The Year Ahead 2013

As the new year begins, we at TD Asset Management Inc. want to provide you with our observations on some of the key issues that we anticipate will influence the financial markets during 2013.

Global Economic Growth
We believe that global economic growth will improve moderately in 2013, but the overall growth rate will remain low. We expect that growth in emerging markets will continue to be stronger than in developed markets, will be driven in large part by the ongoing expansion of domestic demand. However, this growth will be moderated by challenges in the euro zone, which recently entered its second recession since 2009 as continuing austerity measures are making it difficult for countries to maintain their fragile economic momentum.

In the U.S., politicians were unable to reach a grand bargain to avoid the fiscal cliff, but they did manage to reach an agreement on tax increases and they continue to work toward an agreement on the spending cut side of the equation. The partial agreement should reduce uncertainty surrounding taxation issues and allow businesses to plan with more clarity, and we expect it will be positive for investor sentiment. The partial agreement should moderate the fiscal cliff’s impact on economic growth; although there is the potential for significant further slowing should politicians fail to reach an agreement on spending cuts prior to the March deadline. We believe that the considerable liquidity provided by central banks should help to offset some of the remaining fiscal drag. Growth in the U.S. is likely to be modest in the first two quarters as it addresses these fiscal issues, but should pick up in the second half of 2013. We continue to be heartened by the recovering housing sector and believe that the U.S.’s increasing energy self sufficiency will also be a boon for the economy.

Continuing Low Yields
As high levels of sovereign debt continue to exert pressure on global economic growth, we expect central banks will maintain their accommodative stances, which will allow abundant liquidity. Persistent low rates will continue to benefit borrowers as businesses and homeowners refinance debt at attractive rates. However, with low rates unable to sustain purchasing power, investors will be pushed further out the risk curve in order to achieve their financial goals. As such, we believe the transfer of wealth from savers to borrowers will carry on through 2013.

Corporate Balance Sheets
Corporations that survived the 2008-09 financial crisis have streamlined and fortified their balance sheets, and many have either eliminated debt or refinanced it, taking advantage of historically low interest rates. In addition, many corporations are carrying high cash balances. We believe that this could lead to increased mergers and acquisitions activity in 2013 as companies look for ways to remain competitive and to increase shareholder value. During 2012, a record number of U.S. companies increased their dividends, and we expect companies will continue to return some capital to shareholders, in the form of both dividends and share buybacks. All of these should support the continued growth of financial assets.
What this Means for Canadian Investors

In spite of the plethora of doom-and-gloom headlines printed during 2012, both bonds and equities generated positive returns for the year. This highlights the need for investors to tune out the noise and focus on fundamentals. With central banks around the world remaining accommodative, our strategic outlook, which we have held for several years, remains consistent: we favour equities over fixed income.

**Equities:** Within equities, we prefer the stocks of high-quality companies that consistently grow their earnings and dividends. Regionally, we see particularly good opportunities in the U.S. and emerging markets. While equities were strong in 2012, valuations remain attractive from a historical perspective, and we anticipate continued good performance in 2013, supported by strong fundamentals and abundant liquidity. As central banks continue to print money and to buy the majority of the risk-free assets available, investors who want to protect and grow the real value of their savings must look further out the risk curve. We believe this will be positive for equities because it will continue to drive demand for relatively higher risk assets that offer the potential for higher returns.

**Fixed Income:** We expect government bonds will offer exceptionally low yields in 2013. Overall, we believe that government bonds will provide low single-digit returns, which may even be negative once inflation has been accounted for. Although yields on corporate bonds are also low, we maintain our preference for corporate bonds issued by high-quality companies over government bonds. The spreads over government bonds are appealing and the strength of corporate balance sheets continues to make them an attractive alternative. We currently view the fixed income component of portfolios less as an income and return generator and more as a safe haven that provides stability in times of market or economic volatility.

**Commodities:** As a result of lower levels of economic growth, near-term demand for commodities is likely to be muted—particularly in China, which has been a major commodity consumer. We believe gold will continue to provide a hedge against the risk of extreme market or economic outcomes.

**Currency Markets:** The competitive advantages that drove up the Canadian dollar over the past decade have been fully priced into its value, and we believe the Canadian dollar is currently fairly valued against the U.S. dollar. Supported by Canada’s fiscal strength, the dollar should continue to trade within a close-to-par range with its U.S. counterpart. As such, we believe there are diversification and return benefits to increasing the U.S. equity component within portfolios.

At TD Asset Management Inc., we believe our focus on quality and our determination to deliver the best possible solutions to our clients will continue to serve them well through 2013 and the future.

**Have a happy and healthy 2013!**

For more information, contact your Financial Advisor.