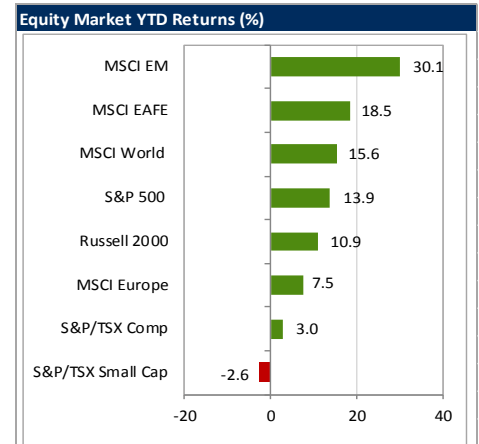


## Canada: Long or Short Duration?

The S&P/TSX pushed to the highest level since February this week. From the August low, the best performing sectors have been consumer discretionary (+7.6%), financials (6.6%) and energy (6.4%). Canadian equities have made up some ground relative to the US, but the S&P 500 differs in that it continues to set new record highs. This week the S&P 500 overtook last week's highest close of 2,552 by closing at 2,555 on Wednesday.

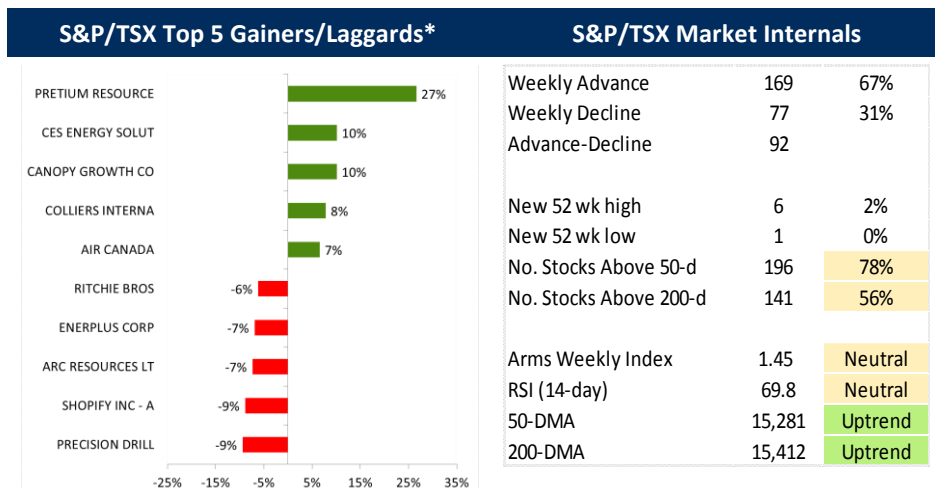
US earnings season has started in earnest with the Street looking for S&P 500 EPS growth of just 2.8% in Q3, down from 7.5% at the start of the quarter. The bulk of the recent downward revisions have been hurricane related. With the bar set so low, the stage is now set for earnings to meaningfully exceed expectations. However, if this is not the case and earnings are somewhat muted we believe investors will look past the soft patch and caulk it up to one-time hurricane effects. In this view, US earnings season should present little downside risk to the market, but could be a positive catalyst in a scenario where earnings significantly exceed expectations.

On Wednesday, the FOMC minutes were released from September's FOMC meeting. The minutes did not differ much from the public statement release after the meeting. As expected, participants noted persistently weaker inflation readings, with many expressing concern this might not only reflect transitory factors, but perhaps some more persistent elements as well. However, other officials worried about upside risks to inflation arising from a tightening labor market. The market interpreted the discussion surrounding inflation as somewhat dovish causing the fed rate hike odds for December to bounce around, but the probability remains high at 76%. The US dollar also slipped on the release of the minutes, while precious metals advanced.

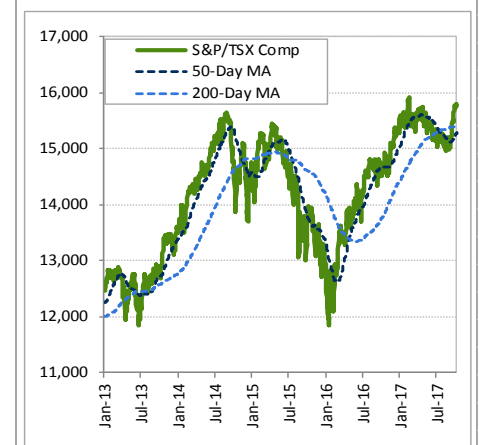


Canadian Sectors	Weight	Recommendation
Consumer Discretionary	5.4	Market weight
Consumer Staples	3.7	Market weight
Energy	19.7	Overweight
Financials	34.6	Overweight
Health Care	0.6	Underweight
Industrials	9.4	Overweight
Technology	3.2	Market weight
Materials	11.8	Market weight
Communications	4.8	Underweight
Utilities	3.9	Market weight
Real Estate	2.9	Market weight

Technical Considerations	Level	Target
S&P/TSX Composite	15,742	16,500



Source: Bloomberg, Raymond James Ltd; \* 5-day price return



Source: Bloomberg, Raymond James Ltd.

Sectors are based on Bloomberg classifications

Please read domestic and foreign disclosure/risk information beginning on page 4  
Raymond James Ltd. 5300-40 King St W. | Toronto ON Canada M5H 3Y2.

2200-925 West Georgia Street | Vancouver BC Canada V6C 3L2.

## Duration Call

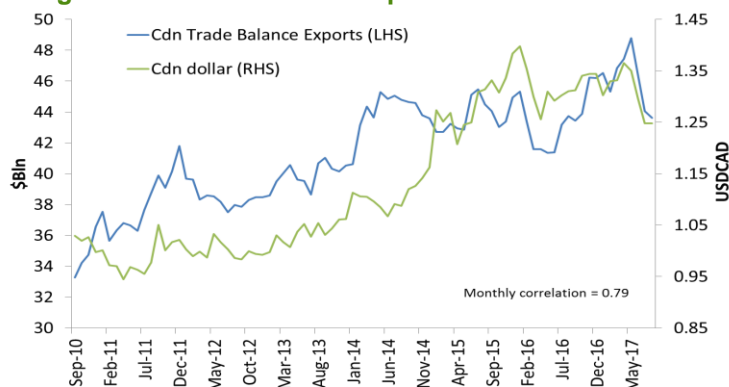
There is no denying it; the global economy has hit its growth stride. Purchasing managers' indices (PMIs) point to an acceleration in economic activity over the next 3-6 months. In fact, PMIs remain securely above their long-term average indicating that manufacturing growth is firmly above trend. Further, the breadth of the expansion is also encouraging as the percentage of countries with PMIs in expansion territory rose to 97%, the highest level since June 2007.

Canada has also participated in the synchronized growth upswing. In fact, the Washington-based International Monetary Fund raised its estimate for Canada's economic growth rate in 2017 and 2018, now implying that Canada is likely to experience the best GDP growth among advanced economies.

Clearly there are many positive factors supporting equity markets. However, from a tactical standpoint we see near-term opportunity in rate sensitive securities. We believe Canadian yields have gotten ahead of themselves and we anticipate yields to pull back in the fourth quarter. We believe the catalyst for this to occur will be the Bank of Canada's (BoC) policy meeting on October 25th. We believe the BoC will remain on hold at this meeting for the following reasons:

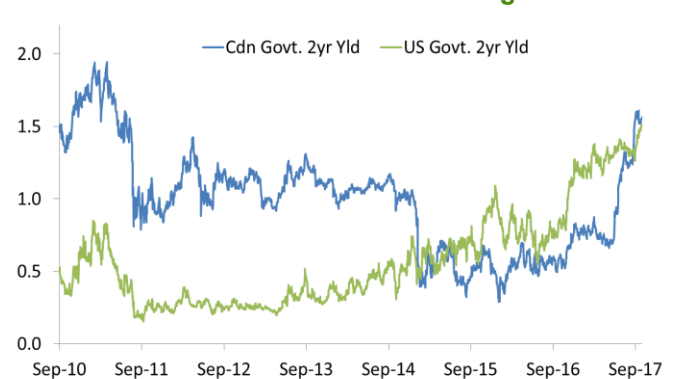
- From May to August, the Canadian dollar advanced 11.6%. Canadian exports peaked in May at \$48.8 bln, but the most recent reading from August revealed a rather large pull back. The contraction from the peak, not too surprising given the correlation between the currency and exports, was 11%. Clearly, Canadian dollar strength has had a negative impact on trade and the BoC will be unwilling to cause further deterioration by pushing the loonie higher.
- The BoC has hiked rates two times this year and changes to mortgage financing rules will further tighten credit conditions. The Canadian housing market has clearly slowed thus policy actions are having their desired effect. However, we believe the BoC will want to take a wait-and-see approach to ensure the slowdown is in fact just a slowdown and not something more severe.
- The BoC rate hikes have caused Canadian yields to rise too rapidly, in our view, particularly given the headwinds that may appear from a slowing housing market and related activity. Financial conditions have tightened to the point where the Canada-US rate differential has been completely erased.

### Strong CAD Dents Canadian Exports...



Source: Bloomberg, Raymond James Ltd.

### ...Canadian Financial Conditions Too Tight



Source: Bloomberg, Raymond James Ltd.

## Investment Implications

If we are correct in predicting that yields to pull back in the fourth quarter, investors may wish to extend duration within their Canadian fixed income sleeve. From a fixed income perspective this would suggest selling shorter maturity bonds, like floating rates, and buying mid-dated bonds, like 5 years. In the preferred share world, it would suggest selling floating and/or fixed-rate resets to add to perpetuals.

Things get a little more tricky in the equity world. We are of the view the S&P/TSX will perform well in Q4 with financials and energy doing most of the heavy lifting. This suggests a cyclical tilt to our investment recommendations. We therefore are hesitant to recommend selling cyclicals to buy defensives, as we see cyclicals outperforming defensives during the quarter. However, for income-seeking investors that have a lower tolerance for risk, we believe adding to defensive sectors ahead of the BoC meeting makes sense.

To help filter down to a few actionable ideas we looked at the past 8 peak to troughs in the Canada government 5 year yield and the corresponding S&P/TSX sector and stock returns. The average retracement experienced by the 5-year yield over the periods was 51 bps. Not surprisingly, rate sensitive sectors performed well during these periods. Consumer staples, on average, performed the best advancing 6.4% followed by telecom (+5.6%), utilities (+3.8%) and real estate (+3.7%). In the table below we highlight the average individual stock returns measured over those periods.

Company Name	Ticker	Average %	Company Name	Ticker	Average %
<b>Consumer Staples</b>			<b>Real Estate</b>		
COTT CORP	BCB	13.4	FIRSTSERVICE-WI	FSV	12.7
ALIMEN COUCHE-B	ATD/B	11.6	COLLIERS INTERNA	CIGI	8.6
METRO INC	MRU	9.5	CAN APARTMENT	CAR-U	7.7
NORTH WEST CO IN	NWC	9.0	BROOKFIELD PROPE	BPY-U	6.3
PREMIUM BRANDS H	PBH	7.4	ALLIED PROP REIT	AP-U	6.1
MAPLE LEAF FOODS	MFI	5.8	SMART REAL ESTAT	SRU-U	6.1
WESTON (GEORGE)	WN	4.7	TRICON CAPITAL G	TCN	6.0
EMPIRE CO LTD A	EMP/A	4.2	GRANITE REAL EST	GRT-U	5.1
LOBLAW COS LTD	L	3.9	PURE INDUSTRIAL	AAR-U	4.8
SAPUTO INC	SAP	2.4	CROMBIE REAL EST	CRR-U	4.4
JEAN COUTU GRP-A	PJC/A	1.6	ALTUS GROUP LTD	AIF	4.0
<b>Utilities</b>			RIOCAN REIT		
ALGONQUIN POWER	AQN	7.8	FIRST CAP REALTY	FCR	3.7
EMERA INC	EMA	7.7	H&R REAL-REIT UT	HR-U	2.7
BORALEX INC -A	BLX	7.0	CAN REAL ESTATE	REF-U	2.4
ATCO LTD-CLASS I	ACO/X	6.8	DREAM GLOBAL REA	DRG-U	1.8
BROOKFIELD INFRA	BIP-U	6.8	ARTIS REAL ESTAT	AX-U	1.7
HYDRO ONE LTD	H	6.6	COMINAR REA-TR U	CUF-U	0.7
BROOKFIELD RENEW	BEP-U	6.6	NORTHVIEW APARTM	NVU-U	-0.3
FORTIS INC	FTS	6.2	BOARDWALK REAL E	BEI-U	-0.5
CAN UTILITIES-A	CU	5.6	DREAM OFFICE REA	D-U	-4.2
NORTHLAND POWER	NPI	4.2			
INNERGEX RENEWAB	INE	3.4			
TRANSALTA RENEWA	RNW	2.0			
JUST ENERGY GROU	JE	0.6			
SUPERIOR PLUS CO	SPB	-0.9			
CAPITAL POWER CO	CPX	-1.6			
TRANSALTA CORP	TA	-7.1			
<b>Telecom</b>					
ROGERS COMMUNI-B	RCI/B	6.4			
BCE INC	BCE	6.3			
TELUS CORP	T	6.2			

Source: Bloomberg

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