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INVESTMENT COUNSEL

Q3 2015 Global Economic Overview

World economic growth in the third quarter varied substantially by region. The weakest economies continued to be those that were most reliant on strong global growth and increasing commodity prices (including Canada, Australia and Brazil).

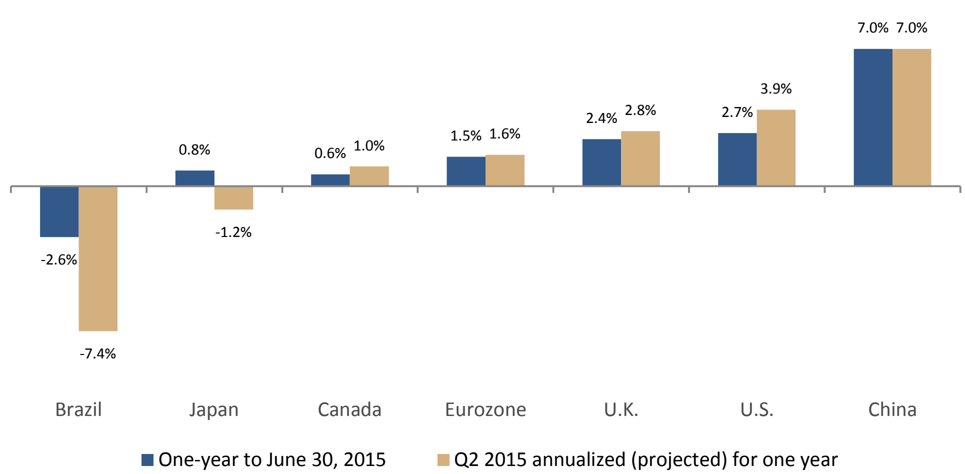
The quarter was bookended by two Greek national votes – an "austerity" referendum in July and a surprise national election in September. In between, the Bank of Canada lowered its overnight lending rate for a second time in 2015, while the U.S. Federal Reserve (the Fed) delayed raising its own rate.

Also during the quarter, China's domestic stocks (or "A-Shares") experienced a significant correction, reversing a sharp market spike. The prices of most major commodities headed downward and discussions revolved around whether or not Canada had technically slipped into recession territory (although most analysts believed the Canadian economy to be on solid footing).

U.S. and European economic data has shown selective improvement, as evidence by strong positive trends in U.S. new home sales and employment levels, as well as higher consumer confidence levels and European Purchasing Managers' Indices. However, the slowdown in emerging markets is beginning to hurt the profitability of many multi-national firms engaged in capital goods and other industrial activities. Resource providers and even industrial companies are feeling the pinch.

In addition, the prevalence of U.S. lending overseas, particularly in emerging markets, may have consequences for the global economy as a whole. Excess capacity in commodities, part and parcel of a deflation trend, can be partially attributed to the central banks' balance sheet expansion, or quantitative easing, since 2008.

Growth of Real Gross Domestic Product



Source: Bloomberg

The U.S.

The U.S. economy remains the strongest economy among developed nations, with an annualized GDP growth rate in the second quarter of 3.9%. The Fed has struggled with the decision to raise its Fed Funds rate, opting to leave its rate unchanged in its mid-September meeting, despite signaling an impending rate increase in earlier meetings this year. Inflation remains below the Fed's overall target of 2%, thus supporting the Fed decision to delay increasing rates.

Some economists feared that a rate increase would trigger additional U.S. dollar appreciation, which would further threaten the economic outlook for select emerging market economies, which have amassed significant U.S. dollar loan obligations. A higher dollar would also hurt the export dependent part of the U.S. economy as well as interest-sensitive industries, such as the housing and auto sectors - two sectors that had been driving the U.S.-led recovery.

The Fed's decision to leave rates unchanged did not have the expected positive impact on global stocks, as markets interpreted the Fed's decision as a sign that foreign economies were in worse shape than they appeared.

Canada

On September 1st, Statistics Canada reported that Canada experienced a technical recession - two consecutive quarters of negative real economic growth - during the first half of 2015. However, due to the small magnitude of the contraction and the overall health of the economy (strong employment and housing growth coupled with a strengthening manufacturing sector), most economists did not place much stock in this technical classification.

Subsequent economic data revisions showed that Canada's economy is, in fact, still expanding, as non-commodity export-focused businesses are benefitting from the lagged effects of a considerable depreciation of the Canadian dollar. This decline was not only against the U.S. dollar but also against other developed economies other than Australia, and is a net positive for the Canadian manufacturing sector.

Canadian growth is still challenged by declining prices of oil and other commodities, so the economy is not entirely out of the woods yet. But this situation may be more of a regional (i.e. Alberta) problem than a country-wide problem, due to continuing growth in the service and non-commodity sectors of the economy.

Europe

Quantitative easing (QE) is finally having an impact in Continental Europe. Despite the apparent slowdown of the Chinese economy, European economies appear to be slowly strengthening.

A progressive reform agenda is leading to more flexibility in the labour market. Subdued wage inflation is boosting competiveness, while lower energy prices are reducing input costs for producers and increasing disposable income levels for consumers. Consumer and business confidence levels are improving as a result.

QE is helping to keep interest rates low and putting downward pressure on the euro, which, in turn, stimulates demand for European exports. These factors together with subdued inflation levels are acting to stimulate the European economy. The success of QE is supporting a market expectation of an expansion of QE initiatives in Europe. The migrant crisis further increases the likelihood of additional QE initiatives.

It is important to remember that the Greek debt problem has not been fully resolved, but has only been kicked further down the road. It is only a matter of time before talk of a “Grexit” reappears. This may create further uncertainty and potential instability in the Eurozone in the future.

Japan

The Japanese economy continues to stagnate, with real GDP declining by 1.2% in the second quarter, due to weaker exports and declining consumer spending. The long-term weakening trend in the yen, since early 2014, has raised corporate profits, but done little to boost wages. There is no end in sight to the Bank of Japan’s (BoJ) massive QE-related purchases of government bonds, which are needed due to stalled structural economic reforms. Moreover, the recent appreciation in the yen is making the BoJ’s 2% inflation target appear more elusive.

Emerging Markets

The emerging market economic story has been dominated by events in China. The Chinese economic slowdown combined with China’s past overinvestment (in infrastructure and housing) and underlying credit risk may continue to negatively impact other emerging market economies, especially those reliant on commodity exports.

Further adding uncertainty to the economic environment was the extreme volatility in mainland China’s stock market caused by the government’s misguided efforts to control the market. Additionally, the renminbi’s small devaluation had a larger negative economic effect on other emerging economies than investors had anticipated.

The International Monetary Fund (IMF) has warned that emerging market corporate failures may increase in developing economies, due to large U.S. dollar denominated debt levels, combined with a significant strengthening of the U.S. dollar.

The weakest of the emerging market economies was Brazil, with the local currency, the real, trading at an all-time low against the U.S. dollar. The country and its economy are faced with stagflation, a credit rating downgrade to junk status and growing political controversy implicating President Dilma Rousseff.