FORSTRONG GLOBAL

GLOBAL THINKING

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EXECUTIVE PERSPECTIVE

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We invite you to review our Summer edition of *Global Thinking.* The objective of this publication is to provide you with a brief overview of our global views, key portfolio strategies and a sense of long-term financial trends. We strive to develop key insights and to share those with you.

As we have often pointed out, investors have been charting through new and unknown waters. One cannot be faulted for perceiving many imponderables — whether the possible impacts of new monetary policy regimes, volatile geopolitics, shifts to political populism, anti-globalization sentiment, major societal trends … and more.

However, uncertainty and good investment returns are sometimes coincident. To date this year, portfolio performance has been gratifying.

Nevertheless, there is one constant … and that is change itself. It never sleeps. Therefore, the need to manage risk is as great as ever. We continue to strive to do so. Broad diversification remains uppermost.

In this issue, the *Global Insight* article (found on this page) provides an excerpt from our *Super Trends and Tactical Views* publication that is updated quarterly. Tyler Mordy, President, tackles the future of the two most influential countries on earth at this time — China and America. Both are experiencing deep change. The world hopes that these two nations will cooperate with each other.

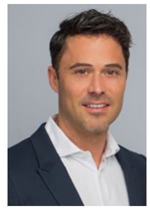
Turning to our current investment policies, the *Portfolio Update* section outlines our tactical strategies and investment views. In these times of change, we hope that our research and strategy decision-making process will succeed in generating resilient portfolio performance over the long-term.

Do you have any questions about our investment views and/or services? If so, please contact us. We also encourage you to visit our website. There, we post additional publications (to which you can subscribe on-line if you wish) as well as updates on key information. As always, we thank you for your patronage.

Notable Quote

"Avoid big losses. That's the way to really make money over the years."

- Julian Robertson (b. 1932), American hedge fund manager



GLOBAL INSIGHT

CONSIDERING THE IMPACT OF A CHANGING U.S.

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(The following is an excerpt from our quarterly *Super Trends And Tactical Views* report. Given the enormous changes underway with respect to America's role in the world and China's new geopolitical initiatives, we focus our comments here on these two juggernauts. We invite readers to access the entire report on our website).

America and the Rest of the World: Divergent Paths. One of Woody Allen's most critically acclaimed films, *Midnight in Paris*, is a 2011 fantasy comedy that follows Gil Pender, a successful, but creatively unfulfilled Hollywood screenwriter, who is pushed to confront the incompatibilities of his relationship with his materialistic fiancée, Inez. The mismatch is painfully obvious. Gil loves Paris in the rain, while Inez longs for a glamorous life in Malibu.

Everything changes one night when Gil is time-transported back to the sizzling Paris of the 1920s. Besotted with the "moveable feast" days of Hemingway, Fitzergerald and other American expatriates, Gil shuttles back and forth each night — between nocturnal bliss and his sobering daylight reality. As he travels back in time every midnight, Inez and Gil's divergent goals become increasingly evident.

A similar drama is unfolding in financial markets. With each passing week, it is apparent that America's policy path is diverging from most of the world. Consider the latest example: America's departure from the Paris climate change accord. Whether readers agree with the science or not, the US's exit further isolates its administration, leaving Trump alone with Bashar al-Assad of Syria and Daniel Ortega of Nicaragua as the world's only non-participants. Oops?

Meanwhile, announcements overseas further highlight the differences. For example, under new policy plans in India, every car sold in the country from 2030 will be electric. In China, policymakers recently reaffirmed their commitment to produce as much clean electricity by 2030 as the US does from all sources today. (Cracks within US have even surfaced. News of the US's exit from the Paris accord prompted Elon Musk, arguably the world's favourite face of climate change, to resign from Trump's strategic and policy forum, tweeting: *"Am departing presidential councils. Climate change is real. Leaving Paris is not good for America or the world"*).

We return to a theme in this quarter's report: America's retreat from its global leadership position. Consider Obama's "pivot to Asia", with the Trans-Pacific Partnership being the centrepiece. It is now dead. That leaves Chinese President Xi Jinping's "Belt-and-

Road" strategy (his own version of "Make China Great Again") as the uncontested blueprint for future economic integration in Asia.

China's diplomacy now also offers a positive vision. In Davos this year, President Xi (a first time visit for any Chinese President) defended globalization, positioned his country as a protector of free trade and urged policymakers to "just say no" to protectionism. "Pursuing protectionism is just like locking one's self in a dark room. Wind and rain may be kept outside, but so are light and air," he said during his address. "No one will emerge as a winner in a trade war." Trump was conspicuously absent from the gatherings.

In Europe, Emmanuel Macron's presidential victory, with his *La République en Marche* party securing a record parliamentary majority, was won on a platform of pro-globalization, pro-free trade, and, importantly, potential federal solutions to the EU's structural problems (which could renew a cooperative Franco-German axis that drove the EU project since the early 1950s). That contrasts starkly with Trump's "America first" agenda, whereby the US effectively withdraws as global hegemon. Expect global leadership to continue to fill the vacuum left by the US's nationalistic policies.

→ Investment Implications. It has been a long — and many would say — well-earned period of outperformance for US assets. Since 2009, America's stocks and its currency have trounced their global counterparts. By early 2017, the US dollar index had surged to a 14-year high as investors bet that Trump's eye-watering fiscal expansion would prove a replay of early 1980s Reaganomics. Yet the big surprise of 2017 has been that the US dollar has stopped rising. This is remarkable considering that the Fed is hiking rates and preparing to shrink its balance sheet.

What should investors make of this? There should be no doubt that America's waning leadership plays a key role in the value of its currency. However, we have argued in the past few reports that US equities are set to underperform. Why? 3 key drivers of US equity outperformance are going into reverse: 1) In recent years, the Fed was the most aggressive liquidity provider in the world—this is no longer the case. The Fed is now tightening, while everyone else is on hold. 2) In recent years, the US benefitted from an extraordinarily competitive currency—this is no longer the case. In a very short period, the US dollar has gone from being significantly undervalued against almost all currencies, to being fairly valued against most, to now being overvalued against the likes of the euro and the yen. 3) In recent years, US equities were attractively priced—this is no longer the case.

Indeed, American past performance is this year's moveable feast. Where may the next phase of outperformance direct itself? Europe and Asia are the most likely candidates — regions that have cheap currencies are showing signs of earnings and economic acceleration and trade on much cheaper valuations.

China: Unloved and Under-owned. It's no secret — China is slowing. The country's GDP growth averaged 11% in the 2002-2011 decade. It's now under 7% and further moderation is almost certain in the years ahead.

But let's separate fact from fiction. Importantly, much of China's slowdown has been coordinated by policy. Many starry-eyed China watchers predicted real GDP growth of 10% plus indefinitely. But there are limits to linear thinking. While trends can stay in place for some time, lines often bend, or even break and gallop off in unexpected directions. China's new path is driven by broad recognition that the growth model of the last 30 years is neither balanced nor sustainable. The new model must rebalance away from export and investment-led production toward private consumption. "Made in China" and Western consumerism can no longer be intimately linked. This is a necessary shift if China is to avoid the so-called middle income trap, which ensnares most emerging economies that rely on cheap labour for growth.

GDP per head in China is now approaching USD $10,000. To move beyond this level, policymakers know productivity must dramatically improve. That requires a litany of change — reduced corruption, middle class rights and an improved operating environment for the private sector. A critical next step is to establish a robust social safety net and, thereby, reduce fear-driven high household savings rates. This will lead to a virtuous cycle of consumption, job growth and, ultimately, higher real wages and corporate profits.

China is also moving from the rapid industrialization stage of growth (where the main objective was to build up infrastructure and heavy industry) to the resource efficiency stage (where the main goal is to maximize the return on investment). Therefore, over the next several years, China will see slower but better growth — due to reduced capital waste and improved profitability.

Lastly, it cannot be ignored that China has an eye-watering amount of debt, reaching the dizzying height of 220% of GDP by the end of 2015. But the fundamental reason behind this credit surge is rooted in its high savings and banking-centric intermediation system. Chinese households have long been the primary providers of savings in the economy and their assets are far larger than liabilities. Thus, viewed from a balance sheet perspective, the debt situation is much less dire than commonly perceived. Further, the bears ignore that most debt has been used for infrastructure buildup rather than funding consumption (imagine that in any Western country!).

→ Investment Implications. Investors naturally worry whether equity prices can keep rising even as the economy keeps slowing. This is the wrong question. Headline GDP should not be the focus. In fact, GDP growth tends to be negatively correlated with equity markets (most likely because investors overpay for headline growth).

The most important facts about China today are not the problems of slowing growth and high leverage. Rather they are the shift away from exports and capital spending to consumer-led growth, improving margins and financial liberalization. The makeup of China's stock market is also rapidly changing. January 2017 saw the most IPOs of any month in the market's history. The upshot is that the Chinese stock market will come to more closely resemble the underlying economy as a whole, rather than being dominated by state-owned enterprises. Short interest for three of the biggest China equity ETFs are massive, totaling about $6.1 billion in assets. Yet now is the time to be investing in an unloved sector. As China makes progress in face of the many naysayers, equities have much room to be revalued upward. The recent decision by MSCI to add 222 China A-share stocks starting in May 2018 is icing on the cake.

PORTFOLIO UPDATE
Q3 2017

FORSTRONG GLOBAL

Forstrong Investment Committee
Wilfred Hahn (Global Strategic Advisor & CCO)
Mark Arthur (CEO)
Tyler Mordy (President & CIO)
Ken Hawkins (Research Manager)

Numerous imponderables have played out for financial markets during the first half of 2017. Following the eruptions of many other imponderables in 2016, such further outcomes should no longer be surprising. There is no doubt that the realm of global economic and financial markets continues to traverse through uncharted waters and high uncertainty.

Analysts generally are struggling to understand the implications of the many massive changes sweeping the globe, and one must always pursue prudence in implementing active portfolio strategies. Although these measures are always defined by past history, at the same time one must remain open to the collateral effects of what is new.

And, there is plenty that is new. For example, policy-driven financial markets, this mainly being the influence of the major central banks, reversals of globalization and globalism, monumental demographic shifts that continue to accelerate, less capital-intensive economies … etc. are some of the epochal and unfamiliar shifts.

These new and unfamiliar factors can cause confusion amongst investors, producing much alarmism. As such, potential negatives are well recognized by almost everyone. We, therefore, must seek to understand the new. In the meantime, given geopolitical uncertainty, we remain adamant that portfolios must be broadly diversified across the globe.

Overall, global economic growth continues apace, notably now including the contribution of Europe. This is a major development. While world economic growth will remain modest by historical standards, nonetheless, a modest cyclical upswing can be observed. This is a major driver of a number of new tactical strategies. We next outline these and existing strategies.

Prudent Global Diversification. Overall, we remain widely diversified across asset types. All portfolios continue to include exposures to global assets as this has proven to significantly reduce portfolio volatility over the past several decades.

Seeking Growth Premium. In a world of restrained GDP growth, any countries with above-average economic growth will attract a premium. These countries are making outsized contributions to world growth. For example, China continues to contribute a significant portion of world economic growth. A disproportionate contribution to world growth is expected from emerging markets in general.

Overall Asset Mix Shifts: Still a Two-Part World. While global asset mix is modestly overweight in equities, U.S., equities are underweight versus benchmark and fixed-income. Contrastingly, in the Rest-of-World, equity assets are favoured over fixed-income. Fixed-income assets in several Asian and emerging market countries are over-weighted.

Again Tilting Against Lower Interest Rates. While we remain postured to pursue income wherever possible around the globe, U.S. interest rates have again fallen in recent months. As such, bond duration has been modestly reduced. Otherwise, we prefer above-average dividend yielding equities. Interest-income scarcity remains an enduring theme that we continue to emphasize as we continue to scour the world for higher yield.

Equity Sectors Favoured. We maintain an overweight position in healthcare and U.S. financials, having recently also introduced a similar overweight in European banks through the opportunity asset allocation. A friendlier regulatory environment, as well as expected reforms, appear beneficial for this latter sector. Also, materials have been over-weighted in Canadian equity exposures.

Changes in Opportunity Strategies. A high exposure to emerging equity markets has been modestly reduced, though remaining substantially overweight. Generally, emerging markets have outperformed in recent months. Indian equities have performed particularly well, and for now, are over-valued. Consequently, Indian equities have been sold. As well, an exposure to frontier markets was reduced. New additions have also been made. Given the general cyclical recovery that is underway, a modest exposure to materials has been added. A position in Brazilian equities has been initiated as well as in senior gold miners. Asian fixed-income markets are generally attractive in local currency terms, and in the case of Chinese yuan-bonds, are offering attractive yields. All portfolios have an allocation to this opportunity set of holdings.

Currency Trends. The U.S. dollar is seen to be generally over-valued vs. most major currencies. In contrast, the Canadian dollar is likely more vulnerable to upside than downside vs. the USD. As such, approximately 50% of U.S. investment positions are now hedged back into the Canadian dollar.

We continue to counsel investors that financial markets are facing high levels of uncertainty and unprecedented conditions. Nevertheless, we forecast long-term portfolio returns to be comfortably above cash returns, recognizing that securities portfolio returns are random over the short-term and can be highly variable for any given year.

3rd Quarter 2017 — Investment Stance

	Versus Benchmark			Change from
	Under	Neutral	Over	previous quarter
Net Global Asset Mix				
Cash		■		● Unchanged
Total Equity			■	● Unchanged
Total Fixed Income	■			● Unchanged
Opportunity		■		● Unchanged
Canada Investments				
Bonds		■		● Unchanged
Stocks			■	↑ Increased
U.S. Investments				
Bonds		■		● Unchanged
Stocks	■			● Unchanged
International Investments				
Bonds	■			● Unchanged
Stocks			■	↓ Decreased