

Market Matters

MAY 2017 HIGHLIGHTS

- May was a strong month for global equity markets, but the Canadian market was the exception (see table 1).
- The VIX market volatility index dropped to levels not seen since January 2007.
- After 15 months of positive monthly total returns the S&P/TSX Composite turned negative, hampered by weakness from the resource sectors and the financial sector.
- The US S&P 500 hit seven new highs in May and closed the month above 2,400 for the first time.
- Canadian corporate bonds underperformed the broad based bond index for the first time since July 2016. Corporate bonds were hampered in part by a record volume of issuance in the month of May.
- The Bank of Canada, US Federal Reserve (Fed) and European Central Bank remained on hold in May. Expectations are now for the Fed to raise rates at their mid-June meeting.

SOME STREAKS END, OTHERS CONTINUE

While markets around the globe steadily booked gains, Canada's three largest sectors (the energy, materials, and financials sectors) lost ground and dragged the Canadian index into negative territory for the month. Note that these three sectors make up 66% of the S&P/TSX Composite weight. Commodity prices weakened in May, contributing to the poor performance of Canada's resource sectors. Oil prices dropped in spite of the Organization of the Petroleum Exporting Countries (OPEC) agreement to extend the cuts to its oil output through March 2018. Investors viewed this as less-than expected, having expected deeper and/or longer cuts, and oil prices declined (see table 2). The Canadian financial sector also weakened as interest rates moved lower (see table 3). May's negative Canadian equity market results put an end to a record 15 positive monthly total returns – the longest such run ever. As some streaks end, others continue.

Table 1 Summary of major market developments		
Market returns*	May	YTD
S&P/TSX Composite	-1.5%	0.4%
S&P 500	1.2%	7.7%
- in Canadian dollars	0.1%	8.2%
MSCI EAFE	1.5%	6.7%
- in Canadian dollars	2.0%	12.8%
MSCI Emerging Markets	2.3%	12.3%
FTSE TMX Canada Universe Bond Index**	0.9%	3.6%
FTSE TMX Canada all corporate bond index**	0.5%	3.9%

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

Table 2 Other price levels/change			
	Level	May	YTD
CAD per USD exchange rate	\$0.741	1.1%	-0.4%
Oil (West Texas)*	\$48.32	-2.0%	-10.1%
Gold*	\$1,270	0.2%	10.1%
Reuters/Jefferies CRB Index*	\$179.77	-1.1%	-6.6%

*U.S. dollars

Table 3 Sector level results for the Canadian market		
S&P/TSX Composite sector returns*	May	YTD
S&P/TSX Composite	-1.5%	0.4%
Energy	-4.6%	-10.8%
Materials	-2.3%	3.0%
Industrials	3.2%	10.8%
Consumer discretionary	0.8%	11.5%
Consumer staples	-0.5%	7.1%
Health care	7.5%	-10.7%
Financials	-2.1%	-1.4%
Information technology	3.1%	14.1%
Telecommunication services	-0.4%	9.3%
Utilities	1.5%	7.6%
Real Estate	-0.3%	4.6%

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

Another page in the record book came from the volume of corporate bond issuance to the Canadian market in May – more than ever recorded for a month! A waterfall of nearly \$17 billion of debt came to market, sending Canadian corporate bond spreads wider and weakening corporate bond results. On a year-to-date basis, new bond issuance in Canada is tracking about 29% higher than last year, and on track for an overall record breaking year. For the first month since July 2016, corporate bonds underperformed the FTSE TMX Universe Bond Index.

Not only were corporate bond returns held back by the massive amount of new issuance coming to market, but there were also growing worries about Canada's residential real estate sector, mortgage market concerns associated with the liquidity woes of Home Capital Group, and renewed pressure on commodity prices. Moody's downgraded the Canadian banking sector during the month citing some of those very concerns, resulting in widening credit spreads and further weakening of Canadian corporate bond results. Canadian sovereign yields followed US yields in May – slightly higher at the short-end of the curve, and slightly lower at the mid to long end of the curve.

In central bank activity, the US Federal Reserve (Fed) took no action on interest rates, as was expected. Markets are currently expecting the Fed to raise rates at their mid-June meeting. The Fed also indicated that it would like to reduce its balance sheet as another way to reduce monetary stimulus, but was light on specifics.

FAANG-TASTIC FIVE

The S&P 500 posted seven new closing highs in May, closing the month above 2,400 for the first time. Helping to boost the US equity market, a string of very strong performance continues to come from the FAANG-tastic Five – Facebook, Apple, Amazon, Netflix and Google.

Most of this group have posted 30%+ returns on a year-to-date basis, with only Google (now called Alphabet) falling below that level with a 24%+ return thus far in 2017. On a year-to-date basis, the quintet account for roughly a third of the S&P 500's total return. Earnings growth continues to be strong for the tech-savvy corporate giants, and their combined market cap is now above a mammoth \$2.4 trillion. For perspective, that makes the group bigger than the market cap for each of the French CAC 40, Germany's DAX, and Canadian S&P/TSX Composite equity indices.

CALM AND COOL

There was much for newsmakers to chew on in May (e.g. European elections, terrorist attacks, the firing of F.B.I. Director Comey, increased tensions over North Korea's missile testing, US disaccord over the Paris Climate Accord). In spite of this, most equity markets stayed calm and cool throughout the month. Good corporate earnings, positive forward guidance from companies, and strong economic data provided solace to investors. For the month of May, the VIX index (a measure of US equity market volatility) traded below 10, at levels not seen since pre-global financial crisis in January 2007. This compares to the height of the global financial crisis when the VIX was just below 90 in October 2008. For more recent context, consider that the night of the US election in November 2016, the VIX hit 23.

MORE THAN MEETS THE EYE

For Canadian equities, it's no fun being an outlier when your global equity market peers are experiencing solid positive returns. So it's worth noting that there was very positive news released in May on the Canadian economy. Canada's economy accelerated in the first quarter of 2017 with real GDP growing at 3.7% annualized on the back of strong housing activity, consumer spending and a rebound for business investment. Compare this with the Q1 annualized GDP results for the US at 1.2%, eurozone at 2.4%, UK at 0.7%, and Japan at 1.0%. Canada's Q1 GDP results follow two prior quarters of decent growth, and Canada's pace of economic growth is handily beating that of other major economies.

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