The big picture:

A look back at 2018 and outlook for 2019

December 2018

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Disclaimer

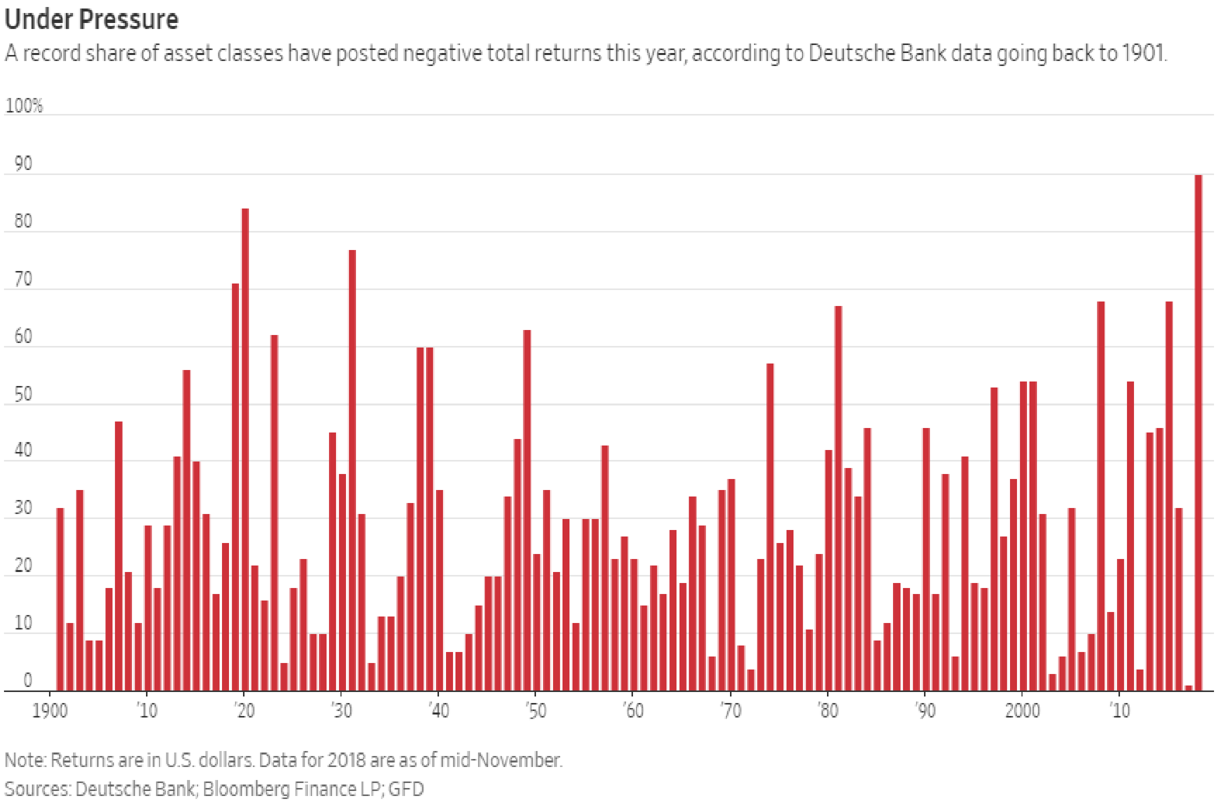
Opinions expressed in this presentation are based on actual market conditions and may change without prior warning. The aim is in no way to make investment recommendations. The forecasts given in this presentation do not guarantee returns and imply risks, uncertainty and assumptions. Although we are comfortable with these assumptions, there is no guarantee that they will be confirmed.

Industrial Alliance Insurance and Financial Services Inc.

Before sharing our view and our outlook on 2019, let’s take a look back on 2018

A look back on 2018:
A harsh year on financial markets

According to Deutsche Bank, close to 90% of combined bonds, equities and commodities indices are posting a negative YTD return.
<u>A first since 1901!!!</u>



Look back on 2018:
Volatility returned in force on Wall Street

Source : iA Economics, data from Bloomberg

S&P 500 : Number of days with absolute returns of 1% and more

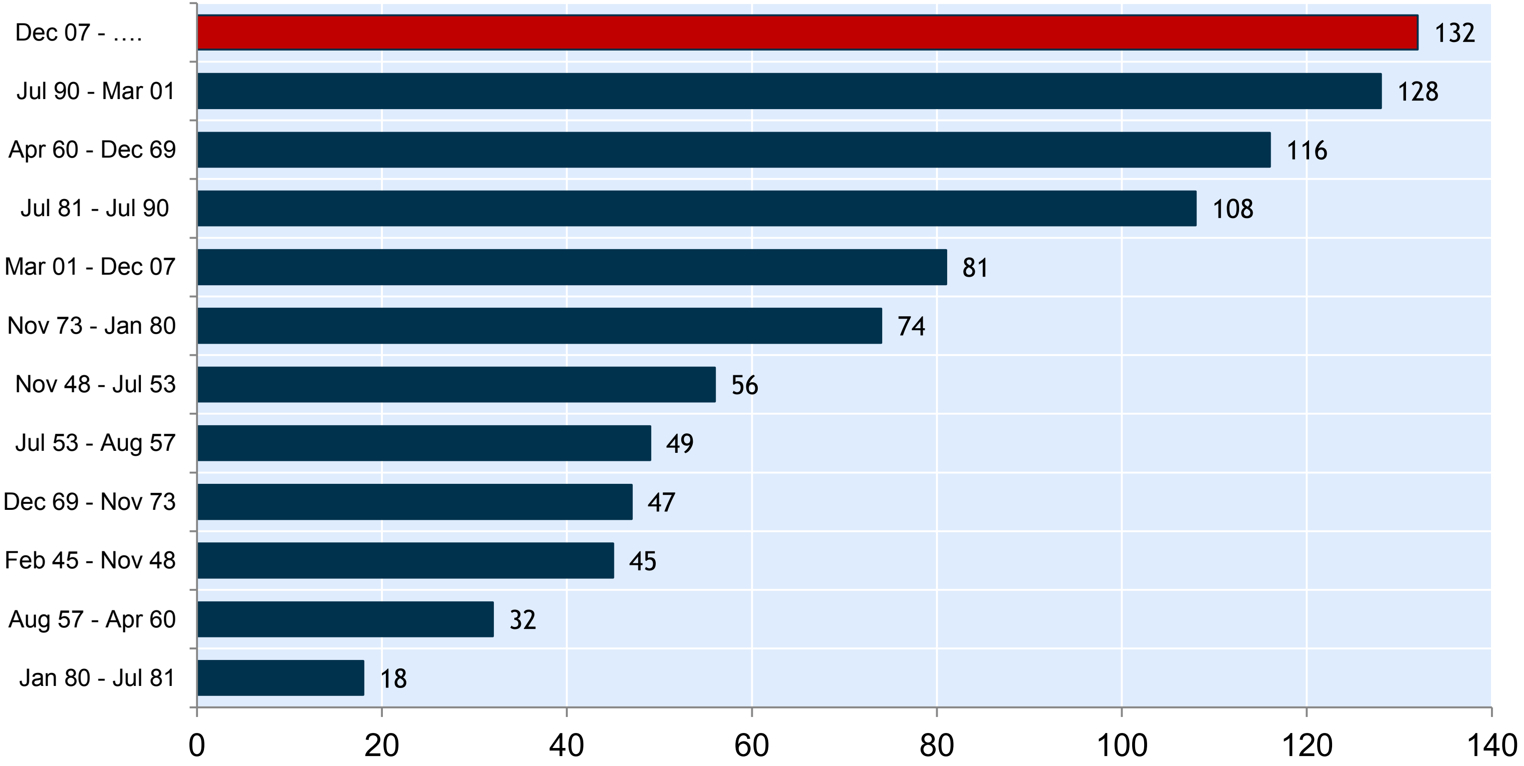
	Between 1% and 2%	Between 2% and 3%	3% +
2010	54	14	8
2011	61	23	12
2012	44	6	0
2013	34	4	0
2014	32	6	0
2015	62	7	3
2016	39	8	1
2017	8	0	0
2018	41	10	5

Source : iA Economics, as of December 5, 2018

Topics to be adressed

1. **Business cycles : Should we expect a recession in 2019?**
2. Monetary policies : Will the rates normalization continue ?
3. Equities : « Simple correction » or bear market in sight ?
4. Recommended investment strategies

U.S.:
The longest business cycle in modern history !!!



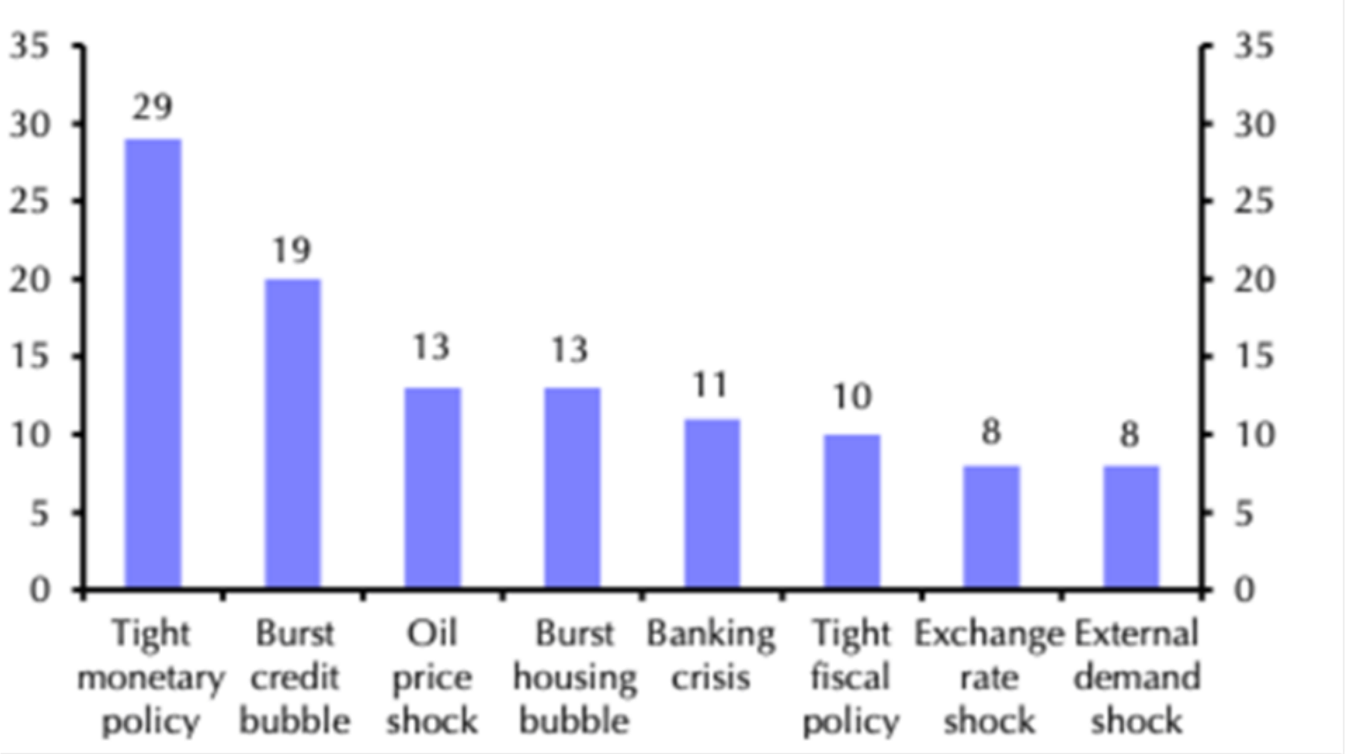
Source: NBF Economy & Strategy

Business cycles never die of old age but…

policy mistakes or external market shocks could jeopardize the US business cycle

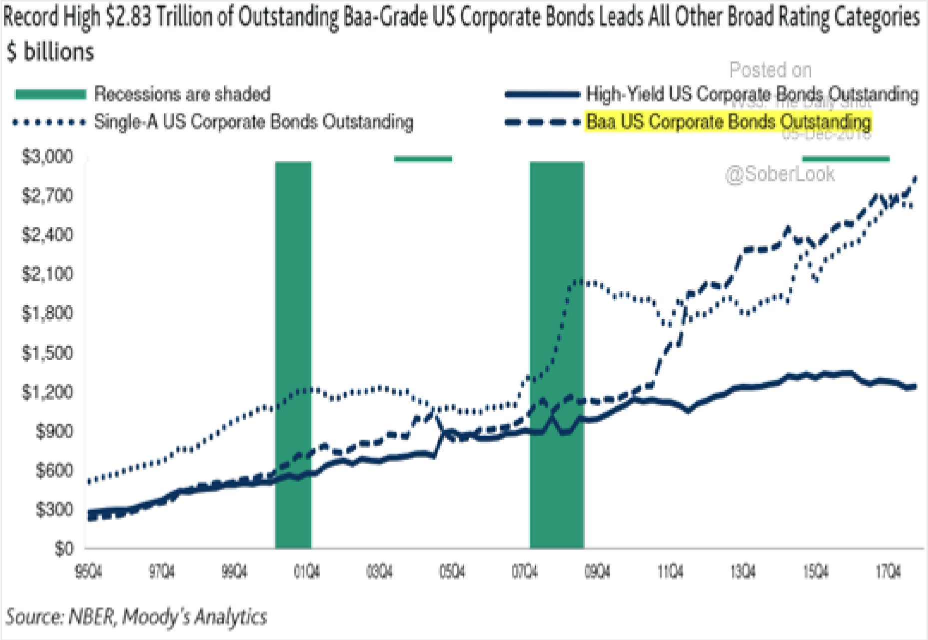
Lessons from the past: Factors that caused past recessions in the G-7 since 1960

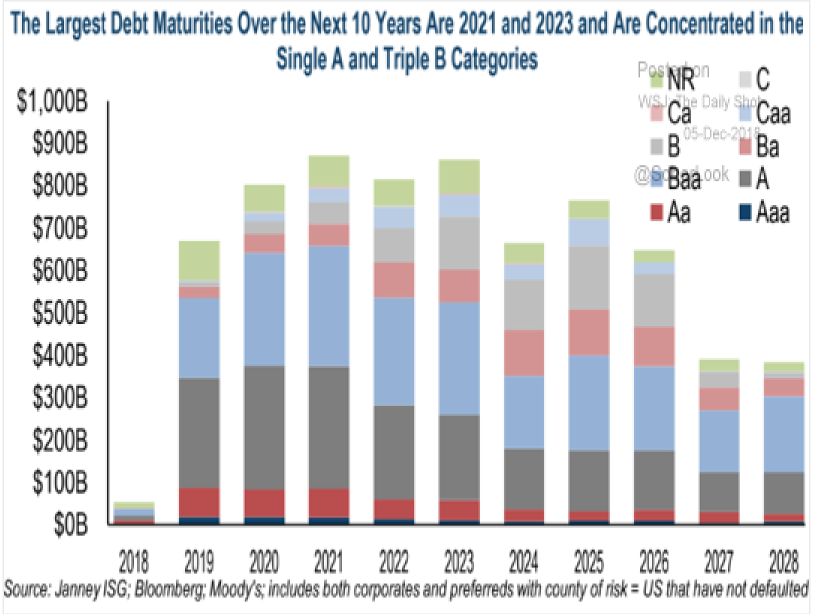
U.S. monetary policy is still very accommodative!!!



Source: Capital Economics

A significant risk factor:
Corporate America'a debt level





Other risk factors to monitor in 2019

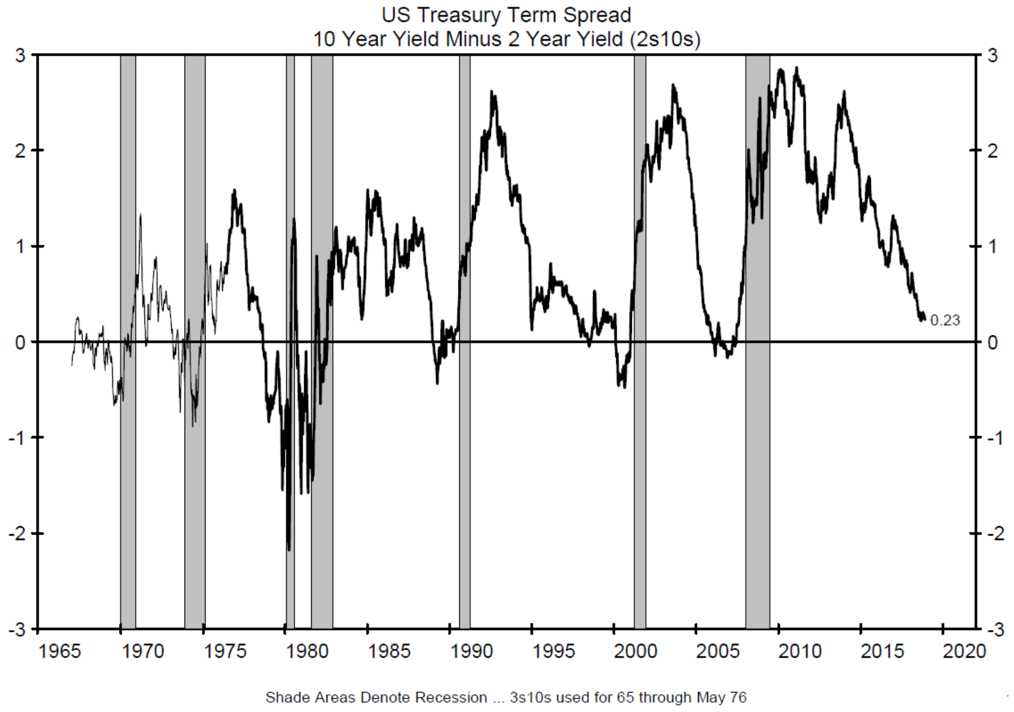
China-U.S. trade tensions

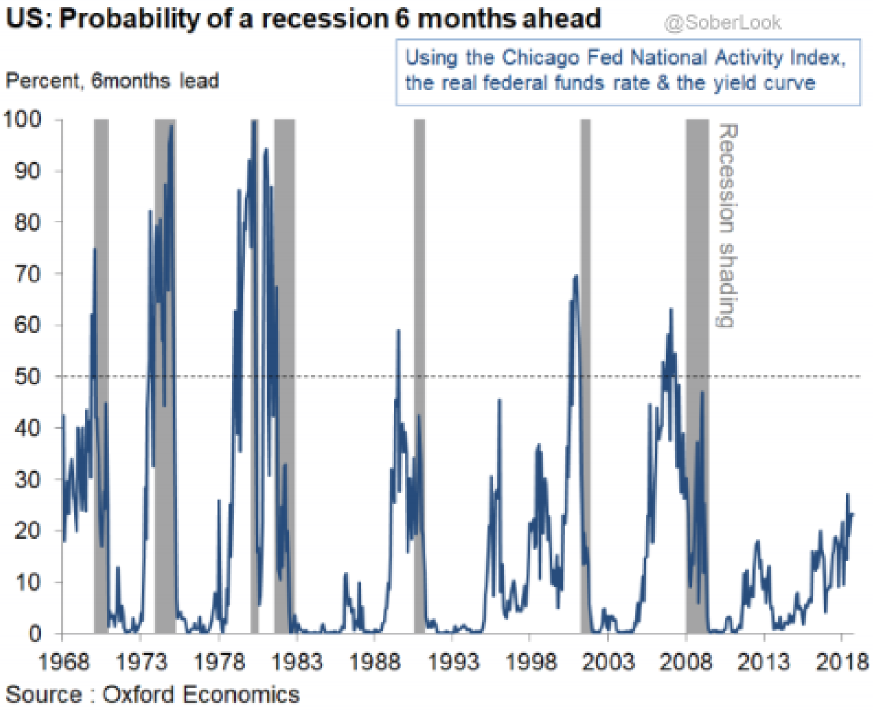
Wage acceleration in the U.S.

Real estate speculation in China

Messy end to Brexit

At this stage, we see the odds of a U.S. recession in 2019 at about 25% (vs 15% in September)



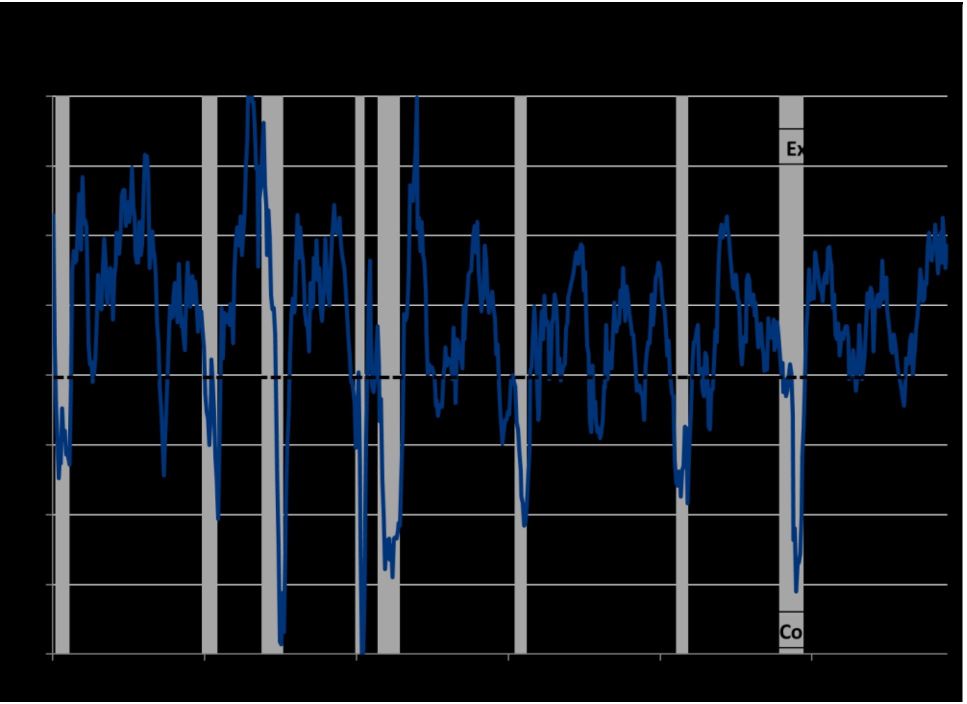


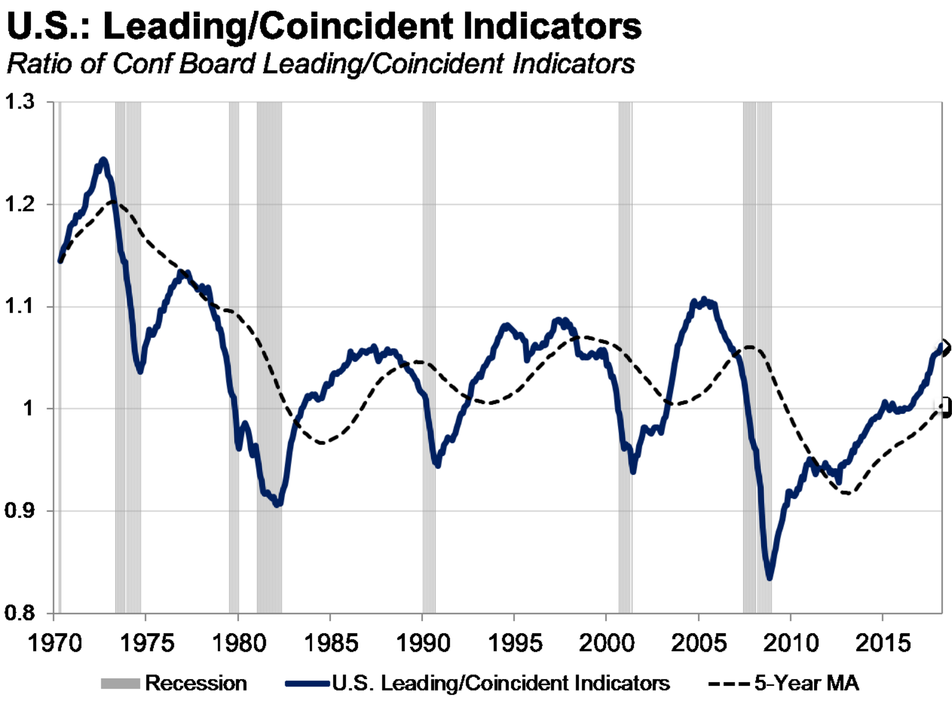
Source: TD Securities, December 4, 2018

Source: WSJ

Reasons to remain optimistic :

US Leading macroeconomic indicators remain quite positive

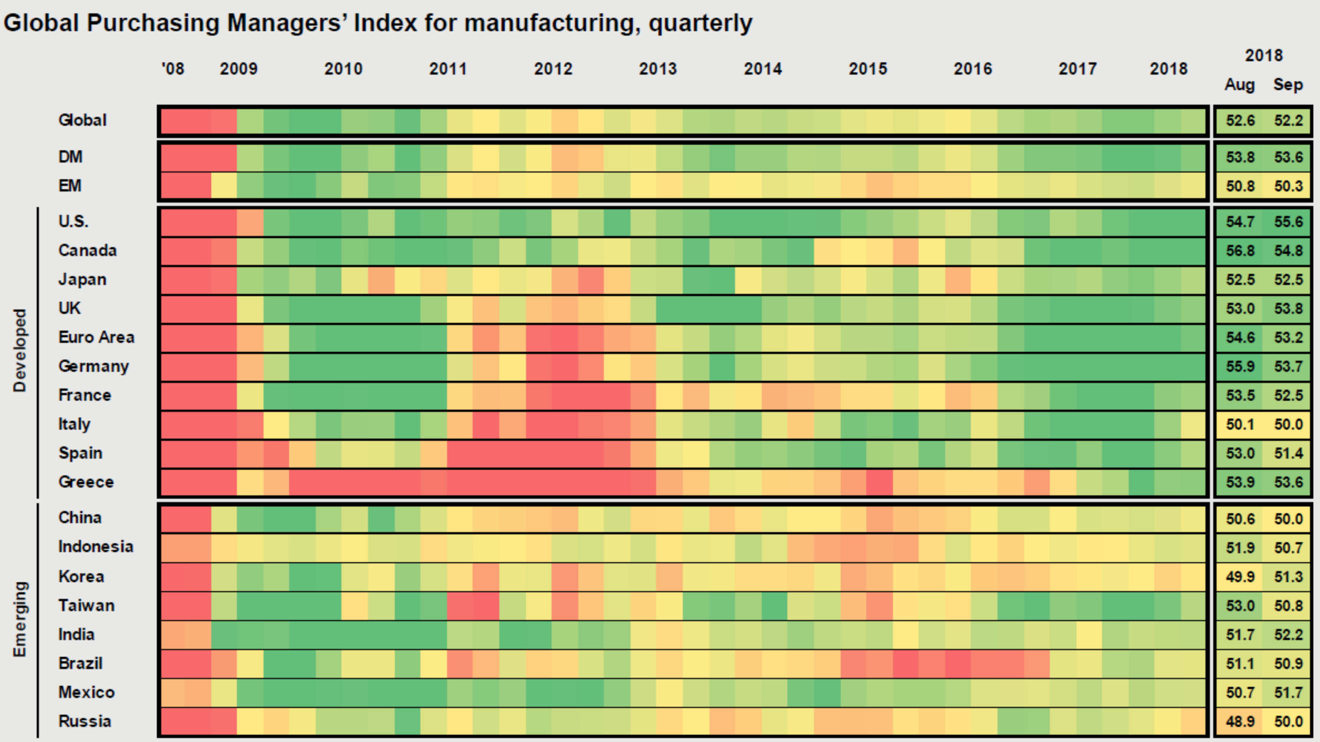




Source : iA Economics, data from Bloomberg

Despite some headwinds in sight, global growth should remain strong in 2019

The IMF is forecasting global growth of around 3.7% in 2019



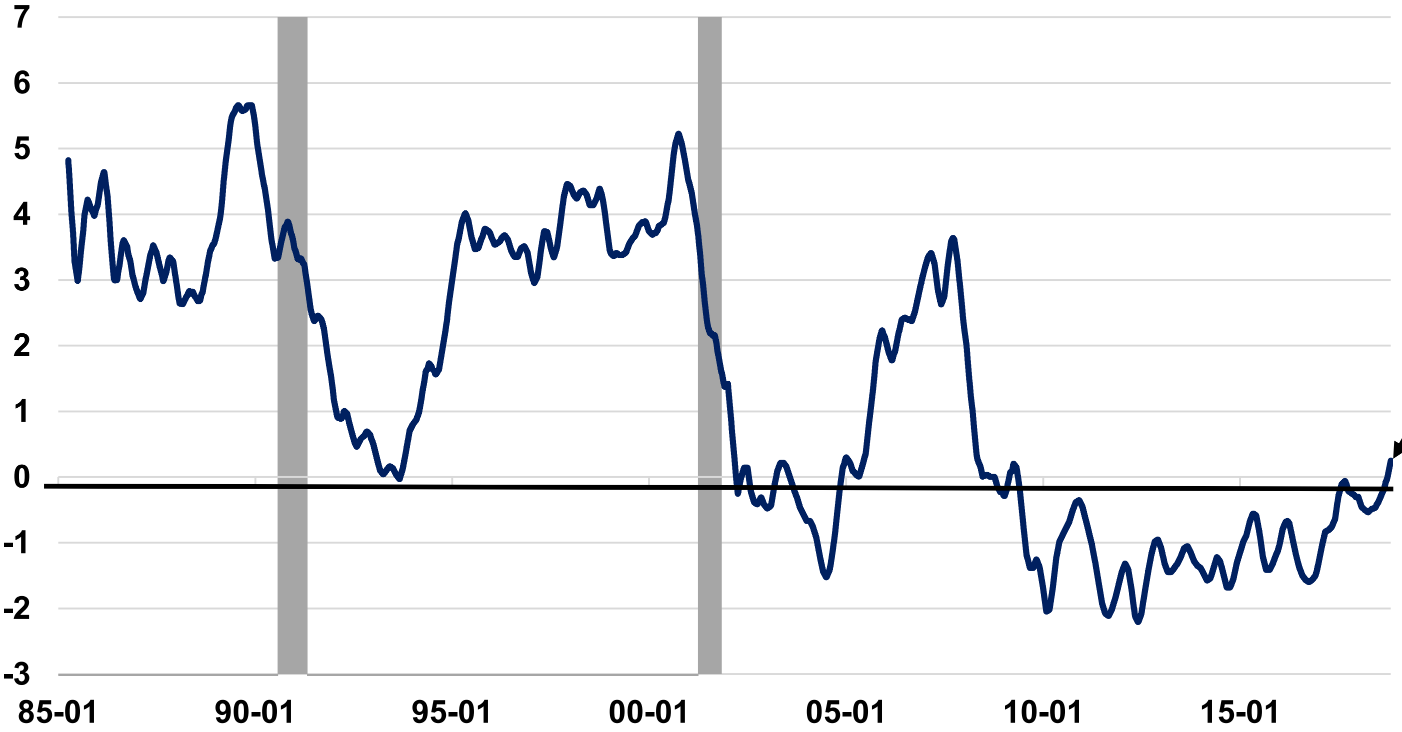
Source: JP Morgan

Monetary policies

Will the interest rates normalization continue in 2019?

U.S. monetary policy:
A late return to positive real interest rates in this cycle!

Spread between the Fed funds rate and core inflation



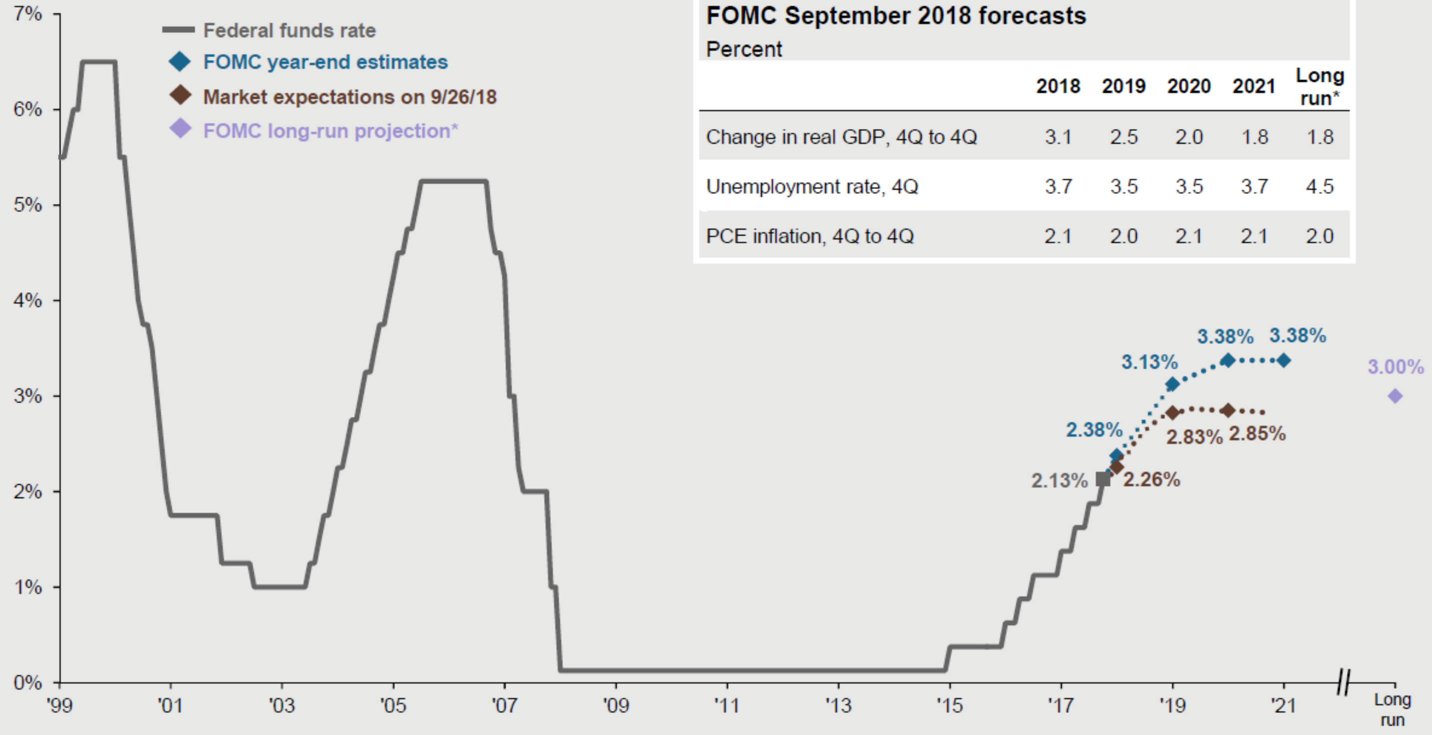
According to the Fed Chairman, the current leading rate is « just below » the neutral rate range

Source: iA Économie, données via Bloomberg

Some good news: The Federal Reserve is quite advanced in this cycle

Federal funds rate expectations

FOMC and market expectations for the fed funds rate



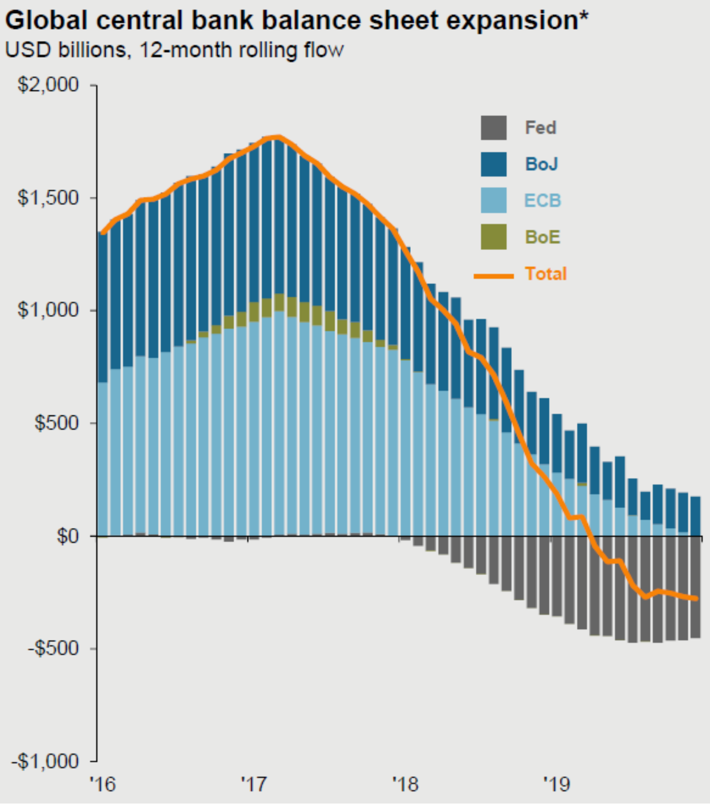
FOMC September 2018 forecasts

Percent

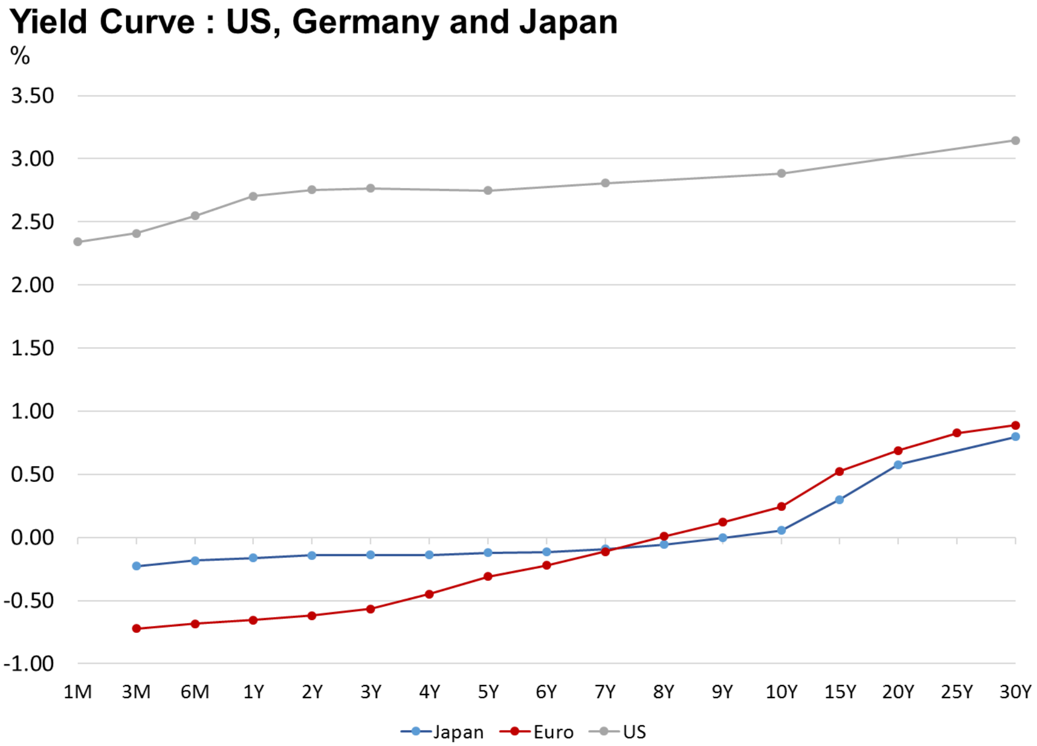
	2018	2019	2020	2021	Long run*
Change in real GDP, 4Q to 4Q	3.1	2.5	2.0	1.8	1.8
Unemployment rate, 4Q	3.7	3.5	3.5	3.7	4.5
PCE inflation, 4Q to 4Q	2.1	2.0	2.1	2.1	2.0

Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.

Monetary policy normalization:
Will overseas central banks follow the pace in 2019?



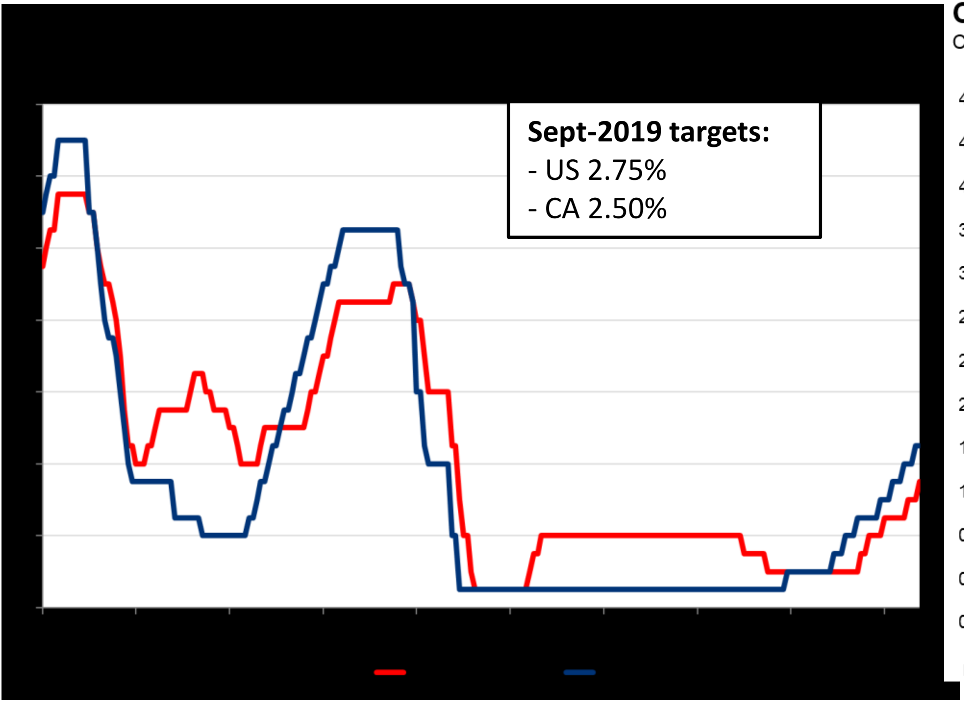
Source: JP Morgan, Sept 30 2018



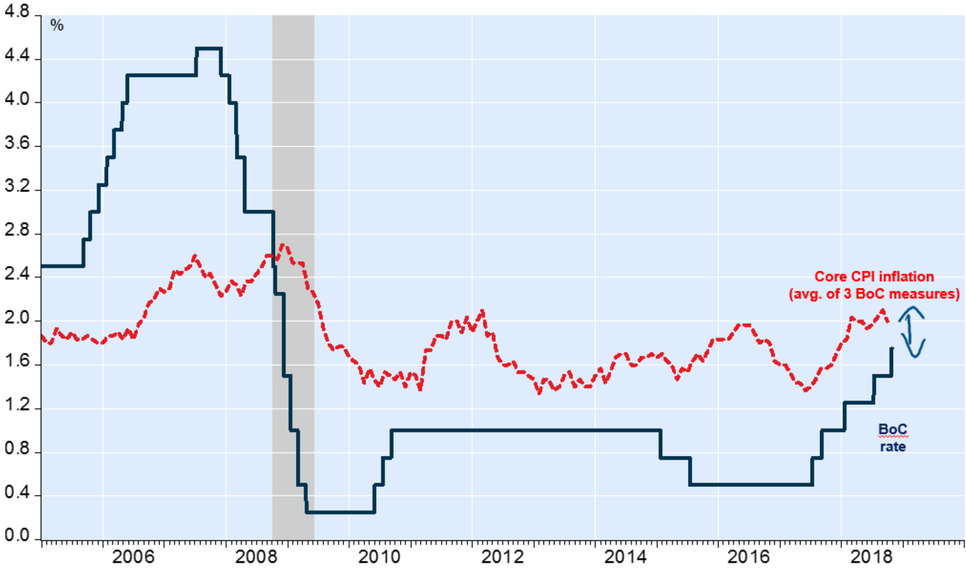
Source: iA Economics, data via Bloomberg, December 6 2018

Bank of Canada :

Interest rate normalization should take longer than expected



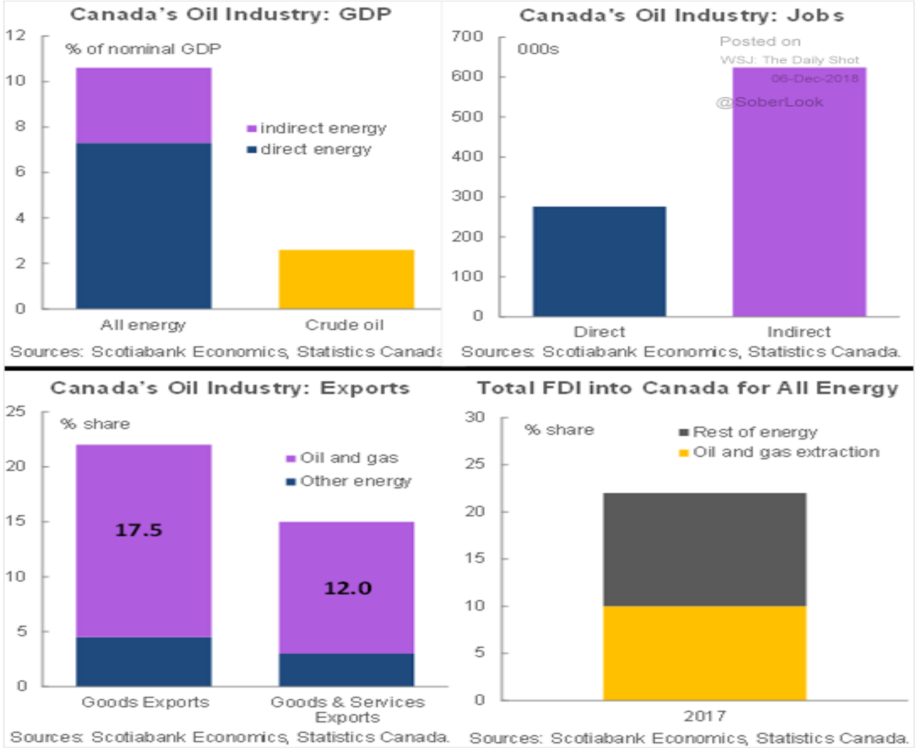
Canada: Perspective on real interest rates
Core CPI inflation (average of three measures) vs. Bank of Canada overnight rate

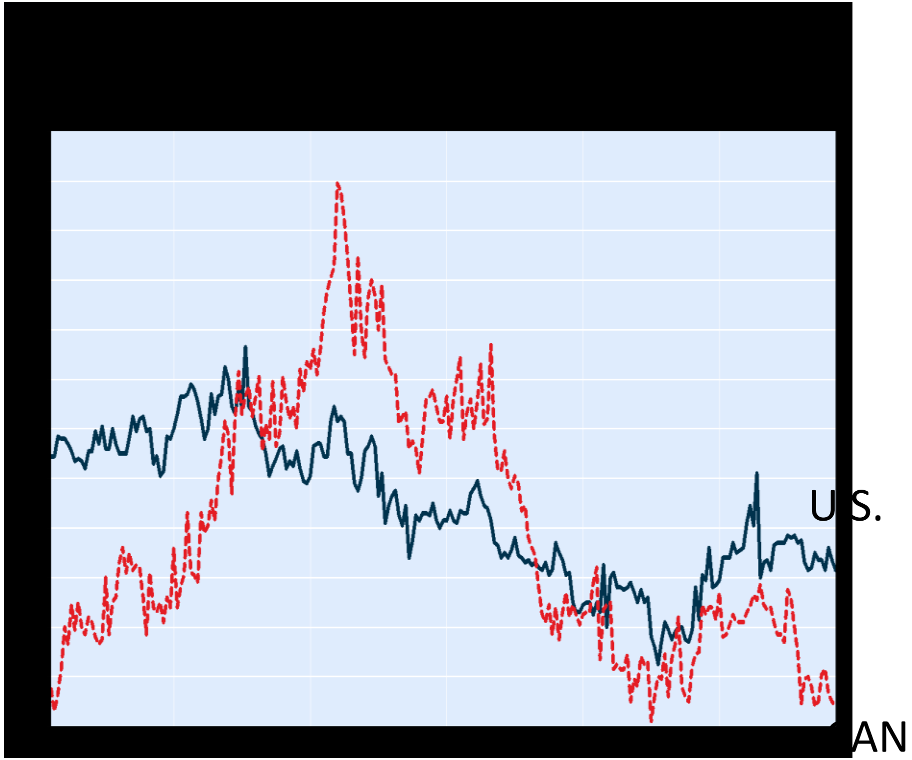


NBF Economics and Strategy (data via Datastream)

Source: IA Economics, data via Bloomberg, December 3, 2018

The situation in Alberta and the drop in the savings rate are worrying the Bank of Canada

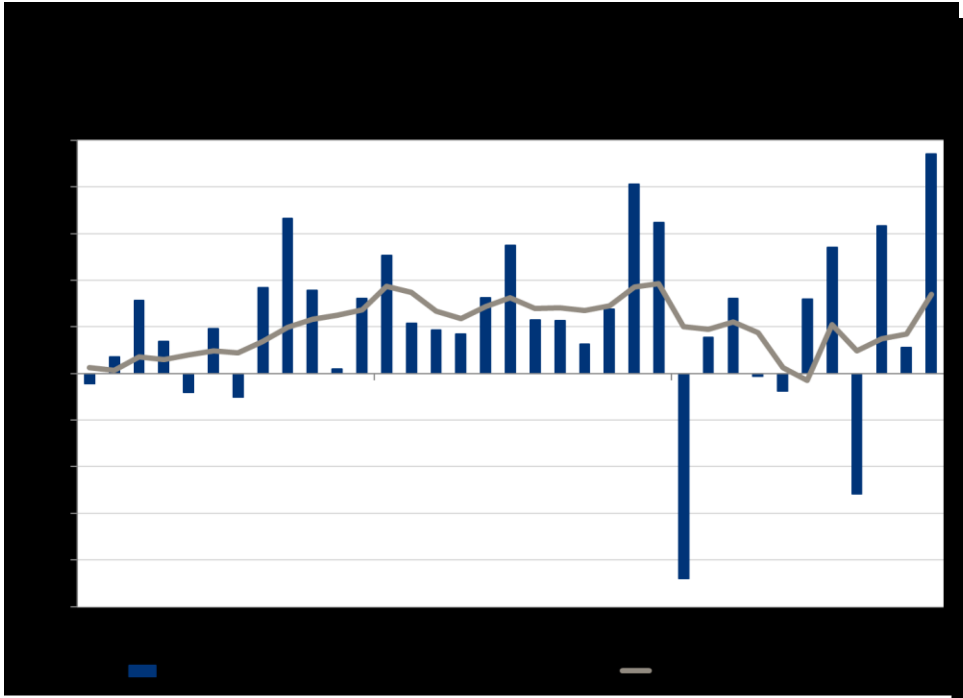




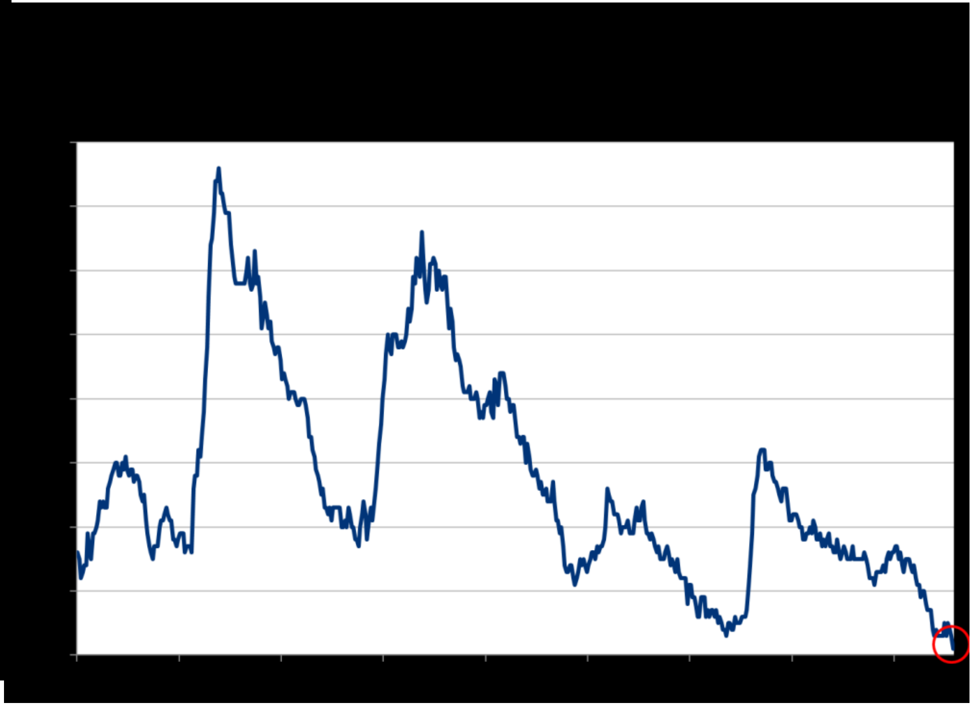
Source: WSJ

Source: NBF Economy and Strategy

Canada:
The labour market is giving reasons to remain optimistic

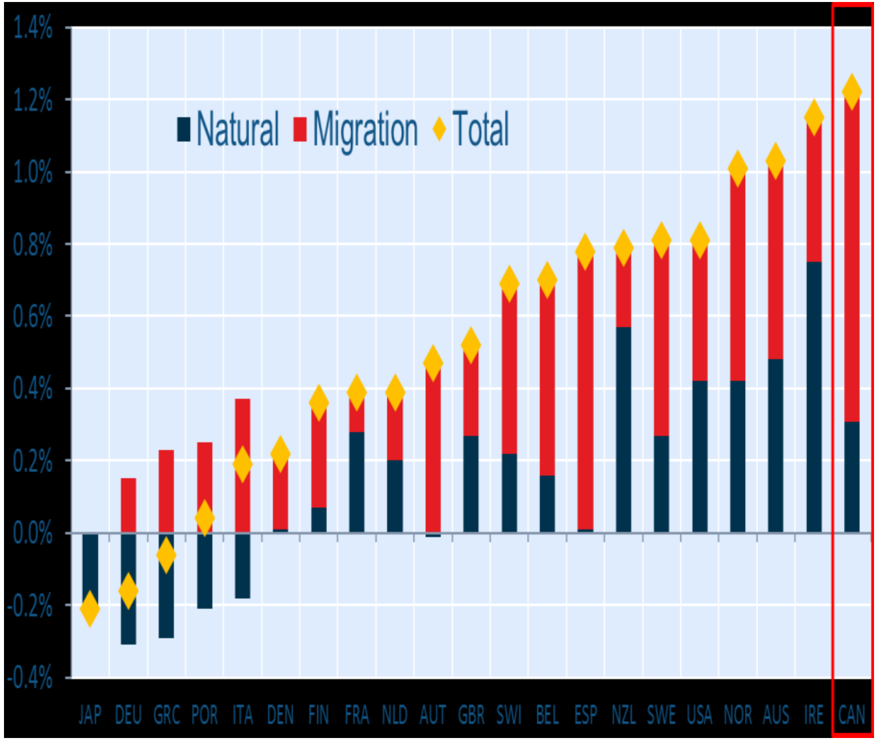


Source: IA Economics, data via Bloomberg, December 7, 2018



Source: IA Economics, data via Bloomberg, December 7, 2018

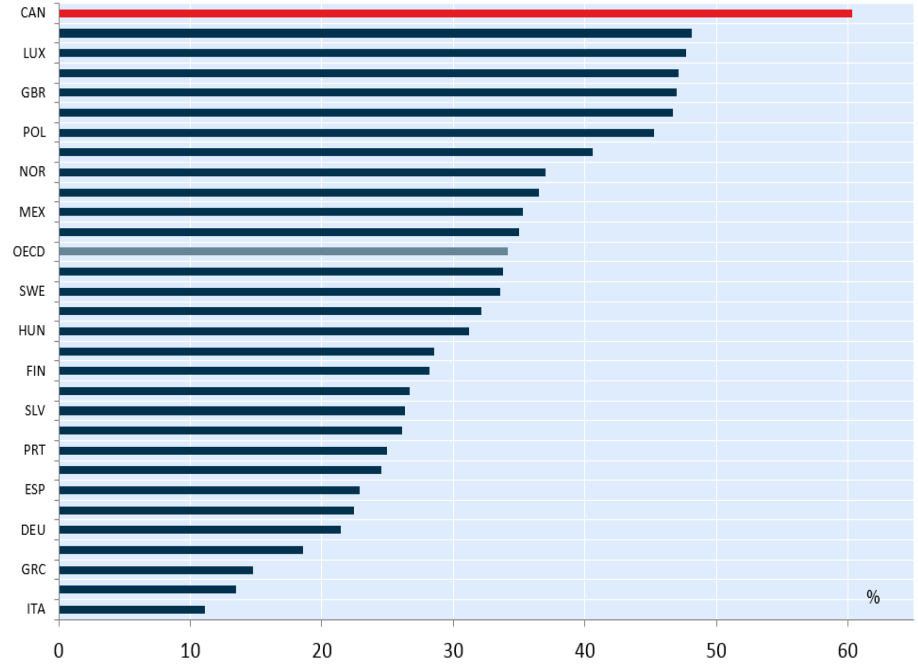
A reason for this great resilience:
Immigration



NBF Economics and Strategy (data via Statistics Canada and U.S. Census), as at December 31, 2017

Canada: foreign-born population is highly educated

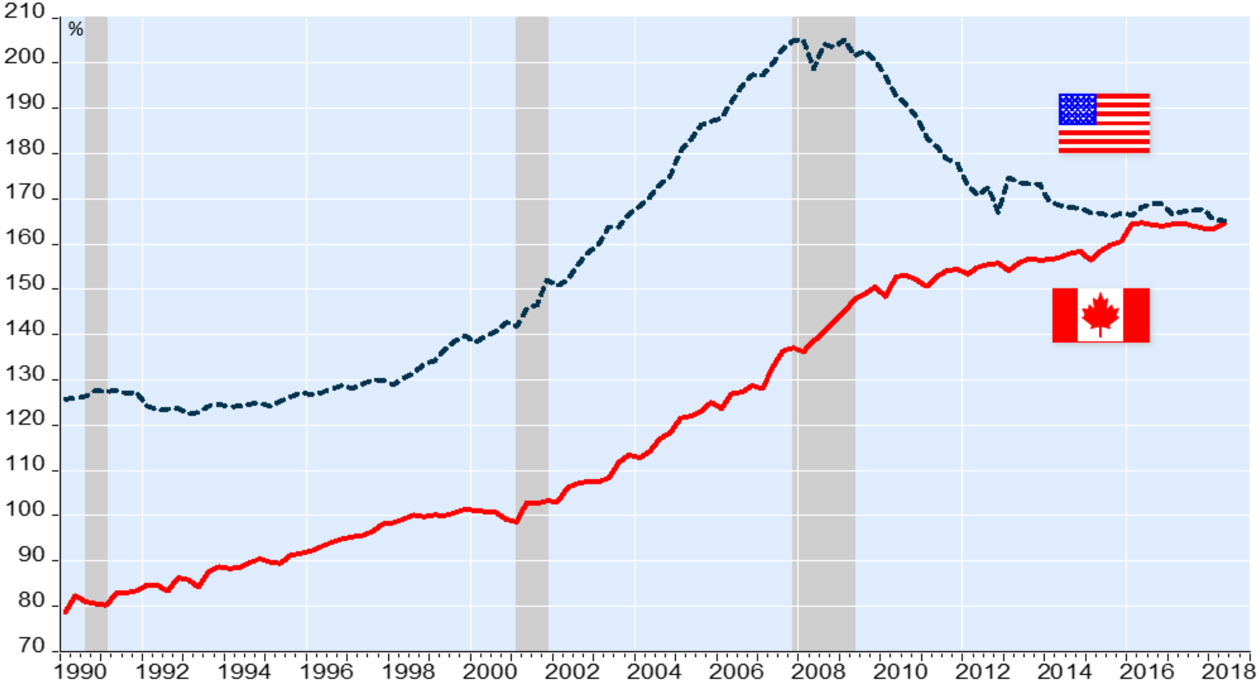
Percentage of foreign-born 15-64 with post-secondary education



NBF Economics and Strategy (data via OECD)

Canadian households are indebted, but we need to compare apples with apples!!

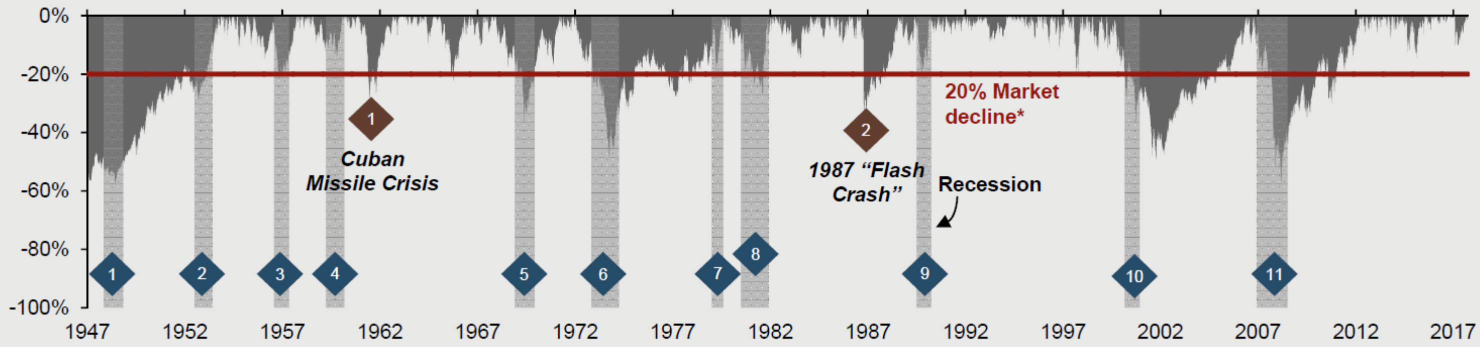
Household debt to disposable income (net of health expenses)



NBF Economics and Strategy, data from Statistics Canada, Federal Reserve and BEA through IHS

Stock market :
« Simple correction » or bear market in sight ?

Lessons from history:
Very few « bear markets » without a recession

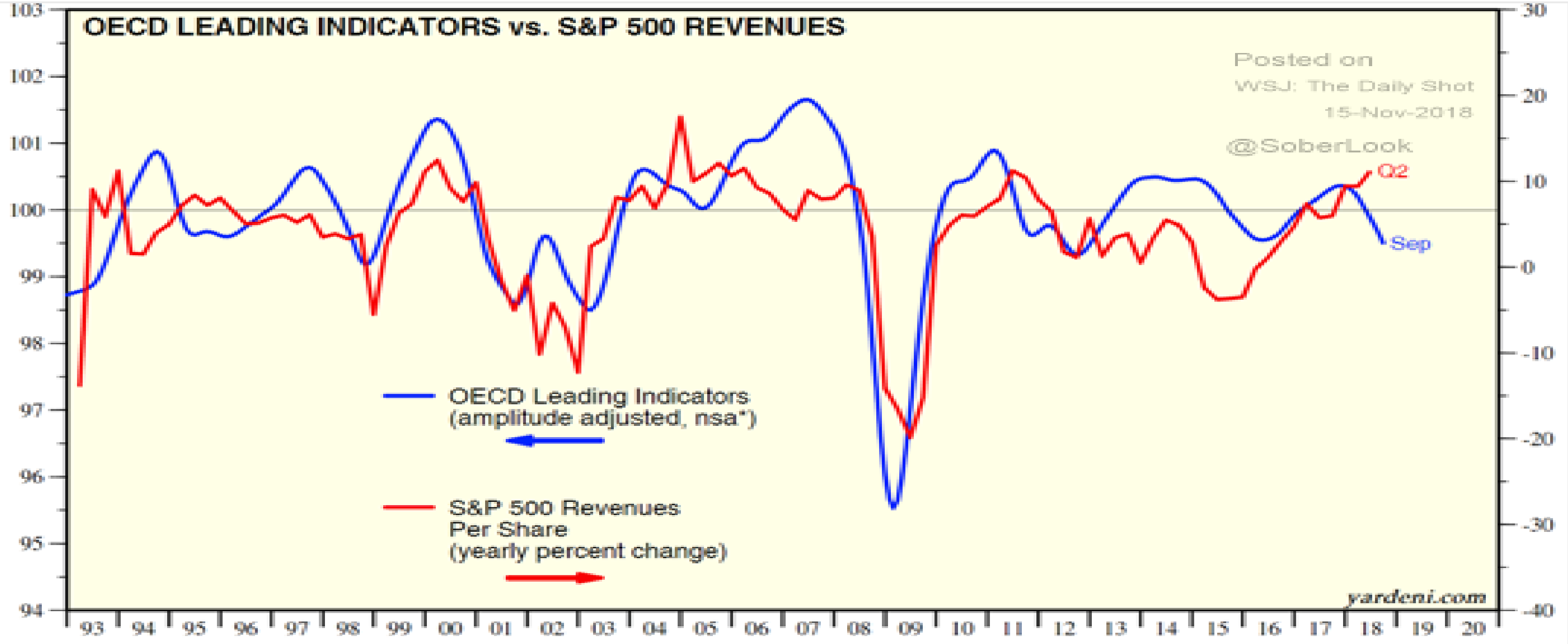


Characteristics of recessions and related stock market declines

Recession	Recession			Related market sell-off			Macro Environment		
	Peak Quarter	Trough Quarter	% Decline	Peak date	Trough date	% Decline	Commodity Spike	Aggressive Fed	Extreme valuations
1 Recession of 1949	4Q48	4Q49	-1.5%	6/15/1948	6/13/1949	-21%			◆
2 Recession of 1953	2Q53	2Q54	-2.4%	1/5/1953	9/14/1953	-15%			
3 Recession of 1958	3Q57	2Q58	-3.0%	8/2/1956	10/22/1957	-22%			◆
4 Recession of 1960-61	2Q60	1Q61	-0.1%	8/3/1959	10/25/1960	-14%			◆
5 Recession of 1969-70	4Q69	4Q70	-0.2%	11/29/1968	5/26/1970	-36%		◆	
6 Recession of 1973-75	4Q73	1Q75	-3.1%	1/11/1973	10/3/1974	-48%	◆		
7 Recession of 1980	1Q80	3Q80	-2.2%	2/13/1980	3/27/1980	-17%	◆	◆	
8 Recession of 1981-82	3Q81	4Q82	-2.5%	11/28/1980	8/12/1982	-27%		◆	
9 Early 1990s recession	3Q90	1Q91	-1.4%	7/16/1990	10/11/1990	-20%	◆	◆	
10 Early 2000s recession	1Q01	4Q01	-0.4%	3/24/2000	10/9/2002	-49%	◆		◆
11 Great Recession	4Q07	2Q09	-4.0%	10/9/2007	3/9/2009	-57%	◆	◆	
Non-recession Bear Markets									
1 1962 flash crash, Cuban Missile Crisis	-	-	-	12/12/1961	6/26/1962	-28%			◆
2 1987 flash crash, program trading, overheating markets	-	-	-	8/25/1987	12/4/1987	-34%			◆
Average	-	-	-1.9%	-	-	-30%			

Source: FactSet, NBER, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management.

Wall Street :
Worries mounting about future earnings growth

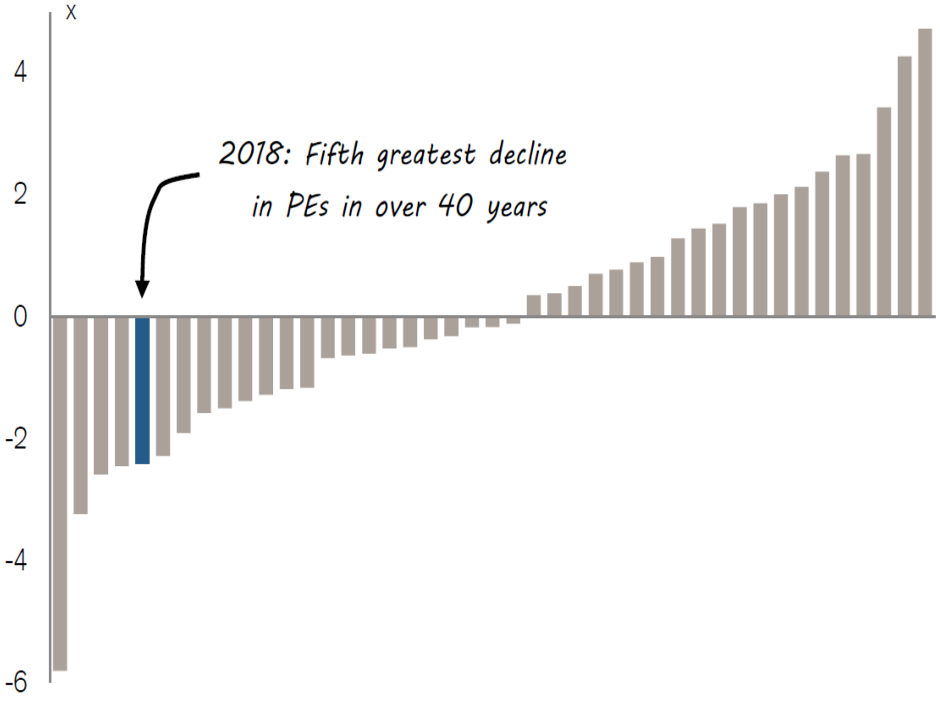


* A reading above 100 that is rising predicts expansion, above 100 and falling a downturn, below 100 and falling a slowdown, and below 100 and rising a recovery.
Source: Standard & Poor's and Haver Analytics.

S&P 500:

One of the worst multiples contraction in the last 40 years

Change in Calendar Year PEs

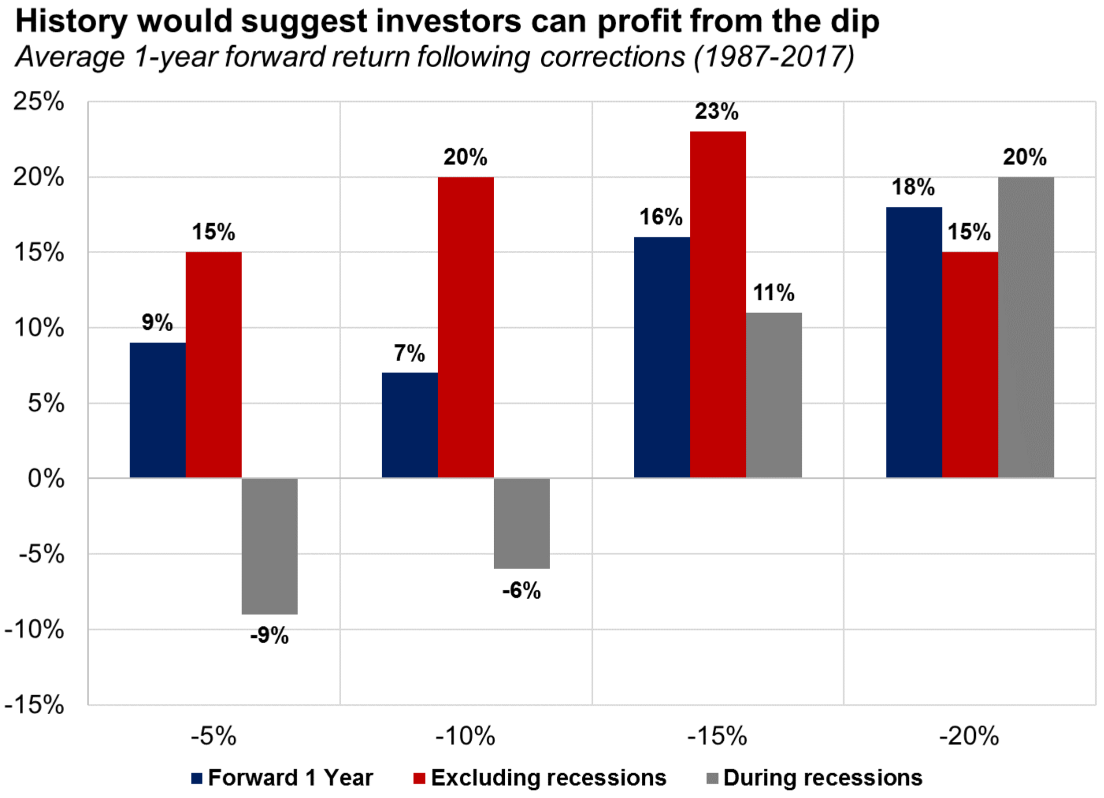


Note: Change in multiple points over calendar year; 2018 is change from 12/31/17 to 10/31/18; 1976 to present
Source: Standard & Poor's, Thomson Financial, FactSet, and Credit Suisse

Exhibit 1: Trailing 12-month S&P 500 return well below level implied by ISM
as of December 7, 2018

Source: Goldman Sachs Global Investment Research

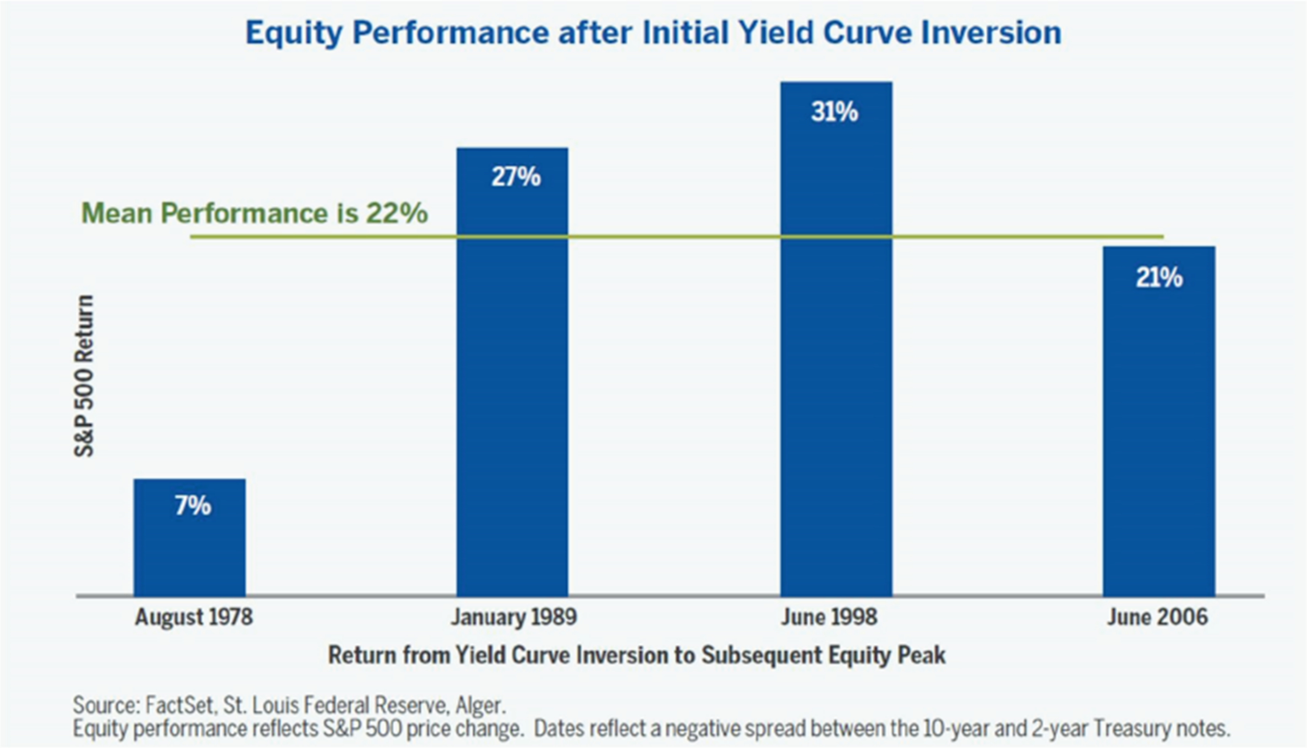
Market corrections are generally good buying opportunities …without no recession in sight!!!



Source : iA Economics, Manulife Investments, Bloomberg.

Yield curve inversion:
A look at the most recent episodes

Chart 1

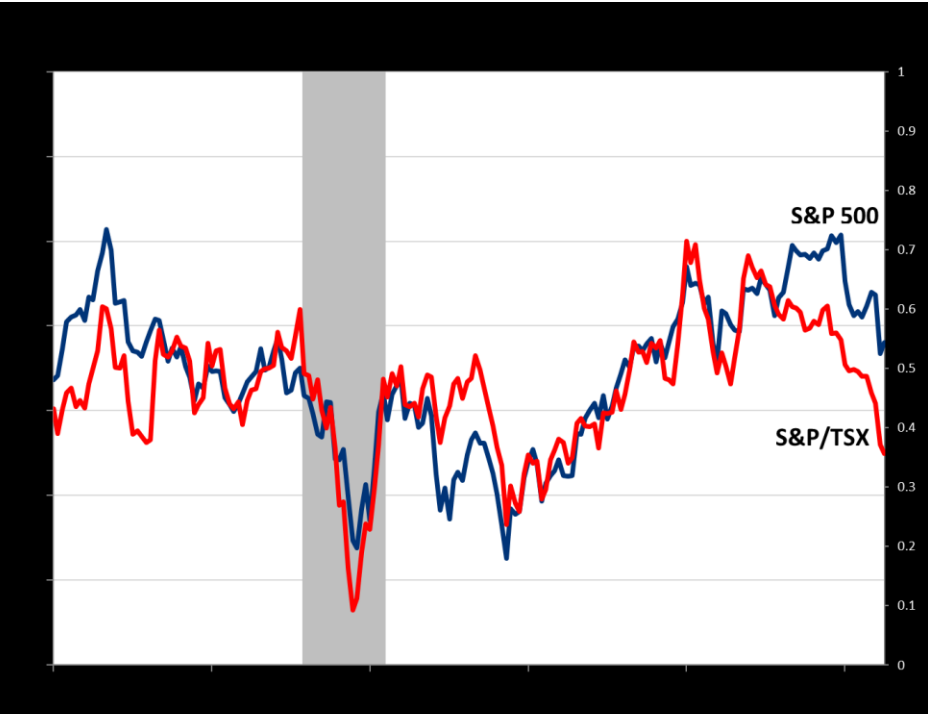


Source: FactSet, St. Louis Federal Reserve, Alger

Following this correction, S&P 500 valuation has become more attractive

Source : WSJ, November 2018

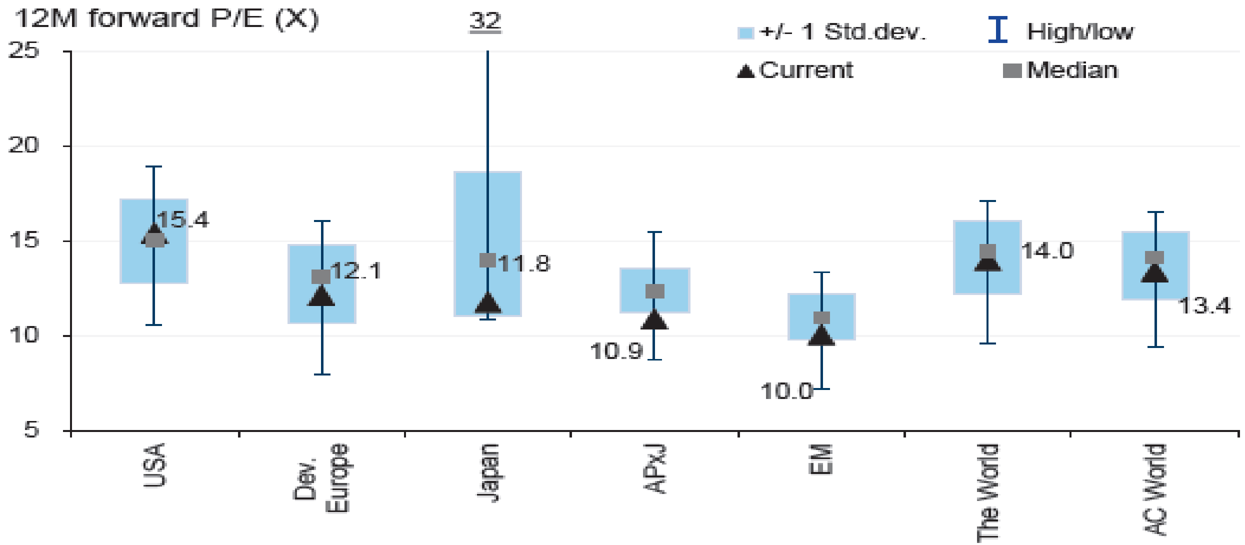
S&P/TSX :
A cheap and undervalued stock market ?



Source: iA Economics, data via Bloomberg, December 5, 2018

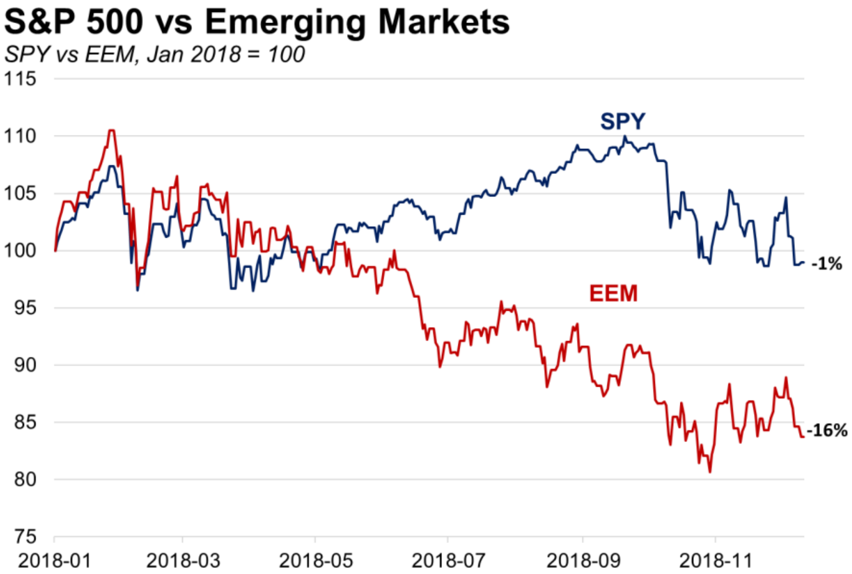
Equities :
Better opportunities overseas ?

Exhibit 16: Valuation ranges (MSCI Regions) over a 10-year timeline
12-month forward price to earnings multiple

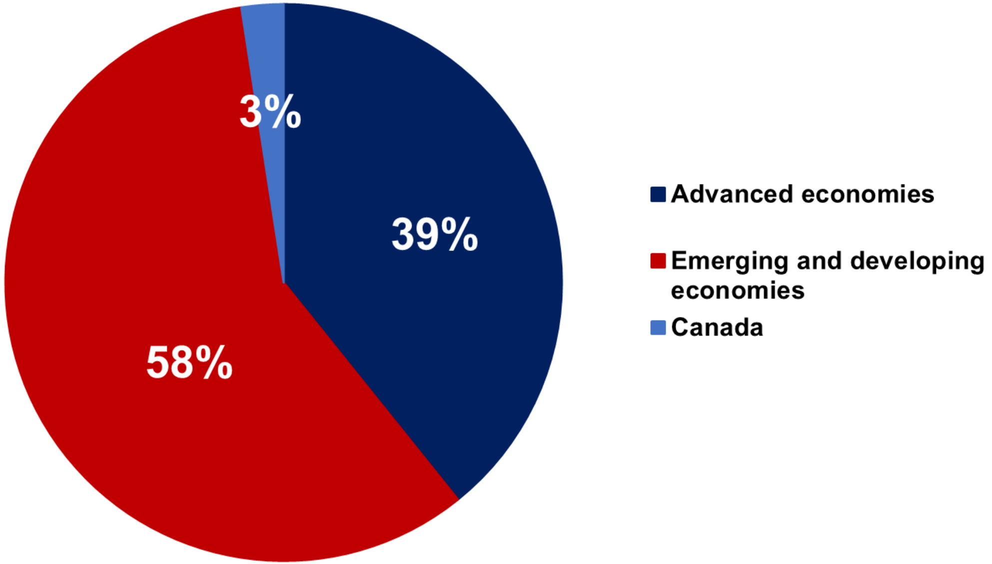


Source: MSCI, FactSet, I/B/E/S, Goldman Sachs Global Investment Research

Emerging markets:
Getting ever more attractive



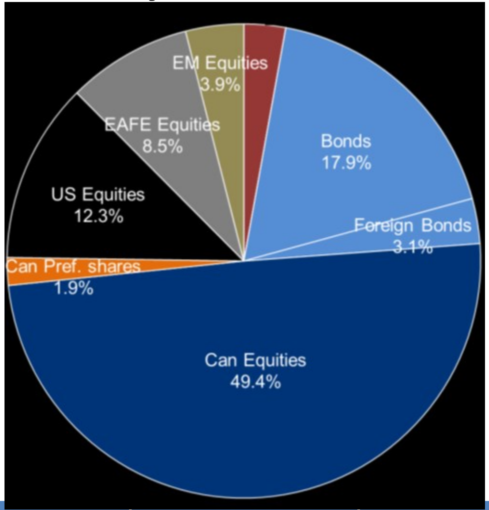
Contribution to estimated global growth of real GDP (2019-2023)



Source : iA Economics, December 10, 2018

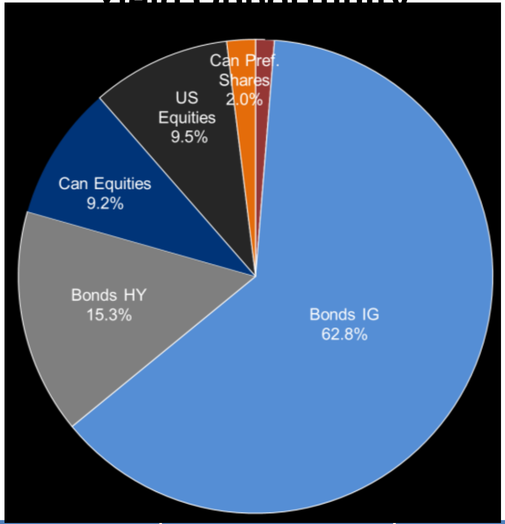
Asset mix: Buying the dip… assuming no recession

IA Clarington Monthly Income Balanced



Asset classes	Neutral weights	Actual weights
Cash	5 %	2.8 %
Bonds	30 %	21.1 %
Equities	65 %	76.1 %

IA Clarington Yield Opportunity



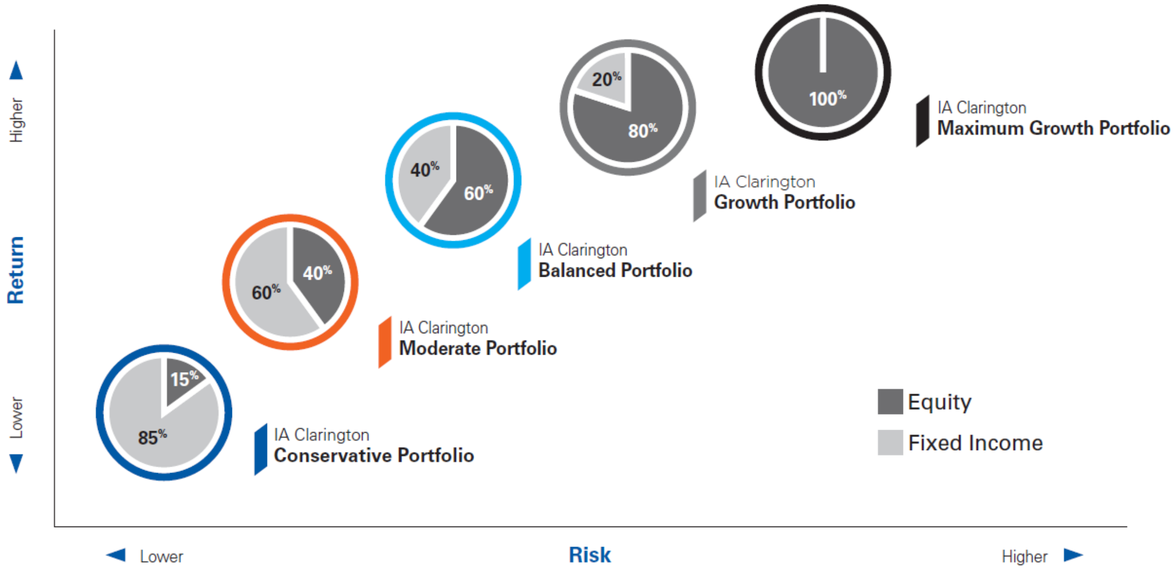
Asset classes	Neutral weights	Actual weights
Cash	0 %	1.3 %
Bonds	87.5 %	78.1 %
Equities	12.5 %	20.6 %

Source: IAIM, December 10, 2018

IA Clarington Managed Portfolios:
Multiple options

IA Clarington Managed Portfolios offer:

- Choice across a range of five broadly-diversified, multi-asset portfolios
- One ticket diversification aligned to an investor's risk profile
- Active management of security selection, tactical asset allocation and foreign currency exposure
- Daily portfolio monitoring with ongoing rebalancing to maintain designated target-risk levels
- In-depth reporting through quarterly commentaries, portfolio analytics and personalized client statements



Investment strategy

- Despite some risk factors, the current business cycle is expected to continue for a few more quarters but at a pace more compatible with potential GDP.
- The normalization of interest rates is well advanced in the U.S, should begin overseas in 2019 and should accelerate in Canada in the second half of 2019.
- With central banks becoming less accommodating, interest rates "should" continue to rise and financial markets to remain volatile.
- Our decision to raise the odds of a recession in the next 12 months to 25% leads us to scale back our optimism on equities for 2019.
- Following the sharp correction in several equity markets, global funds offer better expected returns over the medium term than Canada focused funds, given their exposure to emerging markets.

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March 9, 2018

WEEKLY ECONOMIC PUBLICATIONS

The Canadian labour market is rebounding

Sébastien Mc Mahon | Video and PDF

> This week, jobs creation is strong on both sides of the border and wage growth is moderating in the United States.

March 2, 2018

WEEKLY ECONOMIC PUBLICATIONS

The Canadian economy slowed down in the last two quarters of 2017

Sébastien Mc Mahon | Video and PDF

> This week, Canadian GDP growth slowed down more than expected in the fourth quarter of 2017, and is the White House looking to start a trade war?

February 23, 2018

WEEKLY ECONOMIC PUBLICATIONS

It's Canadian retail sales' turn to disappoint

Sébastien Mc Mahon | Video and PDF

> This week, it was Canadian retail sales' turn to disappoint, and inflation is getting closer to the Bank of Canada's target.

February 16, 2018

WEEKLY ECONOMIC PUBLICATIONS

Clément Gignac

Clément Gignac is Senior Vice-President and Chief Economist at iA Financial Group. He serves as the company's spokesperson on economic matters.

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