FOYSTON, GORDON & PAYNE INC.

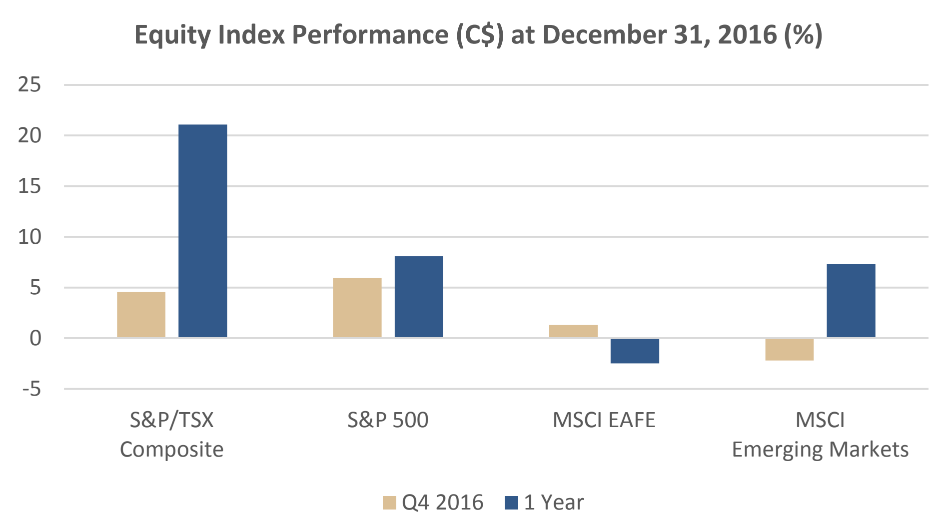
INVESTMENT COUNSEL

Q4 2016 Global Economics Overview

Economic Overview

The surprise election of Donald Trump as U.S. president overshadowed world economic and market events during the quarter. Markets appeared to be focusing solely on the positive points of the Republican Party's platform, namely tax cuts, deregulation, and infrastructure spending. Largely ignored were the "new" politics of populism and protectionist trade policies that were gaining traction not just in the U.S. but in several other world jurisdictions. Central banks were beginning to embrace the notion that their Quantitative Easing (QE) initiatives had unintended economic and market consequences. These banks also questioned the resulting efficacy of their past QE efforts. Governments were switching their attempts to spur growth and inflation from monetary policy (QE) to fiscal policy (debt-financed spending).

The fourth quarter and 2016 as a whole can be summed up as periods that defied predictions. Expected political and economic results were turned on their heads and equity markets benefited. The new year will also be a forecasting challenge. There are several major elections in key European and other markets - France, the Netherlands, Germany, Italy (possibly), and Chile. The results of these contests will indicate whether "anti-establishment" political sentiment is becoming ingrained or is just a passing fad. Polls will continue to unsettle markets but a wait-and-see attitude may be the only prudent course of action.



Source: Bloomberg

P.O. Box 200, 1 Adelaide Street East, Suite 2600, Toronto Ontario M5C 2V9
Tel 416.362.4725 Fax 416.367.1183 www.foyston.com

Inflation and GDP Growth as of September 30, 2016				
	Canada	US	EAFE	EM
CPI (YoY)	1.30%	1.50%	0.60%	2.87%
Real GDP (YoY)	1.34%	1.70%	1.65%	3.46%

Valuation Multiples as of December 30, 2016				
	S&P/TSX	S&P 500	EAFE	EM
P/B	1.90x	2.90x	1.66x	1.58x
P/E (Fwd)	19.9x	17.8x	15.5x	13.8x

Source: Bank of Canada, Statistics Canada, U.S. Bureau of Labor Statistics, Bloomberg, BNY Mellon

Canada

After a weak start to the year, the third quarter showed some economic resilience. While data is somewhat scarce for the fourth quarter, the Canadian economy appears to be settling into a real GDP growth rate of around 2%. Given the general decline in the Canadian dollar over the past year, the export numbers continue to be volatile but improving at a less than robust pace. The Bank of Canada continues to want a weaker dollar and is unlikely to follow any 2017 upward moves in the U.S. Fed funds rate. Longer term interest rates in Canada have risen along with those in the rest of the world, as expected inflation in the U.S. from Trump's initiatives will have effects on the Canadian inflation outlook.

The U.S.

Much ink has been spilled by commentators over the economic and market consequences of the surprise result of the November 2016 U.S. election. "Trumponomics" has had worldwide effects even before "The Donald's" official inauguration. Glowing articles on the shorter term growth and inflation effects of Trump's pro-growth policies have dominated shorter term market expectations. A worsening of the debt and deficit profile of the U.S. economy and protectionist trade and immigration policies have taken a back seat to this near term euphoria. A cautionary wait and see strategy appears to be the best tool for conservative investors to use in the near term.

Europe

The southern European banking system remains under threat with Italian banks getting the focus of market attention during the quarter. This situation, and the general move upwards in developed market interest rates, may prove to be a major headwind for overall European economic growth. As noted above, central banks around the world are reassessing the efficacy of QE. The European Central Bank (ECB) is planning to reduce but not eliminate its QE stimulus later in 2017. However, given pending elections in several European countries, the outlook for monetary and fiscal policy remains more clouded than usual. The fear that other European economies may favour a Brexit approach could prove to be overblown as the year progresses. Further currency depreciation and future inflation may turn out to be a positive for the Eurozone growth outlook.

The U.K.

The U.K. economy remains unsettled since the June 2016 Brexit vote. However, the weakness in the foreign exchange value of the pound sterling has encouraged the stock market, especially those companies involved with the export side of the economy. Haggling over the eventual outcome of trade negotiations with the EU and the lack of a clear and concrete timeline for the British exit remains a major headwind for their economy and markets.

Japan

The Bank of Japan continues to struggle with its attempts to stimulate economic growth and inflation. Its newest initiatives, including capping 10-year Japanese government bond yields at 0%, doubling the purchases of exchange traded funds, and vowing to overshoot the 2% inflation target, had limited economic impact. After strengthening 19% in the first eight months of the year, the yen weakened in the fourth quarter after the Trump election win, closing up only 3% in 2016.

Emerging Markets

Emerging market economies benefited from rising commodity prices and a weakening U.S. dollar for the first three quarters of 2016. However, expectations shifted negatively after Donald Trump won the U.S. presidential election. Trump's victory has potentially weakened the prospects for global trade and emerging market exporters. Rising U.S. interest rates and renewed strength in the foreign exchange value of the U.S. dollar has put a damper on the outlook for emerging markets in 2017. However, these sentiments are more than likely to change as the year progresses, with weaker foreign currencies acting as a longer term ballast to the emerging markets' outlooks.

China's stimulative fiscal and monetary policies continued to underwhelm. The Chinese central bank continued to fight the decline in the Yuan with limited results as the currency closed down approximately 7% relative to the U.S. dollar. China's credit bubble and troubled bank loans remain a concern. However, in a command and control economy, the overall growth picture may surprise on the upside as the year progresses.

There were other trouble spots in emerging markets, including the botched demonetization of the Indian rupee, a controversial tax amnesty in Indonesia, the impeachment of South Korea's president, and a sovereign wealth fund corruption scandal in Malaysia.

There were, however, bright spots, including Pakistan which, after eight years as a frontier market, will return to emerging market status in May. Even beleaguered MSCI Standalone Venezuela (viewed as an emerging market) was temporarily helped by China's offer of a cash lifeline in exchange for future oil exports. China also offered financing to Brazil's Petrobras as Brazil loosened foreign investment rules.

Foyston, Gordon & Payne Inc.
Investment Counsel

Bonds

Despite the mixed but generally softer tone in Canadian economic data, yields moved markedly higher during the quarter, especially for longer dated maturities. The move in yields was not isolated to Canadian yields and can be attributed mainly to a resurgence of global reflation expectations which received a strong boost from the results of the most recent U.S. Presidential election and the resulting prospects of a pro-growth mix of tax reform and upcoming fiscal stimulus.

Canadian Bond Market Performance		
	Fourth Quarter 2016	1 Year
TMX Universe Bond Index	-3.4%	1.7%
TMX Short Term Bond Index	-0.5%	1.0%
TMX Long Term Bond Index	-7.5%	2.5%
Canadas	-3.3%	0.0%
Provincials	-4.9%	1.8%
Investment Grade Corporate	-1.8%	3.7%
High Yield Corporate	3.7%	16.9%

Source: FTSE TMX

All returns shown in the Global Economics Overview are expressed in Canadian dollars unless otherwise stated.