INVESTMENT COMMENTARY

Q2 2017

FROM POLITICS TO CENTRAL BANKS: THE WORLD IS CATCHING UP WITH THE U.S.

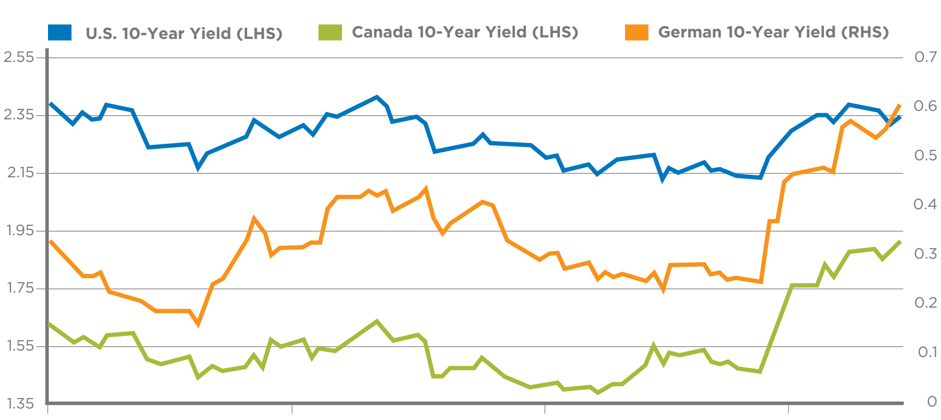
Q2 MARKET REVIEW

Global equities continued their march higher in Canadian dollar terms for the second quarter, but the real action took place in bonds, foreign exchange and commodities. The end of the second quarter marked the beginning of the end for the low-interest rate environment as the rest of the world indicated it would follow the United States in raising interest rates.

A STORY OF YIELDS, CURRENCY STRENGTH, AND CENTRAL BANK MOVES

Ten-year bond yields diverged during the quarter, with U.S. ten-year yields falling while most other major global bond yields increased. Against a backdrop of concerns over slowing global growth and fading China stimulus, weaker economic data in the United States led to lower U.S. bond yields. Meanwhile, European yields remained range bound, helped by somewhat better economic data and decreasing political risk in the region. In the final week of the quarter, the world's central banks – including the Bank of Canada (BoC), European Central Bank and the Bank of England – all made comments within days of each other indicating that the lower rates had done their job, excess capacity was disappearing and Quantitative Easing drawing to a close. We believe this will mark the quarter where the rest of the world began to play catch up to the United States.

GLOBAL BOND YIELDS CATCHING UP TO U.S.



Source: Bloomberg

The impact of rising rates was seen most clearly in foreign exchange moves, which were arguably ahead of the game. In keeping with higher bond yields and rising interest rates around the world—which ran counter to U.S. yields—many major currencies strengthened against the U.S. dollar. The euro, pound sterling and Canadian dollar all gained ground. By contrast, the U.S. dollar fell 4.7%, suffering its worst quarter since September 2010[1].

The Canadian dollar hit a 14-month low of 72.5 cents (USD) in May and bounced back following the BoC hinting at future potential rate hikes. The BoC's change of tone triggered the Canadian dollar's move upwards and the Canadian central bank's comments in the final week of the quarter further strengthened the loonie, leaving the Canadian dollar at 77.1 cents (USD) or 2.74% higher for the quarter versus the U.S. dollar.

EQUITIES MIXED: EUROPEAN MARKET FINISHES ON TOP, IN CAD TERMS

U.S. equities continued their ascent during the quarter, with the S&P 500 hitting new all-time highs as the headwind of rising rates there subsided. The market's ascent was helped by better-than-expected first quarter earnings, with Information Technology stocks continuing to move higher and Health Care stocks bouncing back.

KEY TAKEAWAYS

- During the quarter, the world's central banks indicated that the lower interest rates environment is coming to a close.
- Ten-year bond yields diverged during the quarter, with U.S. ten-year yields falling while most other major global bond yields increased.
- Economic numbers in Europe improved, with data surprising on the upside throughout the quarter, helping European market performance to lead the way in Canadian dollar terms.
- We remain neutral on equities and continue to favour cyclical names over defensives.
- In 2017, earnings have improved, helped by share buybacks as well as rising corporate margins and revenues.

However, the drag from the Energy Sector—due largely to falling oil prices—was more keenly felt in Canada. Softness in the Energy sector, combined with weakness in Materials and Financials, caused the S&P/TSX Composite Index to end the quarter at -2.35%.

In Europe and the UK, equity markets were down in euro and pound sterling terms; however, these moves were offset by stronger currencies, meaning that in Canadian dollar terms they ended up being the best-performing in the quarter. Economic numbers in Europe also improved, with data surprising on the upside throughout the quarter.

Asian equity markets performed well in local currency terms, with the Hang Seng, Nikkei and China all up between 5-7%. The Chinese market received a considerable boost with its landmark addition to MSCI Indices, meaning that more people who follow the Index will be investing in China as a matter of course.

LOOKING FORWARD: OUR LATE-CYCLE REFLATION THESIS REMAINS INTACT

Europe is finally turning a corner, as evidenced by more robust economic indicators, the upward move in European bond yields, and the euro's burgeoning strength. Political risks that plagued Europe earlier in the year have somewhat abated. In 2017, only the German election is left as a potential 'banana peel', and polls have moved sharply in favour of Angela Merkel. We expect the recent yield and euro moves to continue, driven by the European recovery. As such, we anticipate the Financials and Industrials sectors to continue to fare well, with rising inflation and a steepening yield curve providing assistance.

The United States faces a different dilemma. The Fed is trying to balance stronger employment numbers, mixed data and the absence of a sustained pickup in inflation (usually a prerequisite for the Fed to raise rates) with a rising-rate stance. The Fed has indicated that they are still in favour of further rate hikes, with the market pricing in a more than 50% chance of a third rate hike by the end of 2017. Extra rate hikes could tighten financial conditions and curtail growth. This careful balancing act is, of course, contingent on signs of improving economic growth elsewhere in the world.

GENUS INVESTMENT STRATEGY AND ASSET ALLOCATION CALLS

Given the rising-rate environment around the world, we remain neutral on equities as an asset class, especially through the quieter summer months. We believe Europe will continue to outperform the rest of the world due to an improving economic picture and easing political concerns. We continue to favour cyclical names over defensives; although this thesis is less obvious now than it was at the start of the year.

1 As measured by the DXY Index, an index where which measures the value of the U.S. dollar against a basket of foreign currencies.

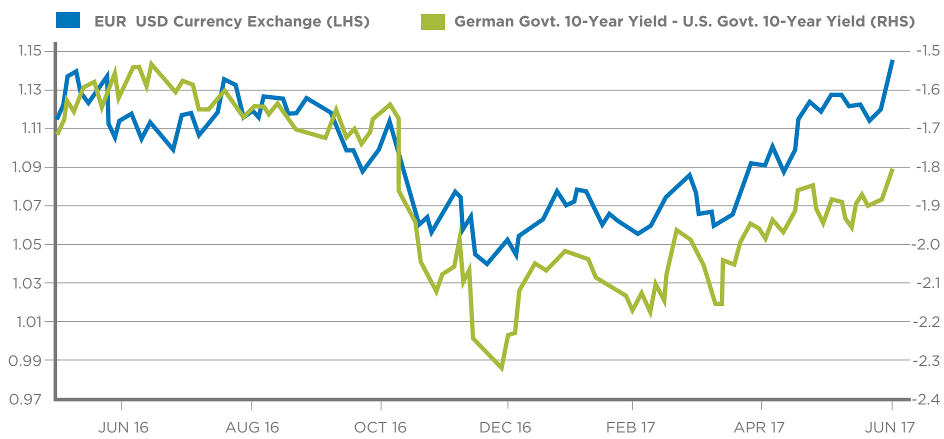
FROM POLITICS TO CENTRAL BANKS (Continued)

Q3: WHAT WE ARE WATCHING

YIELDS AND CURRENCIES

We believe improving macroeconomic fundamentals and continued central bank actions will drive bond yields higher for the rest of the world through 2017. In turn, we expect currencies to continue to respond to these moves, as we witnessed in the second quarter.

EURO STRENGTH DRIVEN BY RISING YIELDS

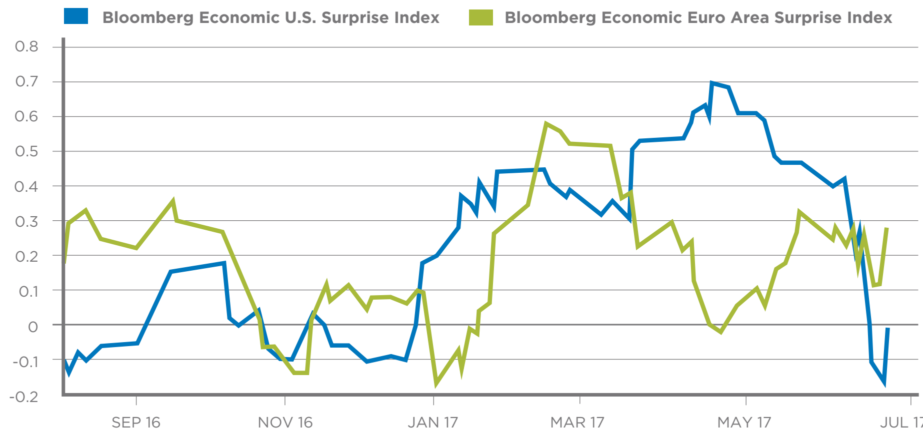


Source: Bloomberg

EVIDENCE OF THE ONGOING ECONOMIC PICKUP IN EUROPE

Eurozone GDP, jobs and inflation are some of the key indicators we expect to continue to improve. The German election in September will start to shift into focus, with Chancellor Angela Merkel appearing safe in the polls. In addition, the election of President Emmanuel Macron in France should boost the chances of business-friendly policies.

ECONOMIC DATA DIVERGENCE BETWEEN EU AND U.S.



Source: Bloomberg

U.S. GROWTH

We are watching inflation data, a bounce back in GDP and other signs of U.S. growth. On the cautionary side, we will be watching for overheating in the already-tight U.S. labour market.

CONTINUED ROBUST EARNINGS

Year to date, earnings have improved, helped by share buybacks as well as rising corporate margins and revenues. For the S&P 500, the consensus is expecting second quarter earnings growth of approximately 7% (versus a year ago). In Europe, full-year earnings estimates have risen approximately 2% during the first two quarters of 2017.

A CLOSING VALUATION GAP

As we asserted previously, we expect the valuation gap between Europe and the United States to narrow through 2017. The gap has started to gradually close and we anticipate this trend to continue. Consensus price-to-earnings ratios (a popular measure of the relative value of equities) for the next twelve months are around 14.3x for Stoxx Europe, 16.6x for the S&P 500 and 12.3x for MSCI Asia (ex Japan).

THE STATE OF OIL

Oil ended the quarter down 9% on continued concerns of oversupply and slower demand growth, in spite of a seven-day gain into the quarter end, which saw West Texas Crude bounce from a low of US$42.31 to close at US$46.04 on June 30th.

On the supply side, the May OPEC meeting produced an extension of the existing production cuts, disappointing those who had hoped for deeper cuts. With U.S. energy policy favouring increased domestic production, concerns over further Russian production cuts, and an increase in Libyan production, we believe upside in oil prices will be limited to the mid-US$50s range for the remainder of the year.

GENUS BALANCED FUND ASSET ALLOCATION
(AS AT JUNE 30, 2017)

ASSET CLASS	CURRENT %
Corporate Bonds	14.1
Commercial Mortgages	11.8
Federal Bonds	1.3
Provincial Bonds	1.5
Cash and Cash Equivalents	11.7
TOTAL FIXED INCOME	**40.4**
Canadian Equity	19.8
U.S. Equity	19.5
International Equity	18.4
Emerging Markets	1.8
TOTAL EQUITY	**59.6**
TOTAL PORTFOLIO	**100.0**

GENUS BALANCED FUND PROFILE
(AS AT JUNE 30, 2017)

ASSET CLASS	CURRENT %
Short-Term Bond	2.1
Government Bond	2.2
Strategic Bond	12.9
Commercial Mortgages	11.8
TOTAL FIXED INCOME	**29.0**
Canadian Alpha	3.8
Dividend Equity	25.8
CanGlobe Equity	26.4
Global Alpha	4.2
Emerging Markets	1.8
TOTAL EQUITY	**62.0**
CANADIAN T-BILLS	**9.0**
TOTAL PORTFOLIO	**100.0**

GENUS POOLED FUND PERFORMANCE

Returns are shown Net of Fund Expenses[1]			Compound Annual Returns			
As at June 30, 2017	**3 month**	**1 year**	**3 years**	**4 years**	**5 years**	**10 years**
Balanced Fund	0.9	10.3	6.3	9.1	9.2	4.9
EQUITIES						
Canadian Alpha[2]	-1.6	7.9	2.0	8.1	8.1	2.5
Dividend Equity	0.7	12.6	8.9	12.5	12.7	-
Global Alpha[3]	2.2	18.4	8.3	13.4	14.8	6.2
CanGlobe Equity	1.4	16.0	7.2	12.1	12.8	4.9
Emerging Markets	3.8	22.1	9.2	10.0	9.4	-
FIXED INCOME						
Government Bond	0.5	-0.6	3.3	-	-	-
Short-Term Corporate Bond	-0.2	1.8	2.4	2.8	2.7	-
Strategic Bond	0.3	2.9	4.6	5.5	5.0	-
Commercial Mortgage	0.4	2.4	3.1	3.6	3.4	-
FOSSIL FREE						
Fossil Free Dividend Equity[4]	0.3	12.0	10.7	12.5	-	-
Fossil Free CanGlobe Equity[5]	1.0	20.0	11.5	15.7	-	-
Fossil Free Corporate Bond	0.2	1.6	4.3	-	-	-
Fossil Free High Impact Equity	3.6	19.0	11.7	-	-	-
INDEX RETURNS						
S&P/TSX Composite	-1.6	11.1	3.1	9.0	8.7	3.9
S&P 500 Index (C$)	0.4	17.9	17.1	19.2	20.3	9.3
MSCI World Index (C$)	1.5	18.9	13.1	16.2	17.6	6.7
FTSE TMX Canada Universe Bond Index	1.1	0.0	3.8	4.1	3.3	5.1

Past performance is no guarantee of future results.

1 Does not include Genus management fees

2 **Mandate change:** Genus U.S. Equity mandate changed to Global Equity (Sept 14, 2012) and Global Alpha (June 30, 2014).

3 **Mandate change:** Genus Canadian Equity changed to Canadian Alpha on June 30, 2014.

4 **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.

5 **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.

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