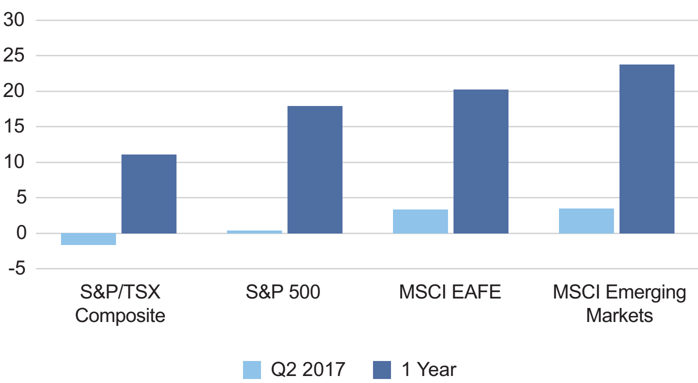
The major global economies continued to expand in a somewhat coordinated fashion, with many entering the middle to late stages of their respective business cycles. Despite continued global conflicts, rising terrorism, and nuclear threats from the likes of North Korea, markets experienced lower levels of volatility. Growth rates remained positive but at varying levels of intensity, and inflation rates for the most part remained subdued. This did not stop central banks from taking their lead from the U.S. Federal Reserve (the Fed) and considering raising short-term interest rates. Even the Bank of Canada (BoC), which was generally expected to hold off raising rates until next year, was seen as potentially raising overnight rates at its meeting in July. BoC Governor Stephen Poloz was quoted as saying that past interest rate cuts had done their job, and that the BoC needed to consider all options. Similar justification came from other central bankers because they did not want to be seen as "being behind the inflation curve" as inflation was eventually expected to escalate if economic growth continued to improve. This about face has been an important shift in G7 countries' consensus on monetary policy. The unintended economic consequences of this policy change make many monetarists cringe.

Equity Index Performance (CAD) at June 30, 2017 %



Source: TD Securities, MSCI

Canada

The Canadian economy continues to show signs of strength. Over the past 10 months, Canadian GDP has grown at its fastest rate since 2010, with job gains the fastest since 2012. Even business investment, long a drag on growth, has shown signs of improvement. Despite recent weakness in the price of oil, the stabilization in the oil-driven provinces has also played a significant role in this national economic rebound. The BoC has acknowledged this strength and, late in the quarter, began warning that a rate increase was being contemplated as early as this summer. This is a dramatic shift in sentiment given the BoC's long-standing concerns over continued low inflation, Canadian dollar strength, and uncertain future trade relations with the U.S. as NAFTA renegotiations begin in August. On a cautionary note, the housing price bubble remains a concern. Over the past year government and regulatory initiatives have been aimed at stabilizing the situation. These attempts remain a work in progress.

The U.S.

Slow U.S. GDP growth in the first quarter of the year extended a pattern of alternating quarters of slow growth followed by stronger growth, a pattern that has been taking place for the past three years. For the second quarter of 2017, the expected rebound in growth may be moderated by a slowdown in housing and auto sales. The Trump administration continues to face a plethora of problems ranging from a lack of action on the fiscal front to accusations of political impropriety. However, politics do not generally overrule the macroeconomic outlook. Employment growth has continued unabated and business investment is registering its fastest growth in more than six years. Continued Fed monetary tightening and renegotiated trade deals may provide economic headwinds.

Europe

Political risk in Europe has continued to fade especially after the convincing presidential electoral win of Emmanuel Macron in France. For the past several months, foreign investment flows have been returning to Europe. These flows have been encouraged by improving economic performance, stronger corporate earnings, rising property prices, and now the potential for substantive fiscal and economic reforms in France. This is not to say there are no risks to an improving European macroeconomic outlook. European Central Bank president Mario Draghi has openly discussed the possibility of ending, or at least tapering, current quantitative easing despite the fact that many European economies are just entering the early stages of a growth rebound.

The U.K.

The surprise U.K. general election in June resulted in the Conservatives losing their majority in parliament. This unexpected political outcome may have weakened the U.K.'s Brexit negotiating position. The election result certainly has added to business and consumer uncertainty. Additionally, rising inflation caused by a currency depreciation that started with last year's Brexit vote has further dampened consumer and investment spending, with real GDP growth at a weak 0.2% in the first quarter of 2017. According to an OECD forecast, U.K. economic growth is expected to weaken further in 2017 and 2018 due to the potential volatility of the Brexit negotiations. These talks are forecast to dampen investment spending, continue to reduce migration, and further disrupt international trade. The Bank of England's governor, Mark Carney, has further exacerbated the weakened economic outlook with conflicting statements regarding when or whether to tighten monetary policy. The risks of a hard Brexit may have diminished judging by how well the British pound has held up since the snap election even though the currency is significantly lower than at the time of the 2016 Brexit vote.

Japan

The Japanese economy experienced its fifth consecutive quarter of expansion with a first quarter 2017 real GDP growth rate of 1%. This pattern has not been seen since 2006. Deflation has been replaced by small upticks in inflation (0.2% to 0.3%) in 2017 after years of deflation. Abenomics appears to finally be having some of its intended effects on Japan's macroeconomic picture. The Bank of Japan is continuing to hold the 10-year Japanese government bond yield near 0%, providing some stability to the weakened Japanese yen, further bolstering investment confidence, and keeping export growth robust. Over the past year, some government officials have actually encouraged labour unions to ask for higher wages. Given the rise in labour costs, businesses have been increasing their investment in productivity improving capital goods, further enhancing economic growth expectations.

Emerging Markets

Growth has been better than expected in the major emerging market countries during the quarter even though recent economic indicators have come in lower than expected. Currencies in many emerging markets such as Mexico, Poland, and even troubled South Africa appreciated against the U.S. dollar. This move has supported local currency-based bond and stock markets. China continues to be the epicentre of the emerging market growth outlook. The Chinese administration is trying to strike a balance between reducing overextended debt levels and maintaining economic stability largely via monetary tightening. This initiative will be challenging and will be a key driver of the overall emerging market economic outlook.

Bonds

Central bank activity leading to higher short-term interest rates was almost exclusively focused on the U.S. in the quarter, and the Fed did not disappoint, raising rates by another 25 basis points.

Globally, however, more central banks began to indicate that this era of low interest rates may soon be coming to an end. The European Central Bank, the Bank of England, and the BoC all served warnings. Given this outlook, the sustainability of the recent move to a flatter yield curve will be reassessed given the continued low level of inflation around the world and, by extension, the ability of central banks to meaningfully increase rates further.

Canadian Bond Market Performance

	Second Quarter	1 Year
FTSE TMX Universe Bond Index	1.11%	0.02%
FTSE TMX Short Term Bond Index	-0.42%	0.20%
FTSE TMX Long Term Bond Index	4.11%	0.40%
Canadian Federal Bonds	0.20%	-1.92%
Provincials	2.12%	0.02%
Investment Grade Corporate	1.02%	2.59%
High Yield Corporate	1.70%	14.98%

Source: FTSE TMX