INDUSTRIAL ALLIANCE INVESTMENT MANAGEMENT INC.

Market Commentaries

November 1, 2018

Turbulence in the stock markets

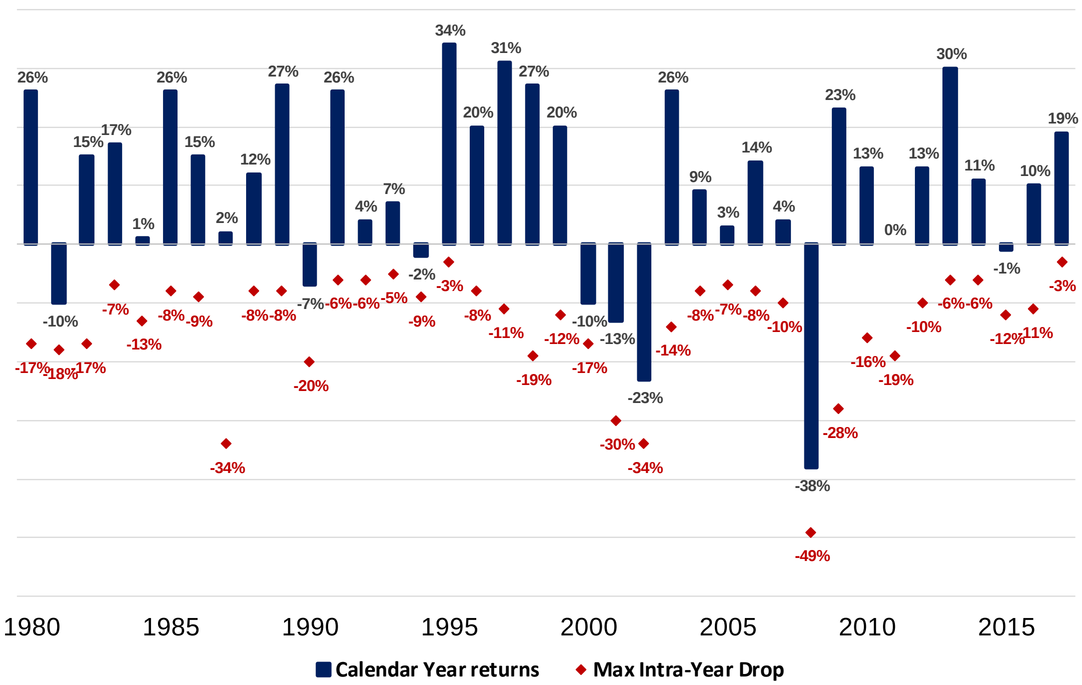
Comments from our chief economist, Clément Gignac

October, which just ended, was marked by a high level of volatility on all stock markets with several indices having recorded corrections of more than 10% during the month. The reference indices of Bay Street (S&P/TSX) and Wall Street (S&P 500) fell by 6.5% and 6.9% respectively, eliminating in the latter case almost all gains collected since the beginning of the year.

This is the second time this year that the U.S. stock market is in "correction mode", which is defined by a decline of more than 10% since its most recent peak. Although painful for some investors, such volatility is not abnormal on a historical basis. As can be seen in the chart below, we can have a successful year on the stock market in terms of returns, even with intra-year reversals that exceed 20%.

Stock market corrections are normal

S&P 500 intra-year declines vs. calendar returns (1980-2017)



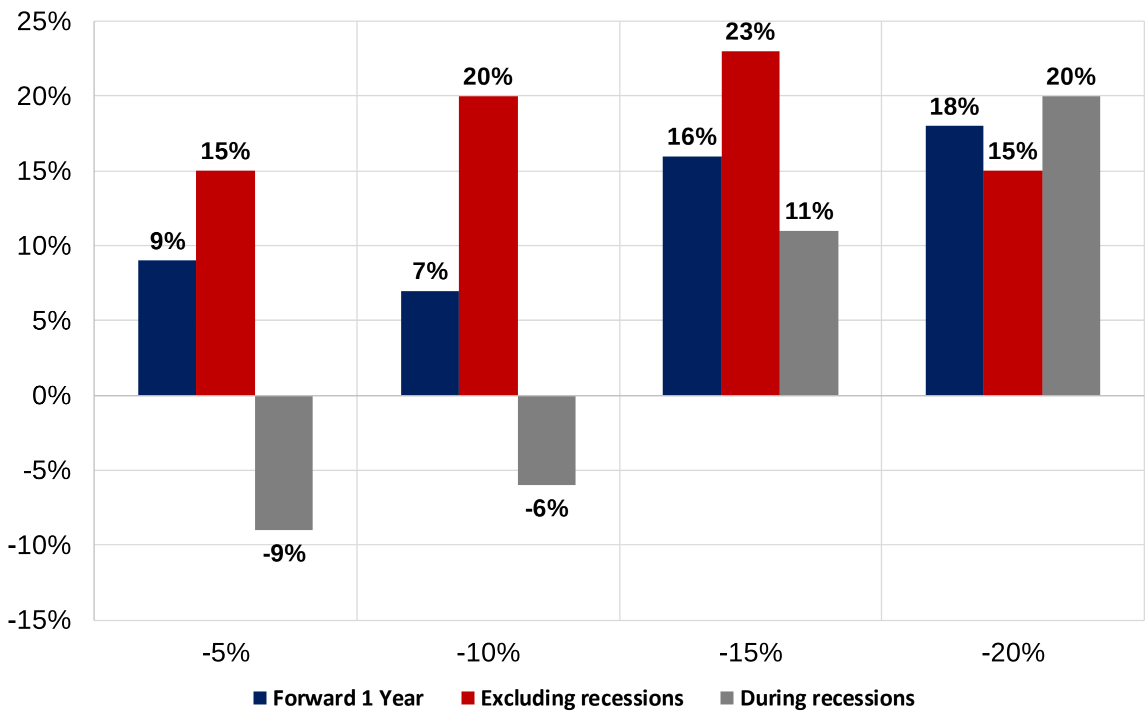
Sources: iAIM, JP Morgan, Bloomberg, as of December 31st, 2017

The anomaly was rather the absence of volatility that prevailed on the stock markets from mid-2016 to January 2018. For example, for all of 2017, the worst decline was limited to 3%, a situation last observed more than twenty years ago.

In our opinion, this type of correction may represent a buying opportunity for investors with a medium to long-term horizon, as the likelihood of the North American economy falling into recession is low. Based on historical data, returns recorded during the 12 months following a stock market correction can be very interesting in the context of an extended economic cycle (see chart below).

History would suggest investors can profit from market declines

Average 1-year forward return following corrections (1987-2017)



Sources: iAIM, Bloomberg, as of January 31st, 2018

Investors suddenly worried about interest rate normalization and trade tensions

While we are likely to see a slowdown in economic growth in coming quarters, as the effects of tax reform begin to ease, there is every indication that the world's largest economy will continue to perform well. Leading indicators still do not signal that a recession is upon us.

In fact, one of the pillars of our strategy is the fact that, in the past, the end of all bull markets has generally coincided with the beginning of a recession. For the moment, almost all leading economic indicators signal that the economic cycle should continue for a few more years: business and household confidence is high, the labour market is creating close to 200,000 jobs per month on average, and wage growth is well established, pushing household income up, to name just a few.

Other financial indicators also suggest that the current episode of volatility is limited to a revaluation of stock markets. We note that corporate credit spreads remain narrow, government interest rates have not fallen sharply and the U.S. dollar has not strengthened significantly (three typical symptoms of a concern about the longevity of the business cycle).

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The observed return of volatility is probably more related to the tightening cycle of monetary policy in North America.

When the Fed raises its key rate, there are usually two phenomena: 1) volatility in the markets increases and 2) the valuation of the stock markets, as measured by the price-to-earnings ratio, contracts (i.e.: investors are willing to pay less to invest in the markets, despite corporate earnings growth that remains positive).

Another element that has added to prevailing uncertainty is the Trump administration's decision to bring its trade war agenda to the forefront.

Let's keep in mind that the trade relationship between China and the U.S. accounts for only 3% and 1% of their respective economies. According to Oxford Economics, even in the worst-case scenario, the impact of massive tariffs between China and the U.S. is expected to be limited to about 1% of the global GDP, an impact certainly significant but not enough to lead the global economy into recession.

How to navigate the current markets

The upward trend in interest rates makes the October market correction more significant than usual for investors with a balanced investment strategy (60% in equities and 40% in bonds). Contrary to their typical behavior, bonds did not come to the rescue this time around thanks to Fed Chair Jerome Powell's early October declaration that he intended to continue the standardization of interest rates. Thus, a Canadian balanced index fund (60% in equities and 40% in bonds) suffered from negative returns in October 2018, which ranks among the four most disappointing months since January 2008.

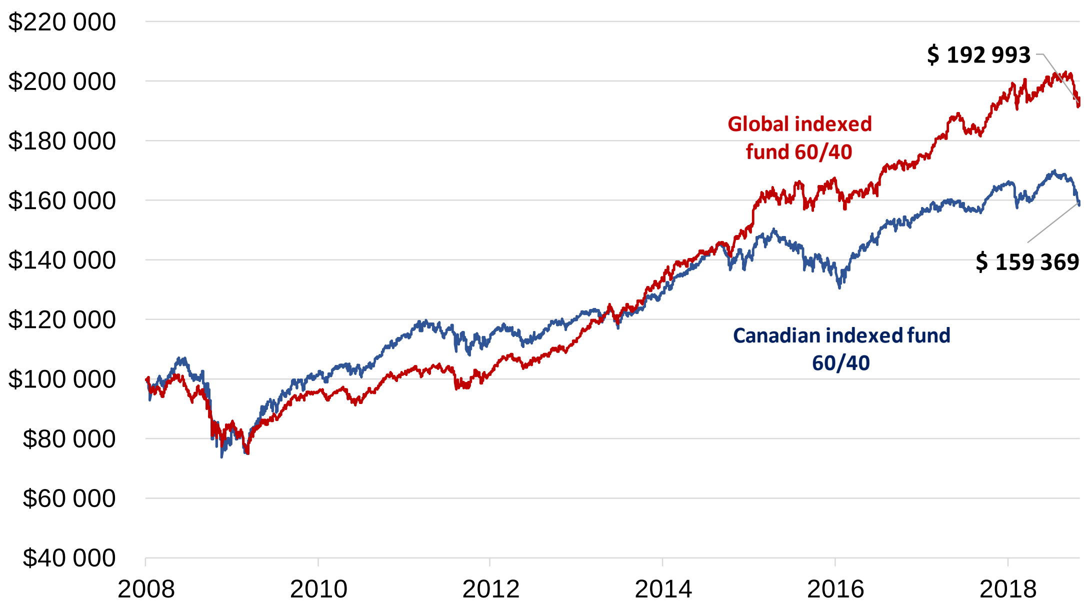
Worst monthly returns* for a Canadian balanced strategy (60/40) since January 2008	%	Worst monthly returns* for a global balanced strategy (60/40) since January 2008	%
October 2008	-10.34%	September 2008	-8.02%
September 2008	-9.45%	October 2008	-5.90%
September 2011	-4.47%	January 2009	-4.65%
October 2018	**-4.01%**	February 2009	-4.43%
February 2009	-3.51%	June 2008	-3.76%
July 2008	-3.15%	May 2010	-3.65%
June 2008	-3.06%	**October 2018**	**-3.65%**

* Total returns. Source: iAIM

A second observation is that in the long term, it is always more profitable to remain invested in the markets than to panic during stock market corrections. The performance of such strategies since the beginning of the current economic cycle remains acceptable (see graph below).

Evolution of a balanced portfolio since January 2008

Canadian and global 60/40 portfolios, January 2008 = $ 100 000*



* Portfolios composed of 60% equities and 40% bonds. Canadian funds constructed with S&P/TSX Composite Index and FTSE TMX Canada Universe Bond Index. Global funds constructed with MSCI ACWI Index (CAD) and Barclays Global Aggregate Index (Hedged CAD). Gross total returns.

Sources: iAIM, Bloomberg

We continue to anticipate that the bull market will continue over the next 12 to 18 months but that a volatility more aligned with historical experience would become the norm.

In conclusion, although it is always difficult to anticipate the turning points of economic and stock market cycles, we believe that there is still enough gas in the tank to make this recent decline a buying opportunity for investors with medium and long-term investment horizons.

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About Industrial Alliance Investment Management Inc. ("iAIM")

iAIM is a wholly owned subsidiary of IA Financial Group ("iA"). Its responsibilities include the portfolio management of iA's general funds, segregated funds and mutual funds including external manager oversight. Its assets under management exceed 78B$ and employs close to 140 resources including more than 100 investment professionals.

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