INVESTMENT COMMENTARY SECOND QUARTER 2016

Keep Calm and Carry On

Heightened volatility and uncertainty are the new normal for the financial markets. Nevertheless, the overall stock market is proving to be quite resilient in the face of so many uncertainties, much more so than many thought it could be, and the global economy, with growth still grinding inexorably higher, continues to prove itself less terminally ill than some pundits and analysts would have us believe.

After a rocky start to the year, with most stock markets falling into correction territory before recouping their losses mid-February, investors entered the second quarter in a positive mood as worries about the myriad of uncertainties that had caused earlier jitters dissipated.

What actually happened that sent the markets back up after their riotous start to the year?

Quite a few things: China's economy and markets stabilized. Oil prices rebounded and the U.S. dollar continues to weaken. The Federal Reserve and other major central banks did not raise interests rates, which are now likely to stay "even lower, for even longer". (Expectations for the Fed's next policy-rate move have been pushed out to late-2017.) Global central banks' policies remained very accommodative. Manufacturing output continued to tick up in more countries around the world. U.S. economic growth, while still tepid, remained on a sustainably positive trajectory. Corporate earnings forecasts improved.[1]

Against this positive backdrop, markets were relieved to take a break from the volatility of the first quarter, and April and May passed without incident. Hopes were high for placid markets going into the summer. Of course, as we now know, that was not to be because by June, investors finally got around to focusing on the referendum in the United Kingdom to decide whether to remain part of the European Union or to leave, dubbed Brexit.

Although global markets are not as driven by politics as they are by economic and financial events, they dislike surprises, and react accordingly, which is why the surprise win by "Leave" caught the markets off guard and sparked a sharp two-day global equity sell-off that disappeared just as quickly as it began, but not before the oft-cited benefit of a steep, temporary drop in prices gave cooler heads and long-term investors fresh buying opportunities. The bellwether U.S. S&P 500 vaulted the Brexit "wall of worry" and kept on going all the way to a new record high on July 11. Other major indexes also edged closer to their peaks as the third quarter got underway. With Brexit's brief impact on equities behind us, we expect that the market (and risky assets) will go back to following the trend of growth prospects … higher. One of the more remarkable aspects of the 87-month bull market in the S&P 500 and its 215% plus total return[2] is how skeptical investors have been almost since the start. Every sharpish correction has been heralded as the beginning of the next bear market. We are reminded of Sir John Templeton's famous quote: "Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria." On that basis, this bull seems to be a long way from death's door.

While keeping nerves steady can be a challenge in this era of uncertainty, recent events prove that maintaining a long term view, focusing on hard data, and not speculating too much on the unknown is the best way to maintain one's composure, especially at a time when the financial markets are acutely sensitive to any disruption, as the knee-jerk reaction to the Brexit surprise showed. That said, investors need to be prepared for more volatility in the months ahead since the uncertainty level will likely remain elevated until another major "known unknown", the outcome of the U.S. presidential election in early November is behind us. There is more. Other upcoming contests include October's Italian referendum to reduce the power of its senate, and general elections in the Netherlands (March), France (May) and Germany (October) in 2017.

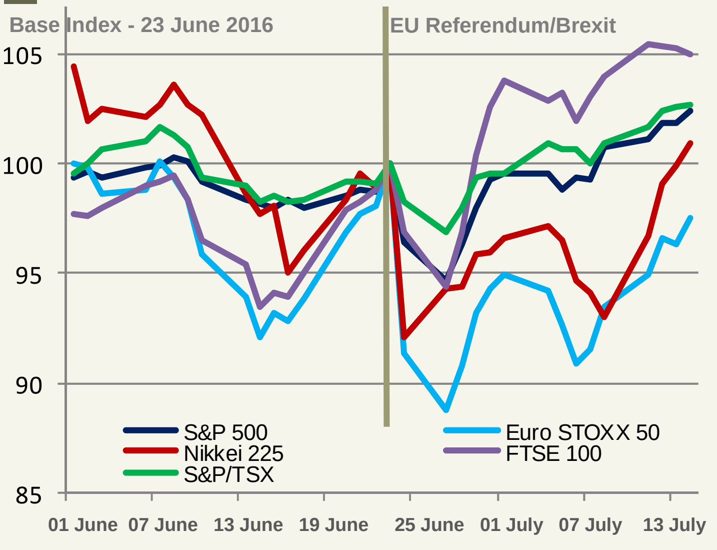
A LEAP INTO THE UNKNOWN

Brexit is a seismic political event with important ramifications for the UK and Europe. The exit of a large, established member from the EU has never been tested. It could take at least two years for the U.K. to formally leave the 28-nation bloc. Given the lengthy process of withdrawal and ambiguity about how it will all shake out, Brexit will likely depress economic growth in the UK in the short-term as business spending gets frozen until some clarity re-emerges on the country's EU trading relationships. Consumer confidence in the UK could also take a hit. Sterling's plunge immediately following the Leave vote, provided a much-needed offset to the mostly negative impact of all the uncertainty, as UK exporters found themselves in a more competitive position. This period of turbulence for the UK economy, which accounts for just 3.9% of global GDP, should not alter the trajectory of the global economy, where steady if unspectacular growth (forecast at 2.6% in 2016) remains the base case.[3]

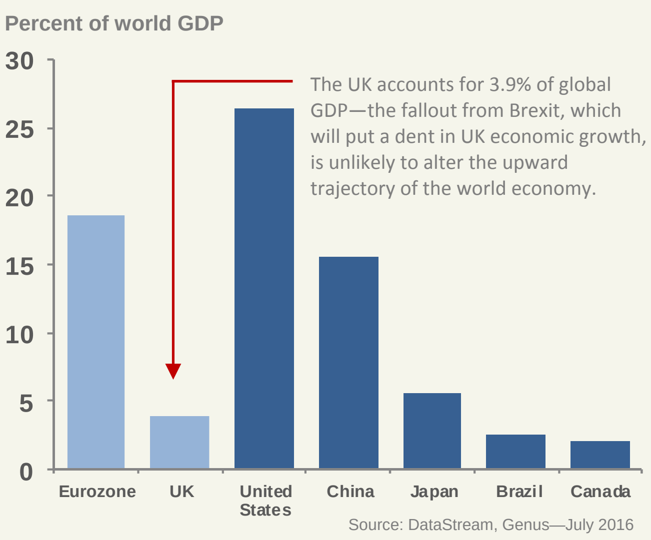
The European Central Bank continues to stand behind the European recovery, and its bond purchase program should help limit the financial contagion from the Brexit vote. With unemployment still high but falling, and credit demand and supply improving, the European recovery appears to be still in the relatively early stages. /Continued on Page ▷

Exhibit 1: Breaking Down Brexit: Kneejerk Market Reaction; Little Impact on Global Economy

1 Global equity markets: pre and post UK EU referendum



2 Contributions to Global GDP



Source: DataStream, Genus—July 2016

GENUS INVESTMENT STRATEGY: During the course of the referendum in the UK we reduced the exposure to equities in our clients' Balanced portfolios by about four percent. We were significantly underweight European financials and banks, periphery stocks and UK domestic cyclical stocks, which were the most negatively affected by the Brexit result. Our direct exposure to the UK was less than one percent. In terms of overall strategy, we continue to emphasize blue-chip defensive dividend payers and select global growth stocks. Through the course of the second quarter (in response to our DynaMix signals) we reduced our exposure to U.S. stocks and brought money home to Canada, increasing our allocation to Canadian stocks. Earlier in the year, we reduced our Emerging Market holdings given the headwinds they faced. However, given their improving backdrop we have gradually increased our allocation to this, given their relatively stronger prospects at this time. Both these decisions proved beneficial. Our allocation to fixed income continues to favour shorter-term investment grade corporate issues and select commercial mortgages at the expense of government issues. Genus bond portfolios are structured to pare bond (interest rate) risk by remaining anchored in shorter and intermediate durations where the impact of rising interest rates is limited. Please feel free to call your Portfolio Manager if you have any questions.

1. DataStream, TD Newcrest, Thomson Reuters. 2. Bloomberg Finance. 3. International Monetary Fund GDP Forecasts, TD Newcrest.

Brexit means EU growth will be about 0.5 percent weaker than otherwise, but that the Eurozone will continue to grow, albeit at a subdued pace. The principal short-term threat to the Eurozone recovery will come from financial contagion with the Eurozone banking sector under renewed pressure with fears surrounding the Italian banking sector a key concern. Italy's banks and their "strained" balance sheets, which are swamped by very high levels of bad loans, are a major area of vulnerability for the Eurozone and will be a key focus over the remainder of 2016.

CHUGGING ALONG

The global economy came into 2016 with a lot of stimulus in the pipeline. The plunge in oil prices since mid-2014 allowed many central banks around the world to lower interest rates in 2015. The combination of lower rates and lower inflation provided a boost to growth prospects in the first half of this year. Although uncertainty and volatility are expected to persist for the rest of this year, the global economy should continue to look better as stimulus in the pipeline (i.e. lower rates) continues to flow through the system.

OIL PRICE REBOUND

Oil prices are reflection of the global backdrop. After being under pressure for about 18 months, oil prices have recovered from their lows at the beginning of February and are now up over 80 percent. Although several factors have had an influence on oil price movements, world demand has been the most dominant force.[4]The recovery in oil prices boosted sentiment in the first half of the year. Since the bottom in oil prices, sentiment for Emerging Markets has also improved, as EM equities have been outperforming Developed Markets.

BETTER U.S. PICTURE

The U.S. economy remains resilient despite numerous shocks over the past seven years and is expected to grow at just below 2% in 2016. It is still the U.S. economy, and in particular its consumers, that analysts primarily look to for clues on what lies ahead for the wider world. Improving monthly income and spending data, alongside higher frequency employment indicators, point to robust consumption growth as we look to the second half of the year. Job openings remain in a solid uptrend, rising well beyond the previous cycle's peak reached in mid-2007, as capital spending and manufacturing activity also continue to rebound. The U.S. is not the only country that has seen an improvement in growth prospects this year. Exhibit 2 shows the percent of global countries with a Purchasing Managers' Index (PMI) above 50 (i.e., in the expansion zone). Whereas less than half of global economies were in expansion territory in mid-2015, this number has improved in recent months to nearly 80 percent. Earnings have historically been well–correlated with the PMI. Historically it takes about six months for sales growth to broadly accelerate after the business cycle bottoms. Therefore sales growth (and improved earnings) is expected to pick up in the coming months. This is something investors have been waiting for, so when it happens, it's likely to be reassuring—and supportive for markets.

CANADA TREADING WATER

Although the Canadian economy is "barely treading water" according to a survey report by TD Economics, Canadian equities have been in favour so far this year. The second quarter echoed the first quarter's themes: gold and energy prices rallied, which drove equities up significantly in both the Materials and Energy sectors. While global equities did not perform as well, Canadian equities are up 9.84% for the year as at June 30.

Economic adjustment among the Canadian provinces is expected to be the single largest theme over the near term, as changing commodity prices, lower interest rates, and softer Canadian dollar manifest on provinces differently. The underlying dynamics support only a moderate recovery in domestic conditions among the major resource producing provinces in 2016. At the same time, exports and housing wealth should continue to pivot national growth towards Ontario and B.C. well into 2017.

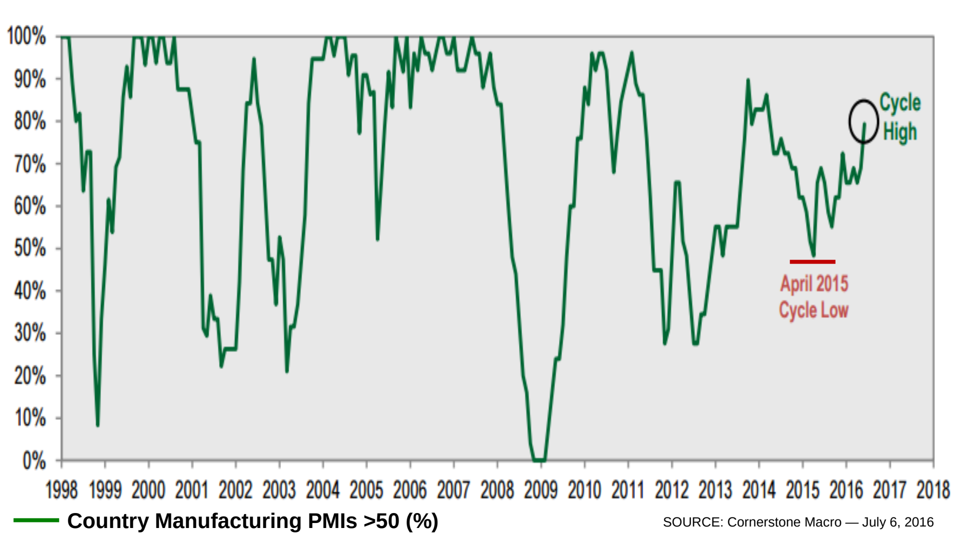
EMERGING MARKETS

The hiatus in Fed interest rate rises bodes well for beaten-down Emerging Market (EM) assets (we have increased our allocation accordingly). The U.S. dollar paused its ascent in 2016, reversing the pressures that plagued EM last year. A weaker U.S. dollar in the past has often coincided with relatively strong performance by EM equities.

The cyclical challenges that led to poor EM returns in recent years are now reversing. Weaker currencies have—with a lag—led to improving trade balances. The price of oil, as well as China's slowing economy have stabilized. Portfolio flows into EM debt have also resumed as investors flee zero or negative rates elsewhere in the world. □

Exhibit 2 Industrial Production Signals Hit Two-Year High

Nearly 80% of countries' Purchasing Managers' Indexes are back in "expansion" territory



Genus Pooled Fund Performance

Returns are shown Gross of Fees — Compound Annual Returns

As at June 30, 2016	3 Months	1 Year	3 Years	5 Years	10 Years
BALANCED FUND	2.0	1.5	8.7	7.4	4.9
EQUITIES					
Canadian Alpha[1]	6.5	2.1	8.2	3.4	3.6
Dividend Equity	2.7	6.1	12.5	10.4	-
Global Alpha[2]	1.6	-8.3	11.8	13.2	6.0
CanGlobe Equity	0.5	-3.1	10.9	8.2	5.1
Emerging Markets	4.4	-2.1	6.2	-	-
Fixed Income					
Government Bond	2.2	5.3	5.1	4.5	5.1
Short-Term Corporate Bond	0.9	1.9	3.2	3.1	4.0
Strategic Bond	2.8	5.3	6.3	6.4	-
Commercial Mortgage	0.8	2.5	4.0	4.0	-
Fossil Free					
Fossil Free Dividend Equity[3]	1.6	4.8	12.6	-	-
Fossil Free CanGlobe Equity[4]	0.9	-0.9	14.3	-	-
Fossil Free Corporate Bond	2.5	5.5	-	-	-
Fossil Free Impact Equity	0.2	3.9	-	-	-
Index Returns	**3 Months**	**1 Year**	**3 Years**	**5 Years**	**10 Years**
S&P/TSX Composite	5.1	-0.2	8.3	4.2	4.9
S&P 500 Index (C$)	2.9	8.2	19.7	19.0	9.1
MSCI Emerging Mkt (C$)	1.2	-8.2	5.9	2.5	5.5
MSCI World Index (C$)	1.6	1.7	15.3	13.8	6.7
DEX Universe Bond Index	2.6	5.2	5.6	5.2	5.6

Past performance is no guarantee of future results.

1 **Mandate change:** Genus U.S. Equity mandate changed to Global Equity (Sept 14, 2012) and Global Alpha (June 30, 2014).
2 **Mandate change:** Genus Canadian Equity changed to Canadian Alpha on June 30, 2014.
3 **Mandate change:** Biosphere Canadian Equity (100%TSX) changed to Biosphere Dividend Equity (40% TSX, 30% S&P 500, 30% MSCI EAFE) as at April 1, 2013. Name change to Fossil Free Dividend Equity on March 31, 2015.
4 **Mandate change:** Biosphere Global Equity (50% S&P 500 / 50% MSCI EAFE) changed to Biosphere CanGlobe Equity (40% TSX, 30% S&P 500, 30% MSCI EAFE). Name change to Fossil Free CanGlobe Equity on March 31, 2015.

Canadian stocks lead global equities higher

Canadian stocks continue to out-perform. They are not only leading global equities higher during 2016, they are also the top-performing developed market so far this year in U.S. dollar and local currency terms.

The drivers are numerous but include higher oil and gold prices, a reversal of crowded short positioning, better-than expected economic activity in the U.S., vibrant housing demand and decent earnings from Canadian banks. The S&P/TSX was up 4.2% for the second quarter – its best quarterly return since the same period in 2014. Materials (+12.8%) and Utilities (+3.9%) posted the best returns. The Materials sector was led by gold. Gold stocks returned +39.9%, marking the sector's best quarterly return since the second quarter of 1993 when it returned +47.6%. Health Care (-21.3%) and Information Technology (-7.1%) were the weakest performing sectors.

U.S. equities gained over the quarter, supported by expectations that the Fed's additional interest rate rises would be delayed. The S&P 500 advanced 2.9% in Canadian dollar terms.

Eurozone equities had a turbulent quarter, with financials particularly under pressure. The MSCI EU index returned -2.2% for the quarter.

The MSCI Emerging Markets (EM) posted a modest 1.2% increase for the quarter in Canadian dollar terms. Latin American equities enjoyed a strong quarter with Brazil (+46% in U.S. dollar terms and +21% in local currency) is the world's top-performing stock market in 2016 so far. □

Genus Balanced Fund Asset Allocation
(As at June 30, 2016)

Asset Class	Percent of Market Value
Government Bond	2.0%
Strategic Bond	17.3%
Commercial Mortgage	11.9%
Total Fixed Income	**31.2%**
Canadian Alpha	**5.4%**
Canadian Equity	*5.3%*
Cash	*0.1%*
Dividend Equity	**19.0%**
Canadian Equity	*7.9%*
U.S. Equity	*7.1%*
International Equity	*3.7%*
Cash	*0.2%*
CanGlobe Equity	**33.2%**
Canadian Equity	*13.2%*
U.S. Equity	*11.3%*
International Equity	*6.3%*
Cash	*2.4%*
Global Alpha	**2.0%**
Canadian Equity	*0.2%*
U.S. Equity	*1.1%*
International Equity	*0.6%*
Cash	*0.1%*
Emerging Markets	**5.2%**
Total Equity	**61.9%**
Total Cash	**6.9%**
Total Portfolio	**100.0%**
Portfolio Equity Exposure	
Canada	42.9%
United States	31.5%
International	17.1%
Emerging Markets	8.4%
Total Equity	**100.0%**