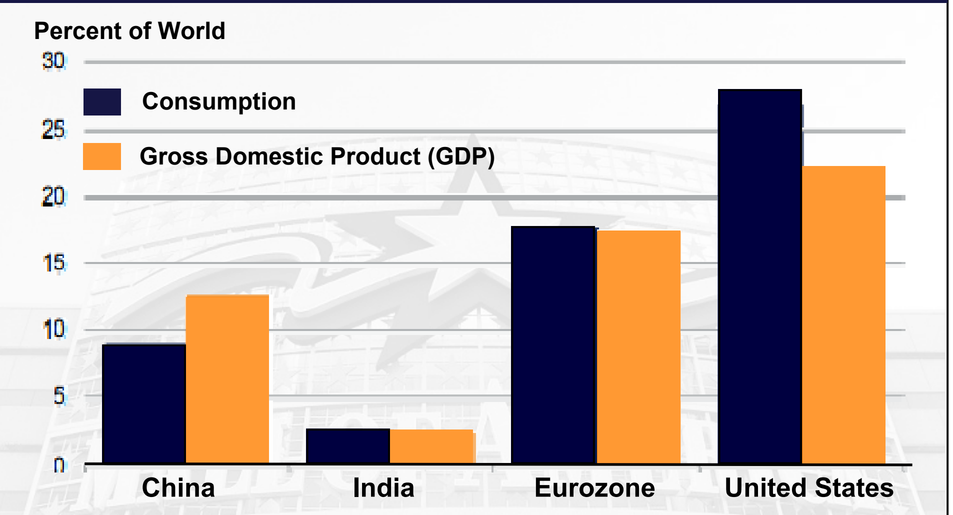
The year of the U.S. Growth Locomotive

You wouldn't know it given the noise from Greece and China, but the world economy is slowly picking up steam as the United States re-establishes itself as the world's growth locomotive. The "noisy" first half of 2015 carried a full year's worth of financial news: we entered the year with a crisis brewing in Russia and ended the first six months with one bubbling over in Greece and another erupting in China. In between those events we absorbed disappointing economic news out of Canada, which likely dipped into recession.

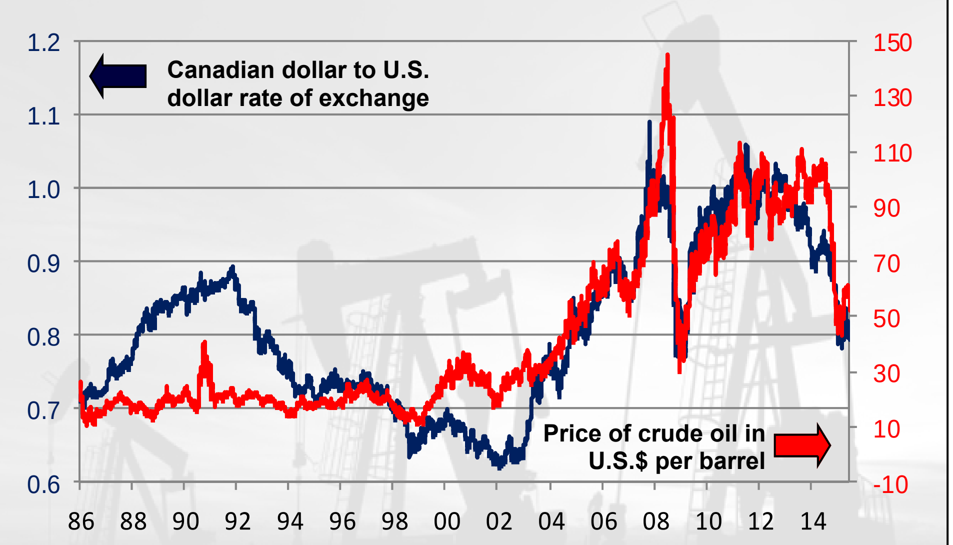
Exhibit 1 U.S. Consumers Still Leading the Road to Recovery



China and India some way from matching the U.S. Consumer

Source: Thomson DataStream, IMF, Genus—June 30, 2015

Exhibit 2 Canadian Dollar Remains Handcuffed to Price of Oil



Source: Thomson DataStream, Genus—June 30, 2015

With all this going on, the world's major stock market indices made essentially no progress in the first six months of the year and bonds shifted into reverse. Interestingly, amid all the dramatic headlines, stock market volatility remained modest, with the VIX "fear index" at the lowest level in over a year as the quarter ended.

Global Economy Grinds On

Despite being pushed and pulled by the offsetting forces of improving activity in the United States on the one side, and a weakening Europe, Greek debt drama and lingering concerns over a slowing China on the other, the global economy continued its slow and grinding recovery. The International Monetary Fund (IMF) predicts an annual growth rate of 3.5% for the world economy in 2015, slightly up from 3.4% in 2014.

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Advanced countries are expected to experience faster growth at 2.4% in 2015 from 1.8% in 2014. On the flip side, emerging markets are forecast to grow at 4.3% in 2015 from 4.4% in 2014 based on downward trends in China and other emerging market economies, such as Russia, Brazil and Turkey. The U.S. is the lone bright spot with a projected growth of 3.1% in 2015, up from 2.4% in 2014. This largely offsets the prospects of the weaker outlook for the Eurozone and China. Stronger U.S. growth also could help boost Canada's tepid economy as it struggles against low commodity prices, a slowing China and instability in Europe.

It is likely that the Canadian economy was in recession in the first half of the year. Growth fell by one per cent in the first quarter of 2015 and is expected to fall 0.6% in the second quarter, which meets the technical definition of a recession of two consecutive quarters of negative GDP growth. The second half of the year is likely to be weaker than expected with annual inflation-adjusted GDP growth around 1.2% for all of 2015. That would be the weakest pace of growth in Canada in more than 20 years. Against this backdrop, the Bank of Canada cut its key interest rate to 0.5% on July 15 and will likely maintain historically low rates until mid-2017. That will keep Canada's exchange rate below 80 U.S. cents this year and into 2016, which will help get the country's export-led economy back in gear.

No Fed Liftoff Yet

While economic activity in the U.S. is looking up, it isn't a slam dunk for the Federal Reserve to raise rates. In fact, New York Fed President William Dudley warned in April that "there are reasons to err on the side of being late than being early." Plus, when you add in the instability caused by the troubles in Greece and China, it's clear that the U.S. remains very much in favour around the world as a safe haven and investor demand for Treasuries should naturally keep rates lower for the foreseeable future. This doesn't mean we can't see rates move higher, as we have so far this year, but we do not anticipate aggressive tightening by the Fed. In fact, the IMF cautioned the U.S. central bank should wait until mid-2016 before raising rates.

Till Debt do Them Part

The long-running standoff between debt-strapped Greece and its creditors entered what could be a final chapter on June 30 as Greece defaulted on a U.S.$1.8 billion loan payment to the IMF and its bailout program expired. The saga reaches another critical point on July 20 when Greece has to fulfill a U.S.$3.9 billion loan payment to the European Central bank (ECB). Failure to do so will lead to the insolvency of Greek banks and full-blown debt default.

With roughly U.S.$350 billion in total debt outstanding (even after having $100 billion erased in 2012 in a massive debt restructuring plan) the standoff is likely to continue until Greece is offered substantial debt forgiveness in exchange for the economic reforms demanded by the lending troika of the ECB, the IMF and the European Union for an extension of their bailout support, or default on their debt and run the risk of being booted from the Eurozone. Against this desperate backdrop, Greeks face a lose-lose choice: Accept the creditors' tough terms, and the economy gets worse; or replace the euro with its own currency, the drachma — and the economy gets worse.

However it plays out, the impact is likely to be reasonably contained. First, Greece is a miniscule 1.8% of the Eurozone economy and accounts for only 0.5% of the exports of other euro countries. Second, Europe's financial system has been implementing policies for several years that should limit the potential contagion from a Greek exit from the Euro or the EU, however messy it might be. Unlike 2012, when Greece's debts were held by highly-leveraged banks, most of it is now held by the IMF, ECB and Eurozone government institutions.

Germany the Real Issue

The real economic issue is not Greece per se, but what the turmoil is doing to business confidence in the Eurozone, particularly in Germany. At almost 30% of the Eurozone, Germany has been the main driver of the currency club's recovery. Even prior to the intensification of the Greek turmoil, German business confidence declined because of the negative developments in China and Russia. The slowdown in China and the recession in Russia are headwinds for German exports, which has resulted in economic growth expectations being lowered from 1.8% to 1.5% for 2015. If Germany can plough through the Greek "tragedy", the Eurozone's economic outlook for this year and next should be okay and, given the weaker outlook, the ECB will more than likely reduce interest rates again.

China's Red Flag

With the world focused on Greece's debt woes, the rout in the Chinese stock market that started in June and continued in July caught some by surprise. In the space of three weeks, various indices lost between 30% and 40% of their value. The sell-off wiped out more than U.S.$2.4 trillion in wealth—a figure ten times the size of Greece's economy. In hindsight, a reversal was not unexpected given the blazing run-up in Chinese share prices. Fueled by record margin debt (up 463% since June last year) as some 90 million novice investors borrowed money to pile into the market and join the speculative frenzy, China's stock market capitalization tripled in the past year to U.S.$9.8 trillion.

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From Page 1▶ Liquidity injections and encouragement by China's central bank, in particular, helped boost speculative sentiment. Credit Suisse estimates that the figure for borrowed funds invested in the market reached between U.S. $708 billion and $950 billion, which helped inflate prices to unsustainable levels. The companies whose share prices were rising weren't actually getting any better—the prices were going up simply because there was so much demand and people were bidding prices up. When prices began to dip, those investors were forced to sell shares to pay back the borrowed money and cover losses. That vicious circle of selling created panic and pushed down prices even further, which only exacerbated the problem for leveraged investors—and helps explain why the government has been unable to stop the rout or stem the tide of selling.

Undoubtedly there will be concentrated financial pain among highly leveraged investors but, on balance, the Chinese economy is still sufficiently disconnected from the equity market that the macro impact on growth will be limited as equities account for only about 20% of household wealth.

The stock market crash does, however, present a challenge for the ruling Communist Party and its efforts to develop the stock markets as a tool to help make the state-dominated economy more efficient; first, by getting state-owned companies to rely on capital markets for funding rather than loans from state banks; and second, creating wealth for households to alleviate the growing pressure on state China's economic slowdown so far has been mainly related to the unwinding of its investment and credit bubbles as it transforms from an economy heavily reliant on investment and manufacturing to one driven by consumption and services. Progress is, at best, at a crawl. The market crash won't instill confidence in consumers and domestic demand will likely remain sluggish at best, which could see GDP growth drop below the government's target of 7% for 2015, its slowest in the past 25 years. However, the end goal of a slower, reformed and rebalanced Chinese economy will be a less risky, more stable force in the global economy.

The Bright Spot

The U.S. economy is the developed world's bright spot with a projected growth of 3.1% in 2015,up from 2.4% in 2014. The performance of the U.S. largely offsets the prospects of the weakening Eurozone and China. The U.S. should be capable of ploughing through the global headwinds because it is supported by: a healthy U.S. consumer, buoyed by employment gains and accelerating wage growth; a sustained, albeit moderate, housing recovery; healthy corporate balance sheets; business capital spending; a manufacturing renaissance; reduced fiscal drag; and low commodity prices.

In short, we expect a relatively strong finish to the year with the global data to continue to point higher in the second half and reinforce a narrative of slow, grinding growth, not one of a global slowdown. □

Genus Pooled Fund Performance

Returns are shown Gross of Fees

As at June 30, 2015	3 months	1 year	3 years	5 years	10 years
		Compound Annual Returns			
Balanced Fund	-1.5	7.3	11.5	9.5	5.3
Equities					
Canadian Alpha[1]	-2.1	-3.7	10.2	6.2	5.5
Dividend Equity	-2.4	8.0	15.0	12.9	
Global Alpha[2]	-2.3	18.8	22.5	19.3	7.0
CanGlobe Equity	-1.7	9.6	17.5	12.6	
Emerging Markets	0.2	8.8	9.5		
Fixed Income					
Government Bond	-1.0	5.2			
Short-Term Corporate Bond	0.1	3.4	3.2	3.5	3.9
Strategic Bond	-1.1	5.7	5.6	6.4	
Commercial Mortgage	1.2	5.1	4.4		
Fossil Free					
Fossil Free Dividend Equity[3]	-2.1	15.6			
Fossil Free CanGlobe Equity[4]	0.1	16.6			
Fossil Free Corporate Bond	-1.2	6.0			
Index Returns	**3 months**	**1 year**	**3 years**	**5 years**	**10 years**
S&P/TSX Composite	-1.6	-1.2	11.1	8.3	6.9
S&P 500 Index (C$)	-1.2	25.9	25.5	21.2	8.1
MSCI Emerging Mkt (C$)	-0.6	11.6	11.4	7.4	8.7
MSCI World Index (C$)	-0.9	19.5	22.9	17.4	7.2
DEX Universe Bond Index	-1.7	6.3	3.8	5.1	5.0

Past performance is no guarantee of future results.

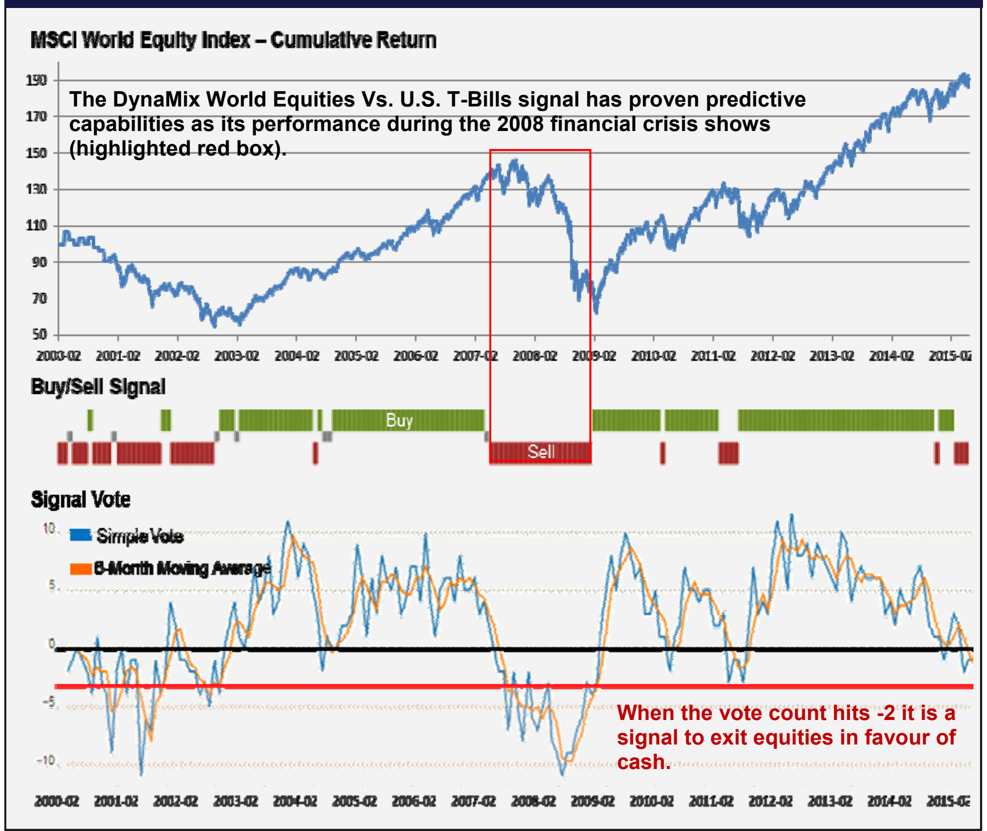
1 **Mandate change:** Genus U.S. Equity mandate changed to Global Equity (Sept 14, 2012) and Global Alpha (June 30, 2014).
2 **Mandate change:** Genus Canadian Equity changed to Canadian Alpha on June 30, 2014.
3 **Mandate change:** Biosphere Canadian Equity (100%TSX) changed to Biosphere Dividend Equity (40% TSX, 30% S&P 500, 30% MSCI EAFE) as at April 1, 2013. Name change to Fossil Free Dividend Equity on March 31, 2015.
4 **Mandate change:** Biosphere Global Equity (50% S&P 500 / 50% MSCI EAFE) changed to Biosphere CanGlobe Equity (40% TSX, 30% S&P 500, 30% MSCI EAFE). Name change to Fossil Free CanGlobe Equity on March 31, 2015.

Asset Allocation and Investment Strategy

We continue to hold a constructive view on global economic growth for 2015, which is being bolstered by low inflation and supportive central bank monetary policies in most regions. This is conducive to moderate performance for equity and fixed income asset classes across most regions for the year.

Consistent with our outlook, we continue to favour equities versus bonds in our balanced portfolios (see table, far right), with an emphasis on market segments that offer good value and potential downside protection should an unfavourable global economic scenario unfold. We are maintaining our emphasis on blue-chip defensive dividend payers and select global growth stocks. Our allocation to fixed income continues to avoid government bonds in favour of shorter-term investment grade corporate issues and select commercial mortgages.

Exhibit 3 Genus DynaMix Signal: World Equities Versus Cash



One of the tools we use to inform our asset allocation decisions is Genus *DynaMix*. This is proprietary quantitative portfolio management tool, developed and built by Genus, that examines over 90 proven market indicators to forecast relative monthly performance amongst cash, bond, stock, currency and commodity sectors. These insights are used to help us systematically increase exposure to attractive asset classes and avoid those presenting more risk, as illustrated below (for the month of July). The chart above showing World Equities to cash is one of the *DynaMix* signals we consider. The Buy/Sell signal is the cumulative vote of some 22 factors that make up the model. This signal is used to provide insight into decisions to move from equities to cash and vice versa.

Asset Allocation	Equities	Fixed Income	Commodities
Reduce equities from overweight to neutral Vs. benchmarks; maintain cash at neutral and underweight fixed income & commodities.	Overweight U.S. equities, maintain neutral weight for Europe and Japan. Underweight Canada and Emerging Markets given their weaker outlook.	Maintain overall under-weight on fixed income; overweight corporates & commercial mortgages Vs. government bonds; and maintain neutral duration (long vs. short)	Remain underweight given the uncertain outlook for global growth; underweight gold and copper and reduce oil to neutral from overweight in June.

Genus Balanced Fund Asset Allocation

(As at June 30, 2015)

Asset Class	Percent of Market Value
Cash CAD	**1.6**
Government Bond	3.3
Strategic Bond	19.6
Commercial Mortgage	11.9
Total Fixed Income	**34.8**
Canadian Alpha	**3.4**
Dividend Equity	**23.9**
Canadian Equity	*8.8*
U.S. Equity	*10.1*
International Equity	*5.0*
CanGlobe Equity	**28.3**
Canadian Equity	*9.7*
U.S. Equity	*11.8*
International Equity	*6.8*
Global Alpha	**6.0**
Canadian Equity	*0.2*
U.S. Equity	*3.6*
International Equity	*2.2*
Emerging Markets	**2.0**
Total Equity	**63.6**
Total Portfolio	**100%**
Portfolio Equity Exposure	
Total Canadian Equity	34.6
Total U.S. Equity	40.1
Total International Equity	22.1
Total Emerging Markets	3.1
Total Equity	**100%**