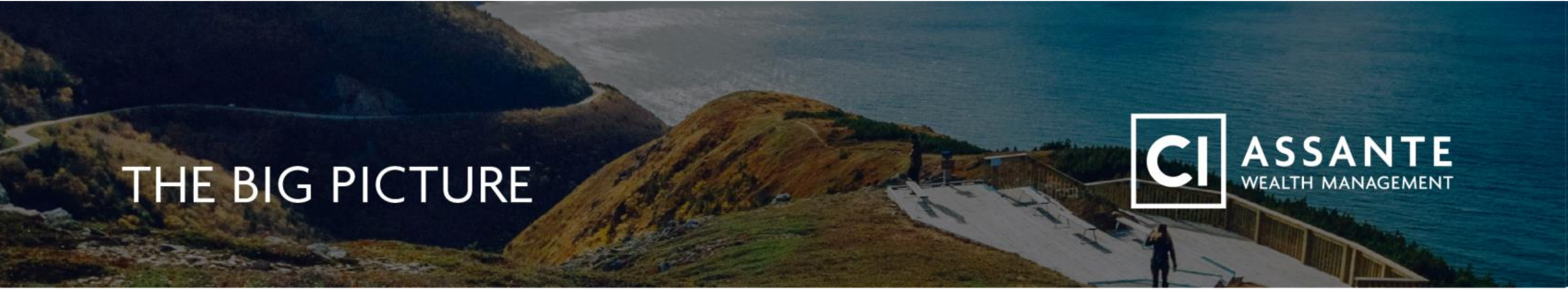

LOONIE STRENGTHENS; FUTURE UNCLEAR

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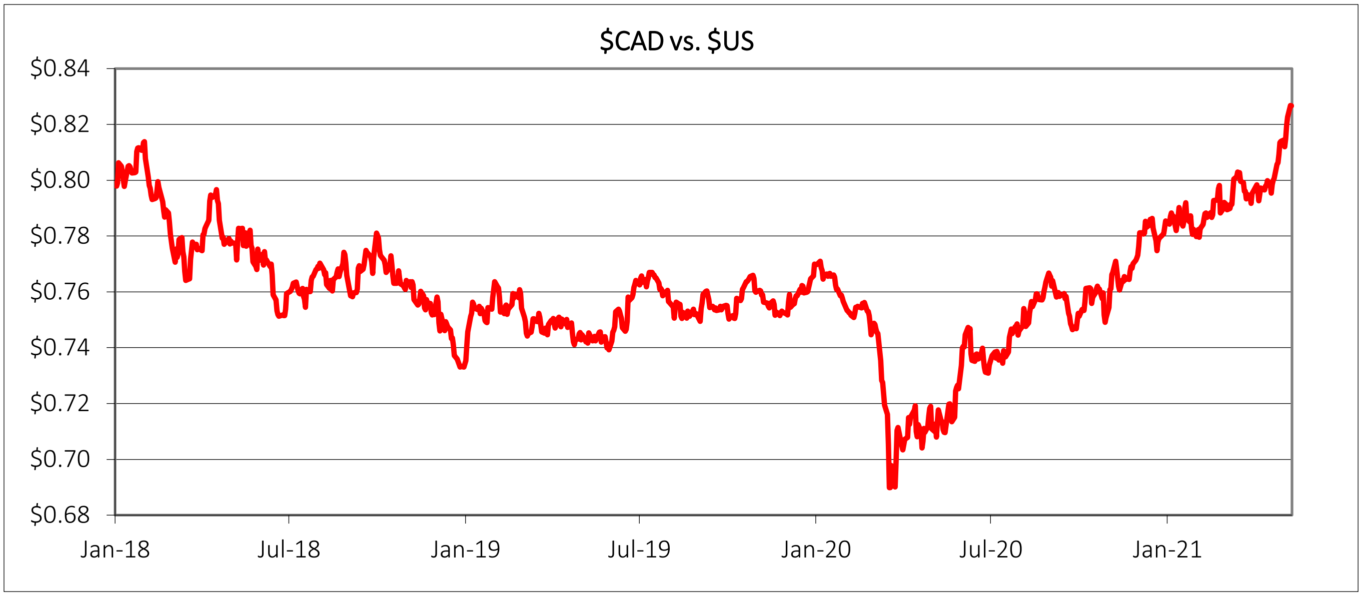
The initial spread of COVID-19 produced world-wide uncertainty. Over a brief period, the pandemic triggered a broad shutdown of many facets of the global economy and the resultant slump in real output was historic. Not surprisingly, investors' initial reaction to the pandemic was a traditional "flight to quality" as even mildly risky securities were sold off. At the same time, the Canadian dollar was caught up in a broad currency shift, with international investors favouring the "safe-haven" status of the U.S. dollar. With vaccinations proceeding at different rates in different countries, the pace of re-opening and economic recovery is expected to follow a similar disparate pattern. Still, expectations for a material pickup in global economic activity have provided support for commodity prices. Despite the evolution of the Canadian economy, natural resources are still closely linked to the value of the Canadian dollar and material strengthening has been apparent. In addition, a return to stronger economic growth has also raised concerns that inflationary pressures will build and central banks will be forced to raise interest rates. For investors, the shifting value of the loonie can provide both risks and opportunities. Further, holding onto the recent currency gains may prove to be challenging for the Canadian dollar as market participants look to gauge the relative fiscal health of national balance sheets around the world. Taking advantage of professional advice and sticking to a financial plan can help calm emotions even during periods of uncertainty.

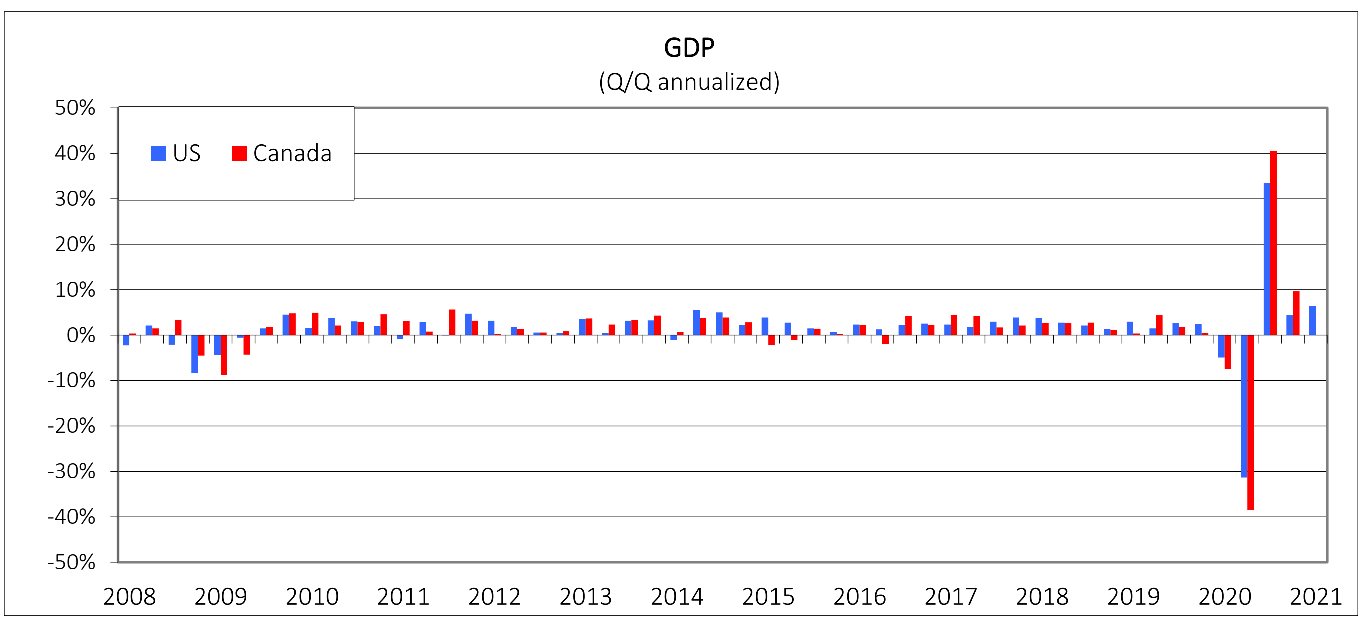
RECESSION AND RECOVERY

As outlined in the graph below, on December 31, 2019 - before the onset of the pandemic - the Canadian dollar traded to a peak at US$0.7720. However, as uncertainty over the health and economic implications of COVID-19 began to spread, the currency saw heavy selling pressure in international markets. By March 19, 2020, the Canadian dollar had quickly lost nine cents (11.7%), touching US$0.6818, its weakest level since April 9, 2003. This was considerably weaker than the low of US$0.7653 seen on March 9, 2009 during the financial crisis. As world governments shuttered their respective economies in response to the global pandemic, activity and output plummeted.



Source: Bank of Canada

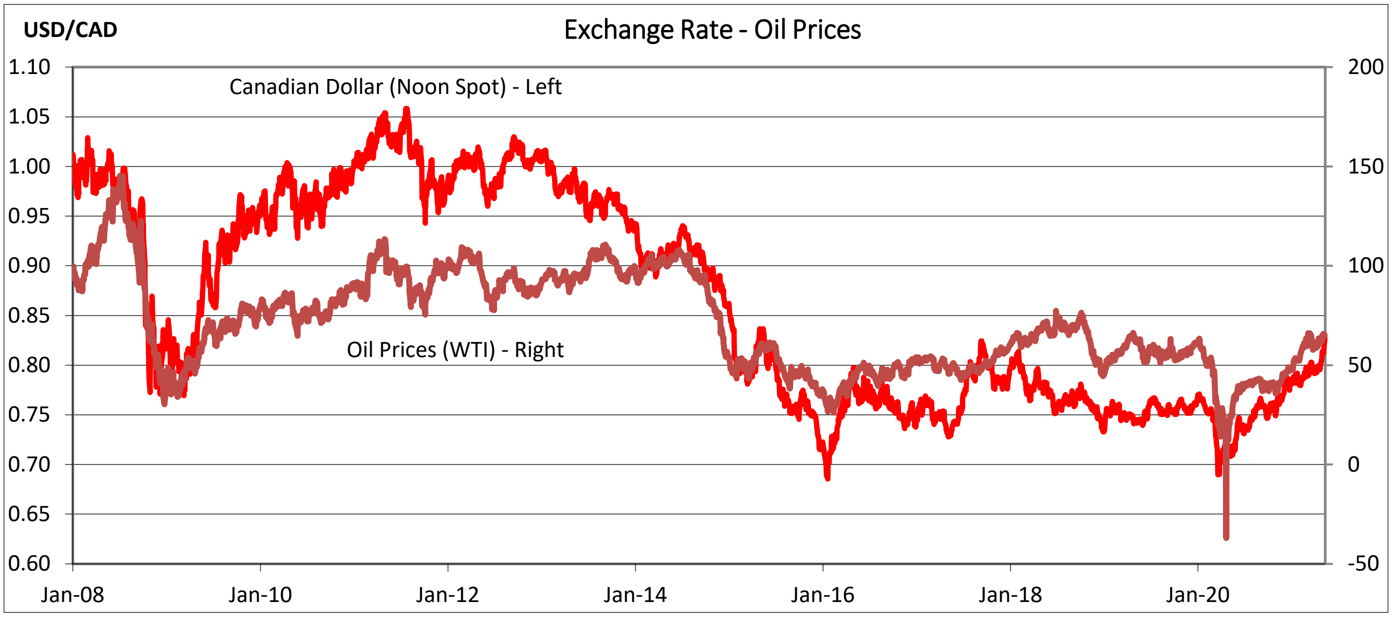
As can be seen in the graph below, the recessions experience in Canada and the U.S. dwarfed the economic retreats witnessed during the 2008-2009 financial crisis. Canadian real gross domestic product (GDP) declined by 7.5% and 38.5% (both annualized) in consecutive quarters, resulting in a cumulative 13.1% drop in the first half of 2020. This was considerably deeper than the cumulative 4.4% retracement seen during the financial crisis and stands as the sharpest recessionary decline on records dating back to 1961. Similarly, south of the border, the historic cumulative 10.1% decline in economic output seen during the first two quarters of 2020 was far greater than the 4.0% loss in output during the financial crisis. In both countries, the initial recovery from the recession was equally dramatic. U.S. GDP surged an annualized 33.4% in the third quarter of 2020. In Canada the gain was 40.6%. However, uneven rollouts of vaccines and heavier caseloads during the third wave are expected to continue to produce differing rates of growth in the two countries.



Source: Statistics Canada; U.S. Bureau of Economic Analysis

COMMODITIES

Due to a long history of resource-based economic development, the Canadian dollar has often moved with the prices of its natural resources. Recent data show Canada as having the world's third largest proven oil reserves[1] following Venezuela and Saudi Arabia. As can be seen in the graph below, the relationship between oil prices and the loonie has been particularly robust.

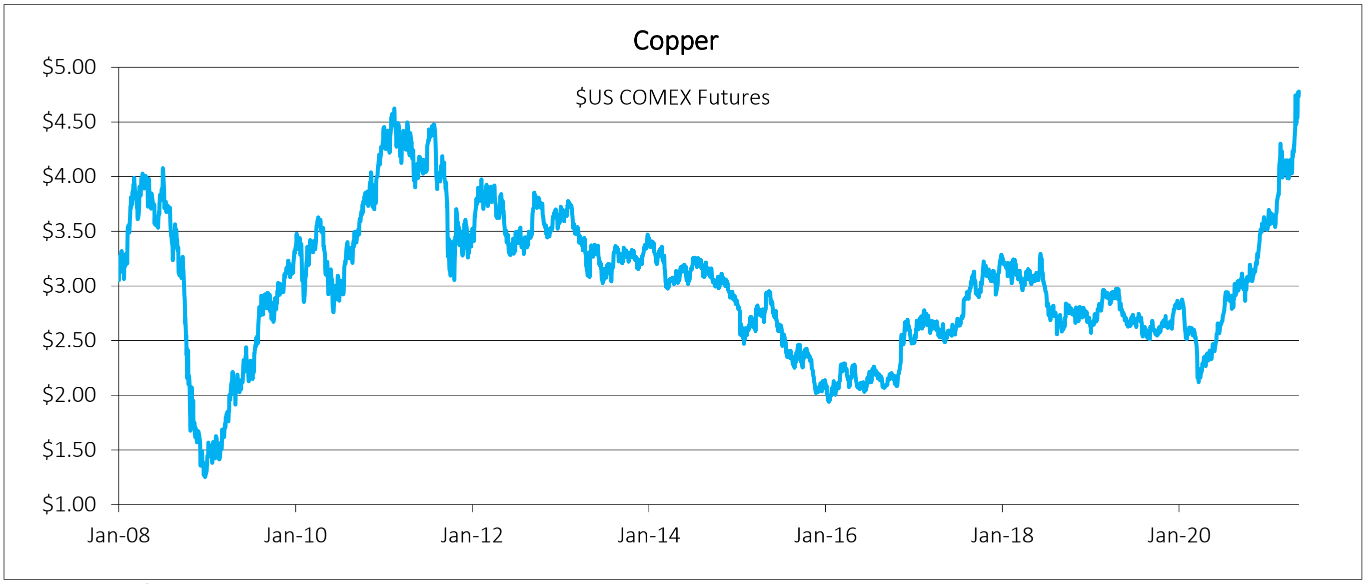


Source: Bank of Canada; U.S. Energy Information Agency

In the early days of the pandemic, the coupling of a steep decline in energy demand with an all-out price war among producers, was sufficient to drive oil prices into negative territory for the first time on record. Benchmark West Texas Intermediate (WTI) hit a spot price of -US$36.98 on April 20, 2020, which meant that ***sellers*** were willing to pay ***buyers*** nearly US$37 per barrel to take the oil off of their hands. Since that time, expectations that the pending economic rebound will drive increased use of traditional fossil fuels (at least until they can be more easily substituted out) have become entrenched within the market. From these historic lows, WTI moved above US$66 in March 2021. This is the first time WTI has scaled these heights in more than two years. Similarly, the Canadian dollar traded to US$0.80 on February 25, 2021 for the first time since February 16, 2018. While world energy prices are correlated with the Canadian dollar, demand for other natural resources can be expected to support the currency through the various stages of an economic rebound. The recent reawakening of global economic activity has prompted a surge in world copper prices. In addition, Chile, the world's largest copper producer, recently introduced legislation that would see a progressive tax that could produce a burden of up to 80% on production prices. Not surprisingly, as can be seen in the graph below, the news pushed copper futures prices to a record US$4.90 per pound on May 10, 2021. While Canada is typically ranked just outside of the top ten global copper producers[2], rapidly rising demand will foster increased production. Perhaps not coincidentally, the Canadian dollar moved to US$0.8277 on the same day, the highest since September 8, 2017.

[1] U.S. Energy Information Agency – beginning of 2020.

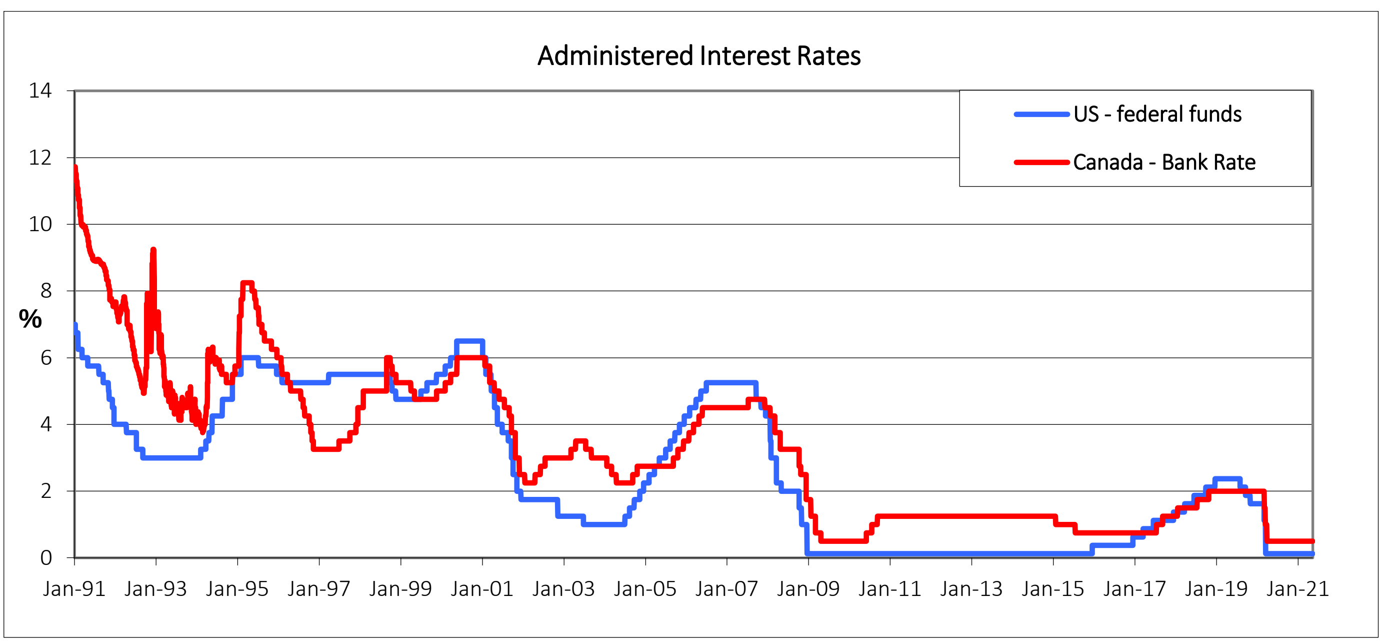
[2] 2019 Canadian copper production totalled 543,600 tonnes (Statistics Canada).



Source: Commodity Systems Inc.

INTEREST RATES

Most of the period between the financial crisis and the COVID-19 pandemic was characterized by concerns over deflation. However, as the North American economies have reopened, concerns over inflationary pressures have resurfaced. April 2021 data from Statistics Canada showed that the consumer price index (CPI) had recorded a 3.4% increase over a twelve-month period. This is now the highest rate of inflation since May 2011 (3.7%) and represents a material change from the 0.4% year-over-year **decline** reported in May 2020. In the U.S., the Bureau of Labor Statistics reported a 4.2% annual growth pace for CPI in April 2021. This is also a dramatic shift from the 0.1% year-over-year advance seen in May 2020 and is the fastest pace of inflation since September 2008 (4.9%). Even though both the Bank of Canada and the U.S. Federal Reserve have been clear that they do not intend to raise interest rates any time soon, as the graph below shows historically low interest rates cannot be expected to persist indefinitely. The question of how much inflation can and will be tolerated remains unanswered.



Source: Bank of Canada; U.S. Federal Reserve

In addition, the large and growing government debt raises red flags for those investors who recall the period of the early 1990s. While the U.S. currency enjoyed and still enjoys its status as a reserve currency, and its debt market reflects that, the Canadian dollar shares no such status. When Canada's debt situation became untenable in the early 1990s the differences in U.S. and Canadian interest rates, even for administered interest rates, widened dramatically. In the wake of the financial crisis, European debt problems gave rise to the derogatory acronym PIIGS[3] for the nations that represented the largest investment risks. The aftermath of COVID-19 can be expected to produce similar international debt uncertainties, however, this time around it may be Canada that finds itself within an unfavorable acronym. A string of federal budget surpluses between fiscal 1997-1998 and 2007-2008 allowed Canada's debt to GDP to fall from 66.6% in 1995-1996 to 28.2% in 2007-2008. Since the most recent surplus in 2015-2016, consecutive deficits, even as the economy expanded, raised debt to GDP to 31.3% before the pandemic hit. The recently tabled budget revealed a debt-to-GDP figure of 49.0% for 2020-2021 and 51.2% for 2021-2022. The budget forecasts an improvement only to 49.2% by 2025-2026. It remains to be seen how these figures stack up compared to other nations and whether they are good enough for investors.

CONCLUSIONS

- Uncertainties and volatility in the currency market raises investment concerns and opportunities. Seeking professional advice can help alleviate these fears while making the most of longer-term investing prospects.
- The post-pandemic recovery will be uneven from an international perspective. Having a well-diversified portfolio with regular rebalancing will ensure that investors will participate in the better performing markets and regions.
- Long-term investors will recognize some of the forces that have moved the Canadian dollar through a wide range of valuations over the years. As always, it will be the broader international markets that will either bid up or bid down the currency.

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[3] PIIGS nations were Portugal, Italy, Ireland, Greece, and Spain