that bank policy may help to mitigate economic weakness and the severity of any future pullback.

How The Markets Performed

The recovery that began in the final trading days of 2018 carried over to the first quarter of 2019. All three geographic regions posted positive equity market returns in each of the first three months of 2019. The strong performance was most profound in January, when each region had a return in excess of 6.0%. For Canadian and U.S. equities, first quarter performance brought the 12-month return to 8.1% and 9.5% respectively, which more than made up for the declines in the fourth quarter of 2018. While there was some dispersion among the different economic sectors during the quarter, each contributed to the strong performance, with only the Financials sector failing to top a 10.0% quarterly return. The continued downward pressure on interest rates held back preferred shares, with the S&P/TSX Preferred Share Index having a relatively flat quarterly total return of 1.1%.

Key Indicators	Dec-18	
90 Day Tbill	1.67%	
CPI (Y/Y) (Nov)	1.5%	
$U/$C	$ 0.75	
Major Market Returns	**3 Month Total Return**	**12 Month Total Return**
S&P/TSX Composite	13.30%	8.11%
S&P/TSX Preferred Share	1.14%	-6.76%
S&P 500 Composite ($U)	13.65%	9.50%
MSCI EAFE ($U)	9.98%	-3.71%
IAIC Equity Sector Benchmarks		
Consumer	18.26%	13.76%
Financial	9.46%	-0.15%
Utilities	11.30%	9.65%
Industrial	17.88%	17.86%
Resource	11.96%	0.62%

Cyber Security – Protecting Yourself

The World Wide Web has become an essential part of everyday life for most Canadians. It has opened up a world of information at your fingertips, and provided a convenient way to manage your life and connect with friends and family around the world. Although this resource is now invaluable to many, it has opened up an opportunity for cyber criminals to monitor and compromise your personal information. Criminals take advantage of security gaps, low cyber security awareness, and technological developments in an effort to compromise systems and steal personal information.

Cyber criminals utilize numerous methods in their attempt to gain sensitive information which can be readily sold or used to gain illicit funds.

One of the more common methods is called "phishing", where the criminals send you fake emails, text messages and links to made-up websites in an attempt to steal personal and financial information from you. Cyber criminals will also attempt to send viruses to your computer via email attachment or link. By clicking on the attachment or link, you "infect" your computer and potentially the computers of everyone on your contact list. The virus could disable your security settings, scan and find personal information or hijack your web browser or computer. And by applying a method called "form jacking", cyber criminals use malicious code to steal credit card and other information from checkout pages on e-commerce sites.

Unfortunately it is not easy to know if your computer has been infected. Sometimes you will notice changes to the computer operation such as: computer shuts down unexpectedly, pop-up ads appear as soon as you turn on your computer or programs you use all the time start crashing. If you suspect that your computer is infected, disconnect the computer from the internet. It is also recommended to update your anti-virus software and scan your entire system to locate and remove any infection.

Finally, upgrade any software you use from the software vendor in order to get the latest security enhancements.

Jason Voll
Manager IT

Cyber Security Facts*

- Cyberattacks are the fastest growing crime globally with damages estimated to be $6 trillion by 2021.
- Ransomware attacks saw a 350% increase in 2018.
- 90 percent of successful hacks and data breaches stem from phishing scams.
- The first-ever website went live in 1991. Today there are more than 1.9 billion websites.
- For the most recent year reported by the FBI, the Internet Crime Complaint Centre received nearly 50,000 complaints from victims over 60 years of age, with adjusted losses in excess of $342 million.
- Personal health information is 50 times more valuable on the black market than financial information, and stolen patient records can fetch upwards of $60 per record.

*according to the Cisco/Cybersecurity Ventures 2019 Cybersecurity Almanac

Security tips to protect yourself and your personal information:

1. Be aware that you could be a potential target. Cyber criminals will try to get information from anyone.
2. Create strong passwords utilizing a mixture of uppercase and lowercase characters, numbers and special characters, and don't write it down or use the same password for multiple sites. Make sure to password-protect all your devices.
3. Back up your data regularly and make sure you have installed up to date Internet security software (Antivirus, Firewall and AntiSpam).
4. Secure your devices at all times including sensitive information on flash drives or external hard drives.
5. Be careful what you share on social networks (Facebook, LinkedIn etc.). Criminals can potentially gain access to your information through these sites.
6. Monitor your accounts for any suspicious activity.
7. Be aware of telemarketers or emails received asking for sensitive information.
8. Any sensitive browsing (banking, shopping) should be done only on your own device and on a network you trust.
9. Be careful when clicking on attachments or links in email. Don't click on it if it's unexpected or suspicious.
10. Stop and think before acting on an urgent email or communication and get a second opinion when in doubt.
11. Log out of apps and websites when you are done using them. Leaving them open could make them vulnerable.
12. Use encryption for your most sensitive files such as tax returns or financial records.
13. For more information on protecting yourself online, visit the Government of Canada "Get Cyber Safe" website (www.getcybersafe.gc.ca)

Keeping Our Record of Your Personal Information Up To Date

In order for our investment management team at IAIC to make appropriate investment decisions for you, we must always be up to date on your personal circumstances that are relevant to your financial situation and objectives.

For example, a material change in any of the following could impact our decision-making:

- Marital status
- Job / business
- Income / net worth
- Health
- Personal residence (especially a move to outside of Ontario)
- Investment time horizon (when do you need cash in the future)
- Appetite and capacity for investment risk
- Investment objectives

If you experience any of these types of changes in your life, please inform us directly, either by phone or electronically (see contact information below).

We are required to keep your personal information up to date. It is our practice that if we have not had a meaningful conversation with you in the past year about your personal circumstances such as those listed above, we will reach out to you directly in order to update our records and determine if any investment strategy changes are needed. We may reach out to you by phone, letter or electronically. In these times of identity theft, if you are uncertain at all about the legitimacy of our request for information, please contact us to verify that the request is indeed legitimate and originating from IAIC.

We look forward to hearing from you!

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Life and Living Benefits - not sure if you have the right policy in place?

Oliver Lee, B.Math

Vice President IALIA

Life & Living Benefits

Independent Accountants' Life Insurance Agency Inc.

It's a common question we receive.

Here are other questions we often receive from our clients.

- How does this life insurance policy work?
- How much life insurance do I need?
- Is there a better life insurance product available?

The topic of life insurance can be confusing and we are here to help.

We will provide you with unbiased professional advice that puts your interests first. We integrate our advice with your Accountant, financial plan and investments to ensure it all fits together.

Contact your Accountant or Financial Planner for more details.

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