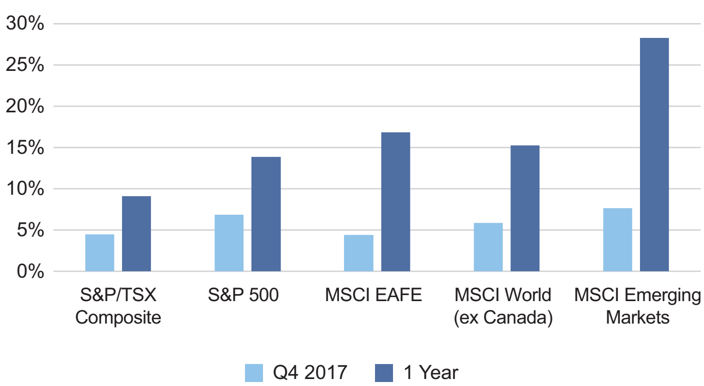
The synchronized global economic expansion continued to support markets during the quarter. The year will be remembered as an unusual one with strong global economic and financial market performance paired with heightened political uncertainty. A lack of clarity around American trade, tax, and immigration policy, plus the beginning of the Brexit process, a number of European elections, and the instability caused by North Korea's missile tests, all led to a tense environment. Normally, investors would be more risk averse and business confidence would weaken, but that was not the case as global output was on track for its strongest growth since 2014. Global stock markets posted double-digit gains.

Equity Index Performance (CAD) at December 31, 2017



Source: TD Securities, MSCI

Canada

Despite U.S. President Donald Trump's continued hard line approach to the renegotiation of the North American Free Trade Agreement and his conflicting tweets and statements, the Canadian economy continued to expand at an above-trend rate. The unemployment rate was at a level not seen since 1976. The Bank of Canada (BoC) refrained from implementing a third overnight rate hike as inflation remained below the Bank's 2% target. However, late in the year, there were some nascent signs of a potential uptick in inflation as commodities rallied, labour markets tightened and, above all, past monetary easing worked its way through the system in a typically lagged way.

U.S.

The U.S. economy and stock markets finished 2017 strongly and look to carry this momentum into the New Year. The U.S. Federal Reserve Board (the Fed) has been the most proactive in normalizing rates but the pace has been slow due to the lack of inflation and continuing concerns about the risk of destabilizing the economy and financial markets. Continuing relatively low interest rates, tight credit spreads and strong equity markets have kept financial conditions easy. The jury is still out on the long-term effects of the recent deficit-financed tax cuts despite the stock market's apparent overwhelming short-term approval. Many traditional signposts – the U.S. dollar, which is completing its worst year in a decade, the yield curve, which is continuing to flatten, and central banks, which are being less dovish on the monetary policy front – confirm that the U.S. is in the late innings of the economic cycle.

Europe

European economies continually bested expectations throughout 2017. Similar to the other developed economies, Europe too will carry some of this positive momentum into 2018. The Eurozone manufacturing sector is growing at the fastest monthly rate since records began in 1997. Germany, Ireland and Austria were the economic standouts with even beleaguered Greece showing the best economic results in a decade. However, the recent fall back in the rate of inflation, a potential reduction in ECB monetary stimulus despite below trend inflation, and geopolitics remain risks for 2018.

U.K.

U.K. economic growth is estimated at 1.5% for all of 2017 which is much better than the Brexit-related recession some economists feared a year ago. To be sure, Brexit negotiations have overshadowed the economic picture, but the global economic expansion and the decline in the British pound have supported exports. The consumer has faced currency-related inflation but overall consumer demand has continued as employment opportunities remain firm given the Brexit related slowdown in immigration. Additionally, after the November 2017 rate increase, the Bank of England is expected to keep monetary policy on hold in 2018. Other than Brexit, the key challenge for the government is to boost productivity growth. However, public and private fixed investment awaits the outcome of the Brexit negotiations. From a contrarian standpoint, the U.K. economy may surprise naysayers in 2018.

Japan

According to the OECD, Japanese economic growth is estimated to have picked up to 1.5% aided by stronger international trade and fiscal stimulus. The Bank of Japan's targeting of the 10-year government bond yield at 0% has also been a support not only to the economy but to the stock market, which has risen to its highest level in almost 26 years. However, growth is projected to slow to 1% in 2018 as fiscal consolidation resumes even as export growth remains robust. Longer term unresolved over-indebtedness (combined household, corporate and government debt has surpassed 220% of GDP) and deteriorating demographics challenge Japan's future prospects.

Emerging Markets

Reflecting underlying strength in their respective economies, China, India and South Korea outperformed the developed world stock markets in 2017.

The Chinese economy continued to advance in the mid 6% range in 2017, with Premier Li Keqiang consolidating power and setting up another five-year plan. Transitioning to a more consumer-led economy, while reducing climate pollution and simultaneously maintaining financial stability are key objectives of the plan. However, fixed investment is still the key economic driver and some slowdown is expected as the government worries about indebtedness and an overheated housing market.

In India, growth is expected to continue as a result of the positive impact of landmark tax reform and a front end loaded bank recapitalization plan.

Latin American countries are also expected to show positive economic momentum, with Brazil continuing to recover from its recession. Chile stands to benefit from the surge in commodity prices, especially copper.

Russia, with its internal political improprieties and potentially increasing American sanctions, is forecast to continue to lag other emerging markets. Saudi Arabia will also continue to face the headwinds of recession and a ruling family shake-up.

Bonds

After hiking interest rates in July and September, the BoC stepped back to monitor the impact of these increases on household finances while also noting that inflationary pressures here remain low and that the uncertainty regarding the direction of NAFTA negotiations remains a concern. With the economy maintaining its strong momentum and the labour market at near full employment, inflation is expected to slowly move to the BoC's target in 2018, which will support additional rate hikes.

The 10-year interest rate was mostly unchanged from the end of September, but what did change was the shape of the yield curve as it continued to flatten – with short-term rates rising, reflecting BoC rate hike expectations, and long-term rates falling. The 2-year to 30-year yield curve flattened by 100 basis points in 2017, with almost 40 basis points of this narrowing coming in the fourth quarter alone. Credit spreads were little changed in 2017 as corporate / Canada yield spreads were stable and provincial spreads were modestly tighter.

Canadian Bond Market Performance

	Fourth Quarter	1 Year
FTSE TMX Universe Bond Index	2.02%	2.52%
FTSE TMX Short Term Bond Index	0.28%	0.08%
FTSE TMX Long Term Bond Index	5.22%	7.03%
Canadian Federal Bonds	0.87%	0.13%
Provincials	3.38%	4.33%
Investment Grade Corporate	1.87%	3.38%
High Yield Corporate	2.39%	9.94%

Source: FTSE TMX