STONE
ASSET MANAGEMENT LIMITED

October
MARKET COMMENTARY & FORECAST

Do bear markets die in October?

October was full of ghosts and goblins with global markets suffering $5 trillion in lost value with the MSCI world down 7.4%. The TSX was down 6.51%, S&P 500 down 6.94%, Dow Jones down 5.07% and the Nasdaq down 9.2%. These returns are after the markets experienced their first consecutive 2-day rally at the end of the month to recover from the “correction” territory they registered. European shares, as measured by the Stoxx Europe 600, were down about 6% and several major Asian indices were down double digits in October. Truthfully your investment management team has had better market performance months to work in. These October losses are the biggest pullback in seven years for these markets. However, we believe this to be a correction and not the start of a bear market.

The Federal Reserve (“the Fed”) has been on a path of higher interest rates to bring rates to more normalized levels. We believe the Fed’s measurement of normalized rates to be approximately 4% and the Bank of Canada’s normalized rate target of 3%. This backup in rates has caused bond prices to drop 3.5% in October. This dual breakdown in both stock and bond prices has upended investors’ traditional safety tool of flooding to Treasuries in times of uncertainty and market volatility. In other words, there was no place to hide in October and no level of diversification would have prevented losses, unless one was in cash.

MARKET PERFORMANCE

Market	Return (%)*
Canada (S&P/TSX)	(6.3)
US (S&P)	(5.0)
MSCI (World)	(5.6)
Best (Brazil)	22.1
Worst (Mexico)	(16.7)

*In Canadian dollar terms as at October 31, 2018

US earnings for Q3 have been decent thus far. Of the 376 companies that have reported to date in the S&P 500, 61% have beat expectations on revenue and 39% were below. In addition, 78% of companies beat earnings expectations, 14% were below and 8% matched expectations. Some concerns about cost increases due to tariff threats have affected the bottom lines of such traditional companies such as PPG, Caterpillar and 3M. The market focused on these earnings warnings as most bear pundits tend to do. The reality is that corporate earnings continue to get revised higher across all segments. Yet, we know not all companies will have rising earnings - this is a stock market for active investing and being a stock picker. The S&P 500 should be on track for 23% earnings growth in 2018 and 10%+ for 2019. The US continues to be the global leader in earnings growth while other developed markets such as Europe is forecast to grow only 2% and 9% while Asia Pacific forecasts are 3% and 5% growth in 2018 and 2019 respectively. At home, Canada is forecast to grow earnings a decent 14% and 13% but you wouldn't know it by the lacklustre performance of the TSX and thus an attractive forward PE multiple of 13.0x. The TSX is basically flat over the past decade while the S&P is up 90%. We struggle to see the TSX as a roaring buy, yet we do see selective opportunities.

Inflation is a lagging indicator and although it is currently at 2.0%, the robust US economy coupled with the threats of tariffs will result in a higher inflation. This will continue to justify the Fed's move to higher interest rates.

The US economy continues to act strongly with a healthy 3.5% GDP growth for 2018. ISM and freight activity are running at healthy clips and the US unemployment rate is at decades low 3.7%. There are now more job vacancies than unemployed people in the US. Wage growth is slow to pick up steam but is likely coming as witnessed by Amazon announcing a $15/hr minimum wage for all US employees starting Nov 1. Average hourly earnings are moving higher, and the recent wage increase of 3.1% year-over-year is the largest gain in 9.5 years. Consumer confidence at 137.9 is at an 18-year high on the back of low unemployment. We see no flashing recession indicators. In fact, the opposite is happening as credit spreads have not deteriorated and the yield curve is not inverting.

It is our position that the markets became oversold in October due to a herd mentality by investors and enhanced short-term volatility due to hedge fund and ETF trading. We expect the US markets to have higher daily volatility in the near term, until it finds a footing to support higher prices. In the meantime one should expect the rest of the world's markets to take their direction from the US markets. We came across a very interesting statistic: since WW II, the S&P has never ended the year lower than the October during a mid-term election year. So, after the excitement of the mid-term election we now have a minute statistical data point to pay attention to.

In September our proprietary investment process led us to increase cash balances in those fully-invested accounts, while maintaining cash balances in those accounts that already had higher levels of cash. We increased the cash weighting in our Growth Fund from a low single percentage to 15%, and we maintained our cash weighting in Dividend Growth Class, GaleForce Dividend Growth Pool and Select Growth Class.

We use our proprietary investment process daily and in volatile market conditions such as these, we seek to ensure that we can manage downside risk and adjust the portfolio accordingly while seeking to achieve our long-term investment goal of providing clients - Growth Over Time®. As portfolio managers we hope November is more enjoyable than October for ourselves and our clients

We remain invested and are committed to companies that provide revenue growth, improving free cash flow and higher earnings per share. We are active portfolio managers with a disciplined investment process including the implementation of various risk management tools to benefit our investors.

FUND PERFORMANCE - Series F/FF

	1 mo	3 mo	6 mo	YTD	1 yr	3 yr	5 yr	10 yr	Since Inception	Inception Date
Stone Dividend Growth Class, Series F	(5.4)	(4.1)	1.1	2.6	3.1	5.8	6.4	8.3	9.4	08/01/2003
80% S&P/TSX Composite, 20% S&P 500 C$	*(6.1)*	*(6.7)*	*(0.6)*	*(2.4)*	*(0.9)*	*7.7*	*7.7*	*9.0*	*8.0*	
Stone EuroPlus Fund, Series F	(7.2)	(9.8)	(9.3)	(10.8)	(11.2)	(1.9)	3.4	6.3	3.0	05/02/2008
MSCI Europe $C	*(6.1)*	*(8.9)*	*(8.2)*	*(5.4)*	*(6.5)*	*2.7*	*6.0*	*7.5*	*3.3*	
Stone Global Balanced Fund, Series FF	(5.5)	(5.1)	(2.4)	(1.4)	(1.8)	2.9	5.5	n/a	7.9	01/05/2009
15% S&P/TSX Composite, 15% S&P 500 C$, 30% MSCI World C$ and 40% FTSE TMX Canada Universe Bond	*(3.7)*	*(3.2)*	*0.6*	*0.9*	*1.7*	*6.2*	*7.0*	*n/a*	*8.3*	
Stone Growth Fund, Series F	(6.1)	(3.8)	5.1	13.0	15.0	3.3	9.9	8.8	6.5	08/01/2003
50% S&P/TSX Composite and 50% S&P 500 $C	*(5.8)*	*(5.0)*	*1.8*	*1.5*	*3.0*	*9.3*	*8.6*	*9.4*	*7.7*	
Stone Global Growth Fund, Series F	(9.4)	(6.7)	(0.5)	5.5	4.5	8.6	13.4	13.6	8.5	08/01/2003
MSCI World $C	*(5.8)*	*(4.6)*	*0.4*	*2.6*	*3.2*	*8.1*	*11.9*	*11.0*	*7.2*	
Stone Select Growth Class, Series F	(8.5)	(10.1)	(10.6)	(17.0)	(13.5)	(5.7)	n/a	n/a	(15.4)	09/01/2014
50% S&P/TSX Capped Energy, 50% S&P/TSX Capped Materials	*(9.2)*	*(16.5)*	*(12.9)*	*(12.1)*	*(10.5)*	*5.4*	*(2.7)*	*1.3*	*(7.2)*	
Stone GaleForce Dividend Growth Pool	(4.6)	(3.7)	0.6	2.6	2.7	5.1	6.1	n/a	5.9	05/17/2012

The returns set out above are historical annualized compounded returns net of all fund fees and expenses. The returns assume a re-investment of all distributions. Historic returns are provided for general information purposes only and may not be indicative of future returns or fund performance.

Performance data of other Series of the Funds may differ from those shown above due to differences in fees. Please visit our website at www.stoneco.com for performance data of all Series.

As at October 31, 2018

CANADIAN FACTS

The pinch and the zoom - Innovators had the idea for multi-touch screens in their minds and down on paper for years. The true breakthrough in this technology came in 1982. It occurred at the University of Toronto when members of the school's Input Research Group actually made the first human-input multi-touch screen. Their screen featured a frosted-glass panel with a camera behind. The camera detected when a finger or fingers were placed on the panel and registered these input points as black spots on a white background. This practical application of plural-point awareness released a cascade of further research and design. It was first most evident in the movies and TV shows we watched. Now it's a fixture on our mobile digital devices, as we pinch and zoom into the future.

*Adapted from Ingenious - How Canadian Innovators Made the World Smarter, Smaller, Kinder, Safer, Healthier, Wealthier, and Happier, by David Johnston & Tom Jenkins

Sleep well

Knowing you'll have the financial resources to live well.

STONE
ASSET MANAGEMENT LIMITED

40 University Ave, Suite 901
Toronto, Ontario M5J 1T1

Toll free. 800 336 9528
Fax. 416 364 8456
www.stoneco.com
info@stoneco.com