Market Matters

2015 Highlights

- In local currency terms, major global equity markets did not have a good year (see table 1).
- Diverging central bank action, the pricing of credit risk within fixed income instruments, moderating global growth, low oil prices and geopolitical concerns were the dominant market themes in 2015.
- Crude oil (West Texas) ended the year at US$37.04/barrel, down 30% this year, and has averaged a touch under US$49/barrel in 2015.
- The impact of weaker commodities negatively impacted the economies (and stock markets) of resource-based countries, such as Canada among developed nations, and Brazil and Russia among developing nations.
- Dramatic moves in currencies affected stocks, bonds and financial markets throughout the world. Headline-grabbers included the Swiss removing the franc's peg to the euro, the Chinese devaluing the Yuan, and the Canadian dollar weakening sharply alongside the price of oil.
- The weakening Canadian Loonie meant that foreign equity results translated back into Canadian dollars experienced a significant boost to returns.
- Canadian fixed income investors managed low single digit returns. Mid and long term bonds performed well, while corporate bonds lagged slightly as credit spreads widened (particularly at the low quality end of the scale).

WHO TICKED-OFF SANTA?

Alright, who did it?! December market gains (often referred to as the "Santa Rally') occur a whopping 74% of the time (since 1928, source: GLC, Bloomberg). But clearly 26% of the time Santa is not happy; he refuses to show up and markets decline – such was the case in December 2015. Adding to a difficult 2015, major global indices declined in December, with a weak Energy sector creating a drag on results around the world. And for those of you on Santa's naughty list (you know who you are), that lump of coal in your stocking lost 11% of its value in 2015 (generic thermal coal, Central Appalachian futures, source: Bloomberg). Could have been worse though…could have been oil!

OIL TANKS

2015 will be remembered least fondly by commodity-tied countries, companies, and of course, commodity investors. After stabilizing in the third quarter of 2015, oil got comfortable in the $30's and briefly dipping below $35/barrel in December after OPEC's refusal to cut production. The overriding reasons behind the dropping oil prices were the same throughout much of 2015: no producer willing to cut supplies, and fears of slowing demand from slowing global growth (i.e. the world is awash with oil). Other resource values suffered too. Concerns about global growth (more specifically Chinese growth) have weighed on the basic materials sector, and precious and base metals have also struggled, with gold and copper down 10% and 25% respectively this past year (see table 2).

Table 1
Summary of major market developments

Market returns*	December	Q4 2015	YTD
S&P/TSX Composite	-3.4%	-2.2%	-11.1%
S&P 500	-1.8%	6.5%	-0.7%
- in Canadian dollars	***1.7%***	***9.9%***	***18.2%***
MSCI EAFE	-2.8%	6.0	2.7%
- in Canadian dollars	***2.1%***	***7.7%***	***15.1%***
MSCI Emerging Markets	-1.3%	-1.1%	-8.0%
FTSE TMX Canada Universe Bond Index**	1.1%	1.0%	3.5%
FTSE TMX Canada all corporate bond index **	0.6%	0.6%	2.7%

*Local currency (unless specified); price only
**Total return, Canadian bonds

Table 2
Other price levels/change

	Level	December	Q4 2015	YTD
U.S. dollar per Canadian dollar	$0.723	-3.4%	-3.8%	-16.0%
Oil (West Texas)*	$37.04	-11.1%	-17.9%	-30.5%
Gold*	$1,062	-0.2%	-4.7%	-10.6%
Reuters/Jefferies CRB Index*	$176.27	-3.4%	-9.0%	-23.3%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX sector returns*	December	Q4 2015	YTD
S&P/TSX Composite	-3.4%	-2.2%	-11.1%
Energy	-5.6%	-2.6%	-25.7%
Materials	-2.4%	3.1%	-22.8%
Industrials	-4.6%	-1.6%	-12.5%
Consumer discretionary	-5.7%	-5.7%	-3.5%
Consumer staples	-0.3%	0.5%	11.0%
Health care	14.5%	-36.9%	-15.8%
Financials	-3.5%	0.6%	-5.5%
Information technology	1.0%	10.3%	14.8%
Telecom services	-7.7%	-2.8%	-1.0%
Utilities	1.8%	-2.6%	-7.8%

*price only
Source: Bloomberg, MSCI Barra, NB Financial, FTSE TMX Global Debt Capital Markets Inc.

Looking for a silver-lining? For investors within a diversified portfolio consisting of both domestic and foreign equities, Canada's weak oil-linked dollar versus most major currencies meant that the currency exchange worked strongly in the favour of Canadian investors who held foreign equities, particularly American equities. Currency moves alone contributed a near 20% gain for the S&P 500 in 2015 on a Canadian dollar basis (see table 1). For the record, we do not anticipate a move of similar magnitude in 2016.

EQUITIES IN 2015

2015 Canadian corporate earnings were derailed by the collapse in energy prices. The S&P/TSX Composite fell 11% with the losses heaviest in the resource and industrial sectors (see table 3). It was also a very volatile year for the health care sector, in particular for Canada's pharma giant Valeant Pharmaceuticals who's soaring results dramatically reversed course when pricing practices came under scrutiny and criticism.

While energy prices weighed on index-level earnings in the US as well, US equities fared better than Canada. Though the year ended slightly down on a price-only basis, US equities were helped by a US consumer on solid footing and secular strength in the information technology and health care sectors.

Outside of North America, European equities benefitted in 2015 as economic growth improved at the margin, a Greek exit of the European Union was avoided, and the European Central Banks (ECB) opened the stimulus taps in an attempt to avoid deflation and support economic growth. Unfortunately, expectations ran ahead of reality late in the year as the ECB was unable to satisfy investors high expectations for the December 3rd ECB meeting. Since a major stimulus boost was already being priced in, its failure to arrive sent bond and equity markets selling off sharply into the year-end as markets readjusted to the actual policy path.

Emerging markets struggled during 2015 on the heels of a stronger U.S. dollar and commodity price declines. Low commodity prices weighed on commodity-producing countries, in particular Russia and Brazil. The constant debate about the direction of Chinese growth and the surprise devaluation of the Yuan played havoc on sentiment toward emerging markets in general.

HISTORY ON OUR SIDE

2015 marks the fifth straight year that Canadian equities underperformed US equities. History would tell us that next year should be better. According to data compiled by BMO Capital Markets the S&P/TSX Composite has never underperformed the S&P 500 for six straight years.

FIXED INCOME IN 2015

Canadian bond markets saw low single-digit returns in 2015. Over the course of 2015 Canadian interest rates fell modestly along the yield curve. Rates in Canada were pushed lower on the back of two interest rate cuts by the Bank of Canada during the year and a struggling economy suffering from the ill effects of significant declines in commodity prices. Meanwhile the US Federal Reserve finally took the step of raising rates by 25 basis point, 7 years since their last rate move. The move was widely anticipated and much of it was already priced into the bond markets.

A NOD TO ACTIVE PORTFOLIO MANAGEMENT

2015 has been referred to as a 'stock-pickers' year, meaning that it was likely a much stronger year for investors using professional portfolio managers who pursue active management strategies. During volatile markets, in which avoiding the 'bad' stocks is as important as selecting the 'good' ones, it takes experienced portfolio managers with conviction along with robust and disciplined processes to guide stock selection and manage portfolio risk. Of particular note, GLC's core Canadian equity and core balanced portfolios exemplified this benefit and significantly outperformed their respective benchmarks for this very reason in 2015.

A GRUMPY NEW YEAR BABY

First Santa got upset, now the New Year's baby is out of sorts. 2016 capital markets have started out with significant drama and volatility, largely resulting from ongoing Chinese growth concerns, escalating geopolitical concerns with North Korea and tensions between Saudi Arabia and Iran. A flight to safety has meant more weakness in risk assets (i.e. equities and commodities).

While we see a number of challenges facing capital market investors in 2016, we see opportunity as well; particularly should we see some stabilization in commodity prices (especially oil) and moderating strength in the US dollar, as this should improve sentiment significantly. Should those conditions materialize, we anticipate opportunities within the resource sectors, and we maintain our view that within the Canadian equity landscape, Canadian banks continue to offer an attractive risk/reward trade-off. We also expect modestly rising yields in the US with Canadian yields pulled along to a lesser degree. Within this context we continue to advocate for a diversified portfolio for investors, but would remain underweight bonds (relative and within personal risk tolerances). Our base case is to maintain a tilt in favour of equities given our return outlook and the relative attractiveness of equities versus bonds. Within corporate bonds we favour high-quality investment grade companies.