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Market Matters

Summary for September 2018

Q3 2018 Highlights

A trilateral north American trade agreement was reached on Sept.30, but trade uncertainty weighed on investor confidence for most of the quarter.

Canadian cannabis stocks soared (and boosted the Health Care sector returns) as marijuana legalization approaches and attract interest from large consumer companies.

The S&P 500 bull market reached record status (longest bull market run) in August, and continued its winning ways for the remainder of the quarter.

Expectations of central bank rate hikes caused yields to rise and weakened bond returns over the quarter.

Q3-2018 Trade concerns: It was 'US' against the world until the very end

Trade was the dominant concern for capital market investors in the 3rd quarter of 2018, with a distinct 'U.S. against the world' feel. Cantankerous trade negotiations and tit-for-tat tariffs created investor and business uncertainty that weighed on capital markets around the globe. The noted exception came from the instigating United States, where tax-reform boosted corporate earnings, strong economic data, and, the record setting 'longest bull market' stoked investor confidence.

Sentiment toward Canadian equities was quite poor during the quarter. This was partly owing to the uncertainties around trade, but not exclusively, as oil pipeline project delays and some economic data (such as household debt and housing values) continued to sour sentiment. A tumbling price for gold weighed on the materials sector. Rising bond yields are kryptonite for gold; a firm U.S. dollar and modest global inflation doesn't help the yellow metal price either. Further weighing on the materials sector, a retracement of earlier-year gains for shares of forest product companies added to the weakness as early signs of cracks in the U.S. housing market begin to appear.

Bucking the trend, the Canadian Health Care sector has been riding high on the eve of legalized recreational marijuana use. This small Canadian sector saw a +31% gain in the quarter, as large global consumer corporations (many facing slowing growth prospects) look to Canada's cannabis ventures to gain access to new markets and product-innovation opportunities in an effort to diversify and juice growth prospects.

Market Summary

Canadian Fixed Income[1]	Month	QTR	YTD
FTSE Canada Universe Bond Index	-1.0%	-1.0%	-0.4%
FTSE Canada All Corporate Bond Index	-0.8%	-0.5%	0.2%

Canadian Equities[2]	Month	QTR	YTD
S&P/TSX Composite	-1.2%	-1.3%	-0.8%

	Month		QTR		YTD	
Global Equities[2]	Local	CAD	Local	CAD	Local	CAD
S&P 500	0.4%	-0.5%	7.2%	5.5%	9.0%	12.6%
MSCI EAFE	1.2%	-0.4%	1.8%	-0.8%	-1.0%	-0.6%
MSCI Emerging Markets	-1.4%	-1.7%	-1.0%	-3.6%	-4.8%	-6.6%

Currencies and Commodities (in USD)	Level	Month	QTR	YTD
CDN $	0.775	1.0%	1.7%	-2.6%
Oil (West Texas)	73.25	4.9%	-1.2%	21.2%
Gold	1,192.52	-0.6%	-5.0%	-8.7%
Reuters/Jeffries CRB Index	195.16	1.1%	-2.6%	0.7%

Canadian Sector Performance[2]	Month	QTR	YTD
Cons. Disc.	-4.6%	-8.4%	-6.2%
Cons. Staples	-0.4%	-1.3%	-4.6%
Energy	-3.6%	-6.6%	-4.0%
Financials	-0.2%	3.0%	-0.4%
Health Care	12.1%	31.2%	29.1%
Industrials	-0.1%	5.2%	11.3%
Info Tech	0.1%	2.9%	25.6%
Materials	-1.5%	-13.2%	-11.0%
Real Estate	-0.9%	2.6%	5.5%
Comm. Services	-1.7%	1.2%	-6.1%
Utilities	-2.1%	-2.9%	-11.1%

Local currency unless otherwise stated.
[1]Total return [2]Price only return
Source: Bloomberg

The U.S. administration also took an aggressive approach on trade with China, where the potential for an all-out trade war remains a major concern. Investor confidence is down as it remains to be seen whether political risks overshadow economic prudence. It should be no surprise that emerging market returns have been weak as the combination of Chinese/U.S. trade disputes, U.S. dollar strength, slowing economic growth and tightening financial conditions add to country-specific woes in Turkey, Argentina, Brazil, and Venezuela.

Meanwhile, Canada's bond market returns also declined over the quarter. Yields rose in both Canada and the U.S. as the U.S. Federal Reserve made the expected move to increase rates in September, while the Bank of Canada looks set to follow suit in October. Corporate bonds, with their increased yield, performed best, but not enough to keep the quarterly returns in the black for investors.

USMCA spells last minute relief for Canada in Q3-2018

After 13 months of negotiation, in the last hours on the last day of the quarter, Canada and the US struck an agreement in principle to reform NAFTA, introducing the new USMCA (U.S., Mexico and Canada Agreement). A deal, even with certain concessions, with our largest export partners is extremely important. Striking the USMCA deal avoids the potential negative economic impact of the harshest of the U.S.' threats. It effectively lifts the veil of uncertainty clouding business investment; something we feel has been holding back the Canadian stock market for the past several months. Therefore, we expect it to be a net positive for the Canadian economy, Canadian dollar and Canadian equities.

Central banks set to normalize (i.e. raise) rate policy

After regularly citing NAFTA uncertainty as a negative risk for the Canadian economy, the positive outcome on NAFTA opens the door for the Bank of Canada to pursue its normalization of policy rates without this lingering risk. We expect Canada's central bank rate to continue with further rate increases, with another likely in October, and see two more increases in 2019.

The rising rate environment does pose a headwind for fixed income market returns in the near term. However, high-quality fixed income securities maintain their value as a risk-mitigation tool and should remain a key component within most investors' diversified long-term portfolios. Active fixed income portfolio management to navigate the yield curve and pick-up additional yield through credit instruments (e.g. provincials, mortgages and investment grade corporates) also provides the opportunity for improved return prospects.

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VP Marketing and Communications, has more than 15 years of investment industry experience and has been writing the monthly Market Matters for over 10 years.