A strong start to the year gave way to a pullback in equities as the prospects for rising inflation and fears of a potential global trade war weighed on investor confidence. Despite the market’s renewed focus on rising rates, bonds slightly edged-out equities in the quarter for the first time since the second quarter of 2016.¹

**The return of volatility** - After trending near record low levels for much of 2017, market volatility made a comeback in the first quarter. Concerns of rising inflation and the potential for more aggressive policy tightening from the U.S. Federal Reserve sparked initial volatility. Daily fluctuations in the stock market averaged 0.9% in the first quarter, three-times larger than the average for all of 2017.²

**Stock markets hit a correction** - The S&P 500 fell 10% from its January highs, recording the first official correction in two years. The TSX was also under pressure, dropping 8%. The Canadian and U.S. stock markets have now experienced four and five 10% corrections, respectively, since the bull market began in 2009. For perspective, stocks have historically averaged one correction per year.

**Rates reached multi-year highs** - While interest rates are still at fairly low levels — historically speaking — they moved notably higher in the quarter. 10-year rates in Canada and the U.S. rose to their highest levels since 2014, reflecting economic growth and firmer inflation expectations. 2-year rates rose above 2% in the U.S. for the first time since 2008 (domestic yields are below 1.8%), indicating recent and upcoming rate hikes from the Fed.

**Action for Investors**

We expect ongoing volatility in response to policy changes, gradually rising rates driven by central banks and persistent economic growth, as well as favourable international market performance helped by ongoing global expansion. We think investors should position with increased diversification and realistic expectations.

*Source: Morningstar Direct, 3/31/2018. Representative indexes are: Real Estate: S&P Canada REIT Index, High Yield Bonds: Barclays High Yield Canadians Index, Canada Large-cap Stocks: S&P/TSX Composite Index, U.S. Small- and Mid-cap Stocks: Russell 2500 Index, International Bonds: Barclays Global Aggregate Bond Index, Canada Bonds: FTSE TMX Canada Universe Bond Index, U.S. Large-cap Stocks: S&P 500 Index, Emerging Market Stocks: MSCI EM Index, Overseas Large-cap Stocks: MSCI EAFE Index. Past performance is not a guarantee of how the market will perform in the future. Indexes are unmanaged and are not available for direct investment. All returns expressed in local currency and include reinvested dividends.*

*Past performance of the markets is not a guarantee of what will happen in the future. Equity investments carry risk, including the loss of principal. There are special risks inherent in international investing, including currency, withholding taxes and high levels of taxation, political, social and economic risks.*
We think Canada is in the later stage of the economic cycle, though we don’t see a recession emerging this year, which should provide ongoing support for the bull market.

**Slower growth as consumers carry less of the load** – Following healthy growth of 3% in 2017, we think the pace of domestic GDP growth is likely to slow to 1.5%-2.0% this year. Positively, labour market conditions are fairly strong, underpinned by the lowest unemployment rate since the mid-’70s. But the expansion downshifted heading into 2018 and we believe household consumption (60% of GDP) will be curbed by weaker housing investment and rising savings to combat restrictively-high consumer debt levels.

**End of the housing boom** – We don’t anticipate a collapse in Canada’s housing market but, having accounted for nearly 8% of GDP recently, we think tighter mortgage regulations and higher rates will moderate housing investment, a new headwind for the economy. Home sales activity has dropped notably in Toronto and Vancouver, while inventory levels remain high, a combination that we believe will put additional downward pressure on real estate prices and contribute to more moderate household spending.

**A mixed outlook for trade** – We anticipate a rebound in exports this year, helped by stronger U.S. demand and the weaker loonie. Policy uncertainties are a risk, however. A global trade war would be punitive to growth and we anticipate the NAFTA negotiations will drag on. Ultimately, we think some concessions from Canada will be required, but a NAFTA resolution this year could unlock pent up investment demand.

**Action for Investors**

We think slower domestic growth will contribute to a less favourable earnings growth picture for the TSX relative to foreign markets, warranting an underweight allocation to Canadian large-cap, mid-cap and real estate equities. Within domestic stocks, consumer staples and utilities, along with commodity-sensitive energy and materials sectors, have underperformed over the past year, offering an opportunity for sector rebalancing.

Equity investments carry risk, including the loss of principal. There are special risks inherent in international investing, including currency, withholding taxes and high levels of taxation, political, social and economic risks.
We think we have moved into the later stages of the cycle, but there is still gas left in the bull market’s tank. Policy risks could spur ongoing volatility, but the positive fundamental backdrop of economic and earnings growth is still intact, which we believe will prevent the recent market correction from spiraling into a bear market.

Volatility isn’t over – We expect uncertain (potentially protectionist) trade policies and the continual withdrawal of U.S. Fed stimulus to stoke ongoing swings in stock prices as we advance through this year. Since 1928, the average 10% correction lasted three months, indicating that even amid favourable economic conditions, pullbacks can be extended. But positively, over the past 20 years, stocks have averaged a 12% return in the twelve months following stock market corrections.

More compelling value – The silver lining in this year’s pullback is that stocks are now trading at their most attractive level in more than two years. The TSX’s 21.1% gain and the S&P 500’s 38.3% total return from ’15-’17 took valuations to well above-average levels. But the forward price-to-earnings (P/E) ratio is down to 14.4 for the TSX and 16.1 for the S&P 500, and with 2018 earnings growth projected to be the strongest in eight years, we view this as an opportunity to buy a healthy market at a more attractive value.

Perspective is important – Although stocks have now experienced corrections in 2015, 2016 and 2018, this is still below average, as historically the stock market has averaged one correction per year since 1900. This recent decline has simply returned stocks to their levels near the end of 2017. The market is still up over the past year and has gained 244% since this bull market began — a 14.6% annual return.


Action for Investors

We recommend a neutral allocation to equities, reflecting our expectation for an extended bull market but with more volatility ahead. We suggest buying on dips, adding to underweight asset classes and sectors to actively rebalance.

Past performance of the markets is no guarantee of how they will perform in the future. Equity investments involve risk, including the loss of principal.
Firmer inflation and central-bank policy tightening should gradually lead rates higher over the course of the year, though we believe the path for rates may be choppy as investment dollars flow to bonds amid stock market volatility. Though we anticipate modest overall returns from bonds moving forward, their positive performance during the quarter demonstrates the value of fixed income in volatile periods.

**Less urgency from the BoC –** After three rate hikes in the past year, we think opposing economic forces will move the Bank of Canada (BoC) to the sidelines for the bulk of 2018. Core inflation has moved up to 1.9% recently, the closest it’s been to the BoC’s 2% target since 2012. The increase in oil prices and drop in unemployment will likely lift inflation slightly over the course of the year, supporting additional rate hikes over time. However, we expect the BoC to pause to evaluate economic headwinds from high consumer debt and a softening housing market.

**Fed frequency in focus –** The U.S. Fed will be more determined in tightening policy this year, with the market focusing on the number of rate hikes anticipated this year. We expect the gap between U.S. and Canadian rates to widen on the back of stronger U.S. expansion.

**Rates are higher but not high –** Over time, higher rates will increase borrowing costs and narrow the attractiveness of stocks relative to bonds. While 10-year yields have risen to 2.74% in the U.S. and 2.09% in Canada, rates are coming off of historic lows and have not yet reached levels that choke-off growth. It’s important to remember we are still well below levels that have historically been associated with the end of bull markets.

**Action for Investors**

We recommend a neutral weight to fixed income, including an increased cash allocation as a cushion against market volatility. We suggest reducing the average maturity of bond portfolios to guard against interest-rate risk, using short- and intermediate-term investment-grade bonds. Internationally, we still favour U.S. bonds over global. We recommend reducing high-yield bond allocations as spreads have compressed to unattractive levels.

Past performance is not a guarantee of what will happen in the future. Bond investments are subject to interest rate risk such that when interest rates rise, the prices of bonds can decrease, and the investor can lose principal value.
International equities have outperformed the Canadian market last year as global growth has accelerated. The pace of improvement is likely to moderate this year but remain supportive of global stock market performance.

**Global growth story still intact** – World GDP growth is expected to accelerate again this year to its best level since 2010. The rate of improvement has stalled a bit to start this year, possibly the result of recent gains and global political uncertainties. Nevertheless, employment conditions, manufacturing activity, credit conditions and monetary policy settings across advanced economies remain quite healthy, pointing to sustained expansion.

**Trade war is a threat** – Protectionist trade strategies and concerns that retaliatory measures could spill into a trade war are a prevalent risk to the global expansion, but we don’t think this will result in the world’s major economies closing their doors to trade. For perspective, the recent tariffs announced on U.S. imports from China represent less than 0.5% of global trade. It’s likely the protectionist rhetoric from the U.S. and other trading partners will continue as part of what we perceive as the larger negotiating process, stoking periods of volatility along the way.

**International equities remain attractive** – Despite strong outperformance last year, we don’t think the relative strength of international equity performance has run its course. The U.S. economy is gaining traction, which combined with the benefits of corporate tax reform, sets the stage for strong S&P 500 earnings growth ahead. Similarly, we think overseas markets are earlier in the cycle. This, combined with lower valuations, supports our positive outlook for international equities.

**Action for Investors**

We recommend an increased international equity allocation, favouring overseas developed-market large-cap equities that should continue to benefit from economic improvement and attractive valuations. Better growth in the U.S. also supports allocations to U.S. small- and mid-cap equities. We continue to recommend a modest allocation to emerging market equities.

Equity investments carry risk, including the loss of principal. There are special risks inherent in international investing, including currency, withholding taxes and high levels of taxation, political, social and economic risks. The prices of small cap and mid cap stocks are generally more volatile than large company stocks.

Sources: 1. International Monetary Fund. 2. Capital Economics.
<table>
<thead>
<tr>
<th>Asset Class</th>
<th>1-Year</th>
<th>3-Year</th>
<th>5-Year</th>
<th>10-Year</th>
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QUARTERLY MARKET OUTLOOK: SECOND QUARTER 2018

Investment Performance Benchmarks as of 3/31/2018
Target Guidance by Investment Category

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<th>START HERE</th>
<th>Investment Category</th>
<th>Asset Class</th>
<th>Target Guidance in Range</th>
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<tr>
<td>Equity Investments</td>
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<td>Commodities &amp; Emerging Markets</td>
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<td>Growth</td>
<td>Small- and Mid-cap Stocks (Canadian, U.S. and Overseas)</td>
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<td>Growth &amp; Income</td>
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<td></td>
<td>Cash</td>
<td>Cash &amp; Short-term GICs</td>
<td>High</td>
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</tbody>
</table>

1 Alternative investments and Stocks trading less than $4 align with the aggressive investment category, but they are not recommended.
2 Large-cap stocks that do not pay a dividend are in the Growth investment category.
Asset classes we don’t recommend separately include alternative investments, micro-cap equities and international high-yield bonds.

QUARTERLY MARKET OUTLOOK: SECOND QUARTER 2018

Asset Class Outlook

We believe well-diversified portfolios should be built by first identifying a targeted mix of equity and fixed-income investments based on your goals and comfort with risk, and then gaining exposure to a broad mix of the asset classes highlighted below.

- **Equity versus Fixed Income (Target = Middle)** – We recommend a neutral position to equity and fixed income. We believe the bull market in stocks will continue. However, rising policy uncertainties increase the risk of ongoing bouts of volatility, supporting the case for proactive rebalancing.

- **Domestic Versus International (International target = High)** – We maintain our overweight international allocation. Faster growth in the U.S. and sustained signs of a synchronized global rebound offer support for continued international outperformance. We expect domestic investments to deliver positive returns, but recommend a reduced allocation given economic challenges and domestic sector imbalances.

- **Asset Class Diversification:**
  - **Income (Cash target = High, Income Target = Low)** – We suggest reducing the average maturity of bond portfolios as a way to lessen interest rate risk. We recommend a higher weighting with your cash range to position for increased volatility. Our low target allocation for income investments includes our recommendation to reduce exposure to high-yield bonds (aggressive income).
  - **Growth & Income (Target = Middle)** – We recommend underweight positions in Canadian large-cap equities and real estate, which we believe each face headwinds from the domestic economic backdrop. We maintain our suggested overweight allocation to overseas developed-market large-cap equities.
  - **Growth (Target = Middle)** – Reduce allocations to domestic small- and mid-cap stocks. Small- and mid-cap equities appear more attractive in the U.S., as we believe they will be more sensitive to U.S. economic growth, are less impacted by currency fluctuations and benefit from U.S. tax reforms.
  - **Aggressive (Target = Middle)** – Emerging market equities have outperformed strongly, but a modest allocation is still warranted given ongoing challenges in China and headwinds from commodity and currency fluctuations. Overall, we continue to be cautious toward direct commodity investments.

Investing in equities involves risks. The values of your shares will fluctuate and you may lose principal. Special risks are inherent to international and emerging-markets investing, including those related to currency fluctuations and foreign political and economic events.

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### Building Your Portfolio - Actions for Investors

#### 1. Overall Economic Outlook:
We think slower domestic growth will contribute to a less favourable earnings growth picture for the TSX relative to foreign markets, warranting an underweight allocation to Canadian large-cap, mid-cap and real estate equities. Within domestic stocks, consumer staples and utilities, along with commodity-sensitive energy and materials sectors, have underperformed over the past year, offering an opportunity for sector rebalancing.

#### 2. Equities:
We recommend a neutral allocation to equities, reflecting our expectation for an extended bull market but with more volatility ahead. We suggest buying on dips, adding to underweight asset classes and sectors to actively rebalance.

#### 3. Fixed-income Investments:
We recommend a neutral weight to fixed income, including an increased cash allocation as a cushion against market volatility. We suggest reducing the average maturity of bond portfolios to guard against interest-rate risk, using short- and intermediate-term investment-grade bonds. Internationally, we still favour U.S. bonds over global. We recommend reducing high-yield bond allocations as spreads have compressed to unattractive levels.

#### 4. International Investments:
We recommend an increased international equity allocation, favouring overseas developed-market large-cap equities that should continue to benefit from economic improvement and attractive valuations. Better growth in the U.S. also supports allocations to U.S. small- and mid-cap equities. We continue to recommend a modest allocation to emerging market equity.

Past performance may not be repeated.
Diversification does not guarantee a profit or protect against loss.
The TSX and S&P 500 are unmanaged indexes and are not meant to depict actual investments.
There are special risks inherent in international and emerging markets investing, including currency, withholding taxes and high levels of taxation, and political, social and economic risks.
Before investing in bonds, you should understand the risks involved, including credit risk and market risk. Bond investments are also subject to interest rate risk such that when interest rates rise, the prices of bonds can decrease, and the investor can lose principal value if the investment is sold prior to maturity.
Equity investments carry risk, including the loss of principal. The prices of small- and mid-cap stocks are generally more volatile than large company stocks.

**Expected Return:** Based on our long-term annual return expectations for Canadian equity (6.0% - 7.5%), U.S. equity (3.5% - 7.5%), overseas equity (7.0%-9.0%) and fixed-income investments (2.75%-3.5%). This describes the average expected return for this Portfolio Objective based on the asset allocation illustrated. This does not factor in potential fees and taxes that could reduce your actual return. There is no guarantee that you will earn this return if you hold investments in line with this Portfolio Objective. Expected Returns source: Edward Jones calculations, February 2018.

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**Pyramid Guide**
- **Aggressive**
- **Growth**
- **Growth & Income**
- **Income**
- **Cash**

<table>
<thead>
<tr>
<th>Balanced toward Growth</th>
<th>Balanced Growth &amp; Income</th>
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<td>Long-Term Expected Returns 4.5% - 6.5%</td>
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<td>International 15% - 35%</td>
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<td>Aggressive Income 0% - 10%</td>
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