



JUNE 2018 NEWSLETTER

Market Review

The second quarter of 2018 was good to equity investors as both the TSX and S&P500 snapped back from their first quarter correction.

At this point Canadian and U.S. markets are discounting favourable NAFTA and other trade agreement solutions. Other markets including China, Mexico and to a lesser extent Europe have been suffering due to the current trade friction.

World trade is reliant on trustworthy trading partners and should the current 'game of chicken' end poorly, we would expect an economic recession. Unfortunately an impulsive tweet from President Trump might be the catalyst for an economic slowdown.

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| | <u>Jun</u> <u>30/17</u> <u>Close</u> | <u>Mar</u> <u>29/18</u> <u>Close</u> | <u>Jun</u> <u>29/18</u> <u>Close</u> | <u>90-Day</u> <u>%</u> <u>Change</u> | <u>1-Year</u> <u>%</u> <u>Change</u> |
|------------------------------|--|--|--|--|--|
| S&P 500 | 2,423 | 2,641 | 2,718 | 2.92% | 12.2% |
| S&P/TSX Composite | 15,182 | 15,367 | 16,278 | 5.93% | 7.22% |

Source: Thomson One

| <u>World Markets</u> | <u>YTD</u> |
|-------------------------------------|------------|
| S&P/TSX Composite | 0.43% |
| S&P 500 | 1.65% |
| iShares MSCI China ETF | -2.92% |
| iShares S&P/TSX Preferred Index ETF | -1.88% |
| DJ Stoxx 50 | -3.08% |
| iShares MSCI Emerging Markets EFT | -8.04% |
| iShares MSCI Japan EFT | -3.37% |

As of June 29, 2018

Source: Thomson One

Canadian T-Bills and Bonds Yields

| | <u>Dec. 29, 2017</u> | <u>Mar. 29, 2018</u> | <u>Jun. 29, 2018</u> |
|---------|----------------------|----------------------|----------------------|
| 90-day | 1.06% | 1.11% | 1.31% |
| 180-day | 1.24% | 1.32% | 1.49% |
| 1-year | 1.54% | 1.60% | 1.73% |
| 2-year | 1.681% | 1.769% | 1.915% |
| 5-year | 1.861% | 1.961% | 2.068% |
| 10-year | 2.039% | 2.086% | 2.169% |
| 30-year | 2.262% | 2.225% | 2.204% |

Source: Thomson One

International 10-Year Bond Yields

| | <u>Dec. 29, 2017</u> | <u>Mar. 29, 2018</u> | <u>Jun. 29, 2018</u> |
|----------|----------------------|----------------------|----------------------|
| Japan | 0.04% | 0.03% | 0.02% |
| U.S. | 2.41% | 2.74% | 2.86% |
| Germany | 0.42% | 0.49% | 0.30% |
| Canada | 2.04% | 2.09% | 2.17% |
| U.K. | 1.19% | 1.35% | 1.28% |
| France | 0.77% | 0.71% | 0.66% |
| Spain | 1.55% | 1.15% | 1.31% |
| Italy | 2.00% | 1.78% | 2.67% |
| Portugal | 1.87% | 1.58% | 1.76% |
| India | 7.32% | 7.39% | 7.90% |

Source: Bloomberg.com

In Canada and the U.S., the bond yield curve is still positive, with long term yields slightly higher than short term yields. Should short term interest rates rise higher than long term rates, we would expect a recession.

Italy has seen their 10-year yields rise, not due to a strong economy but to political turbulence and concerns of their banking system.

Much of today's news is politically motivated and is written with a point of view in mind rather than 'following the facts.' With this in mind, we continue to watch bond yields on a daily basis, for a non-partisan indicator of economic strength.

Featured Stock Canadian National Railway (CNR)

Our investment strategy is to find companies with reliable cash flow, high barriers to entry, and minimal risk of being replaced by technology. CN Rail fits this description. Due to the irreplaceable nature of train tracks and marshalling yards, existing train companies have very high barriers to entry. While oil shipments by train can be replaced by pipelines, moving bulk grain from Winnipeg to Vancouver, or moving automobiles across the country is most cost effective by rail.

CN Rail Track Routes



CN has a very desirable railroad and terminal network stretching from Halifax to Vancouver, and North-South from Chicago to New Orleans. While the shipping of goods throughout North America will fluctuate with business cycles, and the stock price will rise and fall with the market, our thesis is that this transportation network will continue to be valuable in the foreseeable future.

Canadian National Railway (CNR) 20-Year Chart



Source: bigcharts.com

We feel that CN Rail can be a core position for clients within their risk tolerance.

Trade Wars

Trade war fall-out has affected markets around the world. Below are some examples:

Caterpillar Inc. (CAT-US) 1-Year Chart



Source: bigcharts.com

Caterpillar, manufacturer of heavy equipment is down 19.90% since its January 25, 2018 peak.

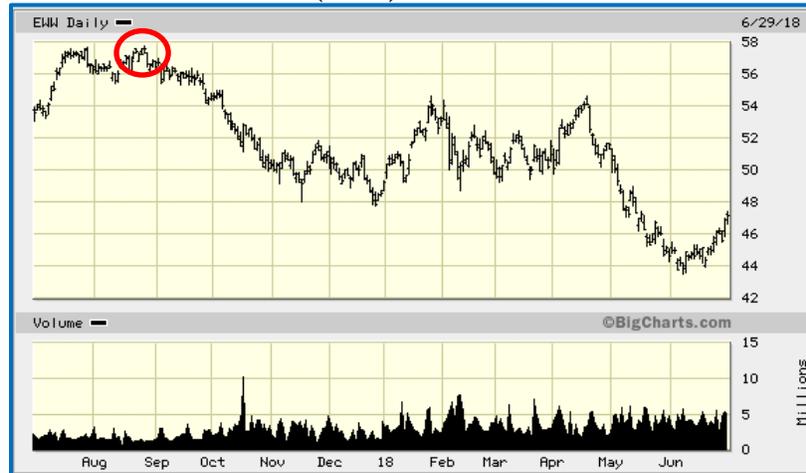
iShares MSCI Emerging Markets ETF (EEM-US) 1-Year Chart



Source: bigcharts.com

The iShares MSCI Emerging Markets ETF is down 16.80% from its January 26, 2018 peak.

iShares MSCI Mexico ETF (EWW) 1-Year Chart



Source: bigcharts.com

The iShares MSCI Mexico ETF is down 18.19% from its August 25, 2017 peak.

iShares China Large-Cap ETF (FXI) 1-Year Chart



Source: bigcharts.com

The iShares China Large-Cap ETF is down 20.43% since its January 26, 2018 peak.

iShares MSCI Germany ETF (EWG-US) 1-Year Chart



Source: bigcharts.com

The iShares MSCI Germany ETF is down 15.69% since its January 24, 2018 peak.

Financial Select Sector SPDR ETF (XLF-US) 1-Year Chart



Source: bigcharts.com

The Financial Sector Select SPDR ETF (an index of U.S. financials) is down 11.51% since its January 29, 2018 peak.

SPDR S&P 500 Index ETF (SPY-US) 1-Year Chart



Source: bigcharts.com

The SPDR S&P 500 Index ETF is down 5.34% since its January 26, 2018 peak.

As these stocks and ETF's indicate January 26, 2018 was an inflection point when markets started to price in the risk of trade disruption, and the chance of an end (or pause) to the economic expansion that started in 2009.

Fortunately we have very limited exposure to the emerging markets and Europe, so we have been relatively unscathed by the sharp corrections in these markets.

Some Good News This Quarter

United States

The U.S. Federal Reserve announced the results of their annual stress test on the U.S. financial companies on June 28, and most U.S. financial institutions received the green light to increase dividends and buy back shares.

Among U.S. banks that our clients own dividend increases were as follows:

| | Previous Quarterly Dividend | New Quarterly Dividend | % Increase | New Yield |
|-----------------------------|-----------------------------|------------------------|------------|-----------|
| JPMorgan Chase & Co. (JPM) | \$0.56 | \$0.80 | 42.8% | 3.03% |
| Bank of America Corp. (BAC) | \$0.12 | \$0.15 | 25.0% | 2.10% |
| Wells Fargo & Co. (WFC) | \$0.39 | \$0.43 | 10.25% | 3.08% |

Canada

June 28 was also an important day for Canadian investors, as Minnesota regulators approved the Enbridge Line 3 project. This will replace the 34 inch oil pipeline built in 1968 that was running at half capacity with a new 36 inch pipeline. This should add about 360,000 barrels per day to Canadian export capacity, and help shrink the price discount between WTI crude oil and Western Canada Select crude. Once construction starts this should be a 'shot in the arm' to the Canadian economy and help the TSX overall. More specifically, if this project is completed our Canadian oil companies will receive a higher price for their oil and would be expected to perform well.

Summary

We currently live during a period of time when the world's largest economy is being run by individuals who think that the U.S. is disadvantaged by the current world trade order. This is in spite of the U.S. accounting for 24.58% of the world's GDP (2016) with 4.28% of the world's population (2018).

While we hope that cooler heads will prevail, the current trade wars elevate the risks to owners of assets such as real estate, publicly traded shares, and private businesses.

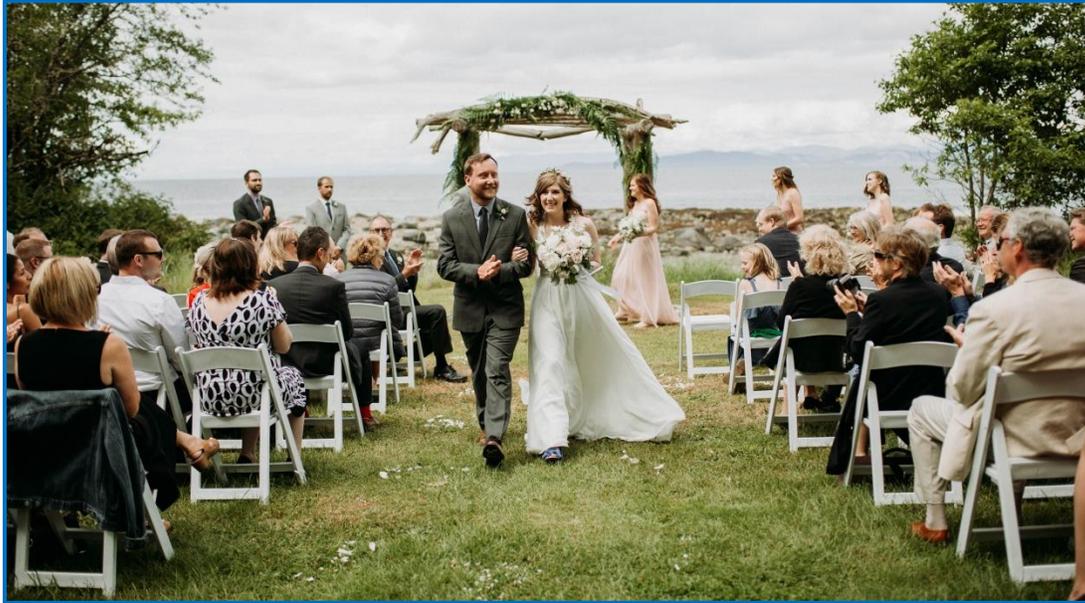
While a positive breakthrough may be negotiated at any time, our investment strategy is to hold a diversified basket of the highest quality equities and to 'keep some dry powder' in case we see a really attractive buying opportunity in the future.

If you have any questions on how you are situated for your financial needs and the current economic climate, please call.

Have a great summer!

Meaghan's Wedding

Meaghan married her partner, Matiss on Saturday, June 2, 2018 at Sea Breeze Lodge on Hornby Island surrounded by their friends and family.



We wish Meaghan and Matiss many happy years together!

With the addition of Mark and Meaghan as Associate Advisors, we now have the ability to take care of more relationships. If you have friends who have expressed an interest in finding a new advisor, we would be delighted to hear from you. Just call our office at 250-729-2830 and we'll take it from there. Thanks!

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