

Market Matters

JULY 2017 HIGHLIGHTS

- Global equity markets continued their upward momentum, with the Canadian market (once again) lagging behind.
- Emerging markets showed continued strength versus their developed markets peers, aided by a weak US dollar and stronger commodity prices.
- Market volatility on the S&P 500 is at record lows.
- The Bank of Canada raised its interest rate by ¼% for the first time in nearly seven years to 0.75%.
- The Canadian bond market saw negative returns across sectors and maturity bands. Shorter-term and corporate bonds performed best. Corporate bonds were helped by higher relative yields and narrowing spreads, while shorter-term bonds are less interest-rate sensitive.
- Commodity prices (e.g. oil, gold, copper) and the Canadian dollar strengthened in value over the month.

EASY-BREEZY DAYS

In the easy-breezy days of summer, most market trends simply carried on from the previous month, while market volatility remained at low levels.

Even the stock markets are taking it easy for the summer! The record breaking low levels of S&P 500 market volatility (as measured by the VIX Index) are starting to garner some attention. The low level of the VIX have some worried that complacency is sowing the seeds for a market pullback, but at this point it is hard to say what is behind the lull in market swings.

Broadly positive economic data and strong earnings results helped keep upward momentum for European and American stocks, while emerging market equities continued to outperform their developed market peers by benefitting from a weaker US dollar and strengthening commodity prices. The Canadian market ended the month close to flat and continues to significantly lag its international market peers in 2017.

| Table 1 Summary of major market developments | | |
|---|-------|-------|
| Market returns* | July | YTD |
| S&P/TSX Composite | -0.3% | -0.9% |
| S&P 500 | 1.9% | 10.3% |
| - in Canadian dollars | -2.0% | 2.4% |
| MSCI EAFE | 0.6% | 6.4% |
| - in Canadian dollars | -1.1% | 6.8% |
| MSCI Emerging Markets | 4.4% | 18.7% |
| | | |
| FTSE TMX Canada Universe Bond Index** | -1.9% | 0.4% |
| FTSE TMX Canada all corporate bond index** | -1.4% | 1.4% |

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

| Table 2 Currency and Commodities (in USD, % change) | | | |
|---|----------|------|-------|
| | Level | July | YTD |
| CDN\$ | \$0.801 | 3.8% | 7.2% |
| Oil (West Texas)* | \$50.17 | 9.0% | -6.6% |
| Gold* | \$1,268 | 2.0% | 9.6% |
| Reuters/Jefferies CRB Index* | \$182.64 | 4.5% | -5.1% |

| Table 3 Sector level results for the Canadian market | | |
|---|-------|--------|
| S&P/TSX Composite sector returns* | July | YTD |
| S&P/TSX Composite | -0.3% | -0.9% |
| Energy | 2.0% | -13.0% |
| Materials | 1.7% | 0.4% |
| Industrials | -4.0% | 6.4% |
| Consumer discretionary | -2.8% | 7.9% |
| Consumer staples | -3.2% | 0.4% |
| Health care | -5.2% | -3.9% |
| Financials | -0.1% | 0.6% |
| Information technology | -1.1% | 7.8% |
| Telecommunication services | 1.5% | 6.9% |
| Utilities | -2.1% | 5.5% |
| Real Estate | -2.4% | 0.9% |

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

STICKING WITH FUNDAMENTALS

Like nearly every month in the past year, President Donald Trump and the state of US politics have dominated headlines, but notably, politics has had much less effect on capital markets of late. In spite of the colourful cast of characters and significant staffing shake-ups within President Trump's administration, market watchers are choosing to act more like BNN than TMZ, and sticking with solid stock fundamentals (such as corporate earnings and sales results) to drive their confidence in capital markets. As a result, the S&P 500 gains can largely be tied back to strong corporate earnings and pleasingly strong sales results.

Where politics and policymakers have played a role is in currency moves. Another failed attempt at American Health Care reform cast further doubt on the Republicans' pro-growth agenda and put downward pressure on the US dollar. In addition to political uncertainty in the United States, shifting monetary policy (the Bank of Canada raised rates in July and signaled more rate hikes to come), and strong economic results (Canadian GDP growth is on track to lead the G7 in 2017), have pushed the Canadian dollar higher.

DE-RAILED

Once again, the Canadian stock market lagged behind its peers, hovering just below the break-even point for both the month and the year-to-date results. While previous blame was rested squarely on the shoulders of the resource sectors, this was not the case in July. The Canadian market experienced a sector rotation in July. The industrial and consumer sectors had a significant pullback, while the materials sector gained ground and the energy sector led the way as the top performing sector – a noted reversal from the sharp declines experienced in the first half of the year.

On the downside, Canadian rail companies weakened in July. Both Canadian Pacific Railway and Canadian National Railway reported decent earnings numbers in July, but management guidance for future earnings was not up to analysts' expectations. The disappointment drove each stock's price down by approximately 6%.

The consumer sectors were also a drag on Canadian market performance. There was no overriding theme across the consumer staple and consumer discretionary sectors in July. Rather, a number of stock specific stories played out, such as Loblaw's profit-cutting concerns in light of Ontario's announcement to raise minimum wage.

To the upside, energy stocks were buoyed by rising oil prices. Oil prices closed July a smidge above USD \$50 (significantly up from June, but still down from the 2016 year-end price of USD \$53.72). Improving supply fundamentals for oil, such as falling inventory levels and production quota agreements, have eased some of the pricing pressure. A weaker US dollar was also a significant contributor to the higher price per barrel.

Within the Materials sector, copper prices (up 7% in July) boosted returns. Copper values were also aided by a weaker greenback, as well as the potential for increased Chinese demand.

TOUGH MONTH FOR CANADIAN BONDS

Bond yields rose in Canada across the board and the 10-year Government of Canada bond topped the 2% mark for the first time since November 2014. Tightening monetary policy (as earlier noted, the Bank of Canada raised its interest rate), a slew of strong Canadian economic data, and firmer oil prices are all putting upward pressure on yields. As yields rose, bond prices dropped, with the more interest-rate sensitive longer-term bonds losing the most ground.

Pretty much the only relief in the Canadian bond market came from credit products, like corporate and provincial bonds. Credit spreads narrowed and the relatively higher yield (compared to Government of Canada bonds) helped to offset some of the headwinds faced by fixed income products in a rising rate environment.

We appreciate that highlighting the 'best performing' bond sector is small comfort for a negative month. Losing money is never pleasant (though losing less is usually better!). While equity volatility is currently low, it is unlikely that it will remain so indefinitely - and then again we will see the stabilizing benefits of bonds within a diversified portfolio shine.

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