October 2017

Market Matters

Q3 2017 Highlights

- Global equity markets continued a steady march upward and onward.
- Bond markets weakened as interest rates rose.
- The Bank of Canada raised interest rates twice during the quarter, while the US Federal Reserve and the European Central Bank held rates steady.
- Oil prices rose back above $50 US. Tighter supply levels and increased demand arising from synchronized global growth provided the stimulus.
- In spite of significant global and geopolitical events that took place over the quarter, stock market volatility remained remarkably low.
- After lackluster performance in the spring and summer, the S&P/TSX Composite rebounded in September.
- Higher oil prices boosted the Canadian energy sector, and higher interest rates boosted the Canadian financial sector.

PLAYING IT REALLY COOL

While equity markets steadily moved onward and upward this quarter, the 'big news' for stock markets was…that news didn't seem to matter.

Consider the following significant events that occurred this quarter with little discernible effect on market sentiment:

- Civilian attacks, heightened geopolitical tensions, military posturing, and verbal confrontations between the leaders of North Korea and the United States barely caused a shudder for stock markets.
- Markets hardly paused while a massive earthquake rattled Mexico and a triple hit of hurricanes devastated the Caribbean and southern American states.
- The U.S. Federal Reserve announced it will start shrinking its swollen balance sheet, and received the market reaction equivalent to a collective yawn.
- Washington's string of political rhetoric and NAFTA renegotiations failed to get markets excited.

And so, the low volatility days of 2017 continued. So far this year only 4% of trading days for the S&P 500 have seen a move greater than +/-1%, and we've yet to see a move of greater than +/-2% at all. These low levels of volatility are well outside of historic norms. On average, (over the past decade) a typical year sees roughly 25% of days with a +/-1% move and 7% with a +/-2% move.

Table 1
Summary of major market developments

Market returns*	September	Q3 2017	YTD
S&P/TSX Composite	2.8%	3.0%	2.3%
S&P 500	1.9%	4.0%	12.5%
- in Canadian dollars	*1.6%*	*-0.1%*	*4.4%*
MSCI EAFE	2.4%	2.8%	8.6%
- in Canadian dollars	*1.9%*	*0.7%*	*8.8%*
MSCI Emerging Markets	0.3%	6.7%	21.3%
FTSE TMX Canada Universe Bond Index**	-1.3%	-1.8%	0.5%
FTSE TMX Canada all corporate bond index **	-1.1%	-1.3%	1.5%

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

Table 2
Currency and Commodities
(in USD, % change)

	Level	September	Q3 2017	YTD
CDN$	$0.802	0.1%	7.8%	$0.802
Oil (West Texas)	$51.67	9.4%	-3.8%	$51.67
Gold	$1,283	-2.5%	11.3%	$1,283
Reuters/Jefferies CRB Index	$183.09	1.2%	-4.9%	$183.09

Table 3
Sector level results for the Canadian market

S&P/TSX sector returns*	September	Q3 2017	YTD
S&P/TSX Composite	2.8%	3.0%	2.3%
Energy	7.4%	5.7%	-9.9%
Materials	-4.0%	2.9%	1.6%
Industrials	3.4%	2.3%	13.4%
Consumer discretionary	5.5%	4.2%	15.7%
Consumer staples	-0.3%	-3.1%	0.5%
Health care	5.2%	-10.5%	-9.3%
Financials	3.8%	3.7%	4.5%
Information technology	2.8%	3.1%	12.5%
Telecom services	-1.3%	1.2%	6.6%
Utilities	-2.3%	-2.9%	4.6%
Real Estate	-1.1%	-2.2%	1.0%

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

In September, the intra-day trading range for the S&P 500 narrowed even further as day-to-day highs and lows averaged only +/-0.4%, according to data compiled by Bloomberg. Needless to say, the year isn't over yet, and we don't expect the markets to be this tone deaf to global and geopolitical events forever.

THE MARKET'S FOCUS

What did stock markets care about this quarter? Earnings. Specifically, strong Q2 earnings results and a bright outlook for global synchronized growth to help push equity markets higher. North American equities were broadly supported by better-than-expected corporate earnings growth. The result was a slow and steady climb for stock markets. In the US, it was the continuation of a steady march forward (in Q3 the S&P 500 hit its 39th new closing high of 2017). In Canada, the quarter started off slow. The S&P/TSX Composite waited until September before rebounding from a lackluster spring and summer.

TSX REBOUNDS

After muddling along for much of 2017, the S&P/TSX Composite rallied to post the strongest monthly gain since July 2016, rising 3% percent in September.

The large Canadian energy sector was the top performing sector. Oil prices rose sharply in September on the back of improving fundamentals (tightening supply and strong global demand) and a weaker US dollar. Synchronized global growth should act as a tailwind for Canadian equities in general, and cyclical resource stocks in particular.

The Canadian financial sector also had a strong month of September. Recognizing Canada's strong economic momentum, the Bank of Canada (BoC) hiked interest rates twice in the quarter. In July the BoC made their first rate hike decision in nearly seven years, hiking by 0.25%. More surprising was the move to raise rates another 0.25% in September, effectively removing the stimulus that was added during the oil price slump. The higher rates helped share price performance for Canadian bank and insurance stocks alike. Conversely, the spike in bond yields caused a downturn for Canadian bond market returns. Rising bond yields also led to strong Canadian dollar appreciation (up over 7% vs the US dollar for the quarter).

Within fixed income sectors, the Canadian corporate bond index performed best. The shorter duration of the corporate bond index (relative to the broad Canadian bond index) meant that it was less sensitive to rising interest rates.

HAWKISH BANKERS

Globally, central banks continue to lean more hawkish (toward raising rates and/or reducing economic stimulus), which is putting upward pressure on global interest rates.

There is a chance that the BoC will raise rates again before the end of the year. Canada's economic data is turning out better than expected and oil prices are holding in at level above $50 (US). However, BoC Governor Stephen Poloz and other BoC representatives have stated that they are watching carefully the impact of their two rapid moves to see how the economy digests the now stronger loonie and higher yields. Additionally, geopolitical risks among North Korea and other countries could halt the rise in interest rates faster than expected.

In other central bank news, the US Federal Reserve announced its plan for balance sheet reductions to commence in October. Janet Yellen, Chair of the US Federal Reserve, voiced her concerns for tightening "too gradually", which has put the possibility of a December hike back on the table. Meanwhile, Mario Draghi, President of the European Central Bank (ECB), revised the ECB-forecasted inflation expectation lower and made no changes to the policy rate at this point.

BLAME IT ON THE WEATHER

Regular readers will know we like to highlight the benefits of keeping a longer-term focus when it comes to capital markets and the economy. We think that longer-term perspective will serve investors particularly well as economic data rolls in over the next several months. Specifically, we anticipate that economic data (particularly US data) will be skewed to the downside due to the particularly damaging hurricanes. Further on, we may then see a temporary boost to data results as the rebuilding takes hold in the hurricane-damaged areas. We generally have a positive outlook regarding North American equity markets. Consumers are in a healthy position, we are seeing a rebound in business investment, heading into hurricane season the US economy had been growing at decent clip, and the outlook for global growth looks both positive and synchronized. Overall, we expect the underlying economic trends to remain positive and supportive of equity markets, while fixed income investors may face the headwinds of rising rates.