CIBC Asset Management

Market Spotlight

March 2017

Global Markets

Global financial markets experienced another month of positive returns in February. Global equity markets rose 2.8% in U.S. dollar terms, 4.4% in Canadian dollar terms. Optimism continues to grow that world economies are stabilizing and, in some cases, improving. The rising popularity of an anti-"established government" movement, or populism, continues to sweep the global political scene, as Brexit and the U.S. election plainly demonstrated. Better U.S. economic data and recent statements from U.S. Federal Reserve Governors and Chairperson Yellen have convinced investors that a March U.S. interest rate increase is a near-certainty.

The Canadian equity market hit a new all-time high on February 21, but fell sharply by month end, for a total return of +0.2% over the period. Trade policy concerns with the new U.S. government increased towards the end of the month, especially surrounding the potential ramifications of a border adjustment tax. The Canadian dollar was lower by almost 2% against the U.S. dollar.

U.S. broad equity markets rose about 4%, with the S&P 500 Index establishing a new all-time high during the month. Supporting the rise has been the view that the global economic environment, while not robust, is on a path to steady growth. The anticipation of the implementation of more corporate-friendly policies from the Trump Administration is also supportive.

International equity markets rose about 1.5% (USD). European equity market gains registered closer to 2.5% in local currency, but a weak euro depressed gains in USD. Investors are looking ahead to elections in France and the Netherlands in the next several months as an important gauge of the global political climate.

Emerging markets gained 3% (USD), 4.0% in local currency, with China higher by 3.5% (USD). India reported 7% GDP growth in the final quarter of 2016, a very strong showing, and overtook China as the world's fastest growing major economy. Emerging market debt also rallied.

Current Asset Allocation Outlook*

Asset Class	Weighting
Canadian Bonds	Overweight
International Bonds	Underweight
Canadian Equities	Market Weight
U.S. Equities	Underweight
International Equities	Overweight
Emerging Market Equities	Overweight

**For balanced portfolios, as at February 28, 2017.*

"Sound Bites"

Luc de la Durantaye

"There are multiple forces pushing yields higher in 2017. First, the U.S. Federal Reserve is expected to stay in renormalization mode and gradually and prudently hike interest rates. While this is, for the most part, already priced into the bond markets, it should provide a floor for bond yields.

Second, other major central banks, such as the Bank of Japan and the ECB, will likely experiment further with the "QE with yield curve control" policies already implemented. The implicit objective here is to gradually re-steepen yield curves in an orderly fashion, as conditions allow. The efforts deployed to control the shift in term structures in Japan and the eurozone should indirectly limit the size and speed at which yields can rise in North American markets. Finally, our forecast accounts for the inflation risk associated with potential developments on the fiscal and trade fronts in the United States. The policy changes envisaged have the potential to significantly alter the U.S. inflation backdrop. As a result, the inflation premium embodied in bond yields is likely to rise. Altogether, we see these factors as moderately bearish for bond prices, marginally favourable to Canadian bonds vs. U.S. and still supportive of an outperformance of corporates relative to sovereigns."

Fixed Income

Although a U.S. rate increase is likely on March 15, bond yields remained stable in February. The upward pressure on yields that would normally result was offset by tempered expectations for higher growth resulting from the Trump administration's policy changes. Pressure was also dampened by concerns about potential disruption in Europe from upcoming elections. The Bank of Canada (BoC) is unlikely to raise its rate anytime soon. Canada's economy likely grew faster than the BoC's forecasts in the final quarter of 2016. However, Canada continues to face challenges on the export front that could be exacerbated by more protectionist trade policies in the U.S. and disappointing growth in household incomes.

Canadian Equity

The Canadian equity market hit a new all-time high on February 21 but fell sharply by month end, for a total return of +0.2% over the period. On a year-to-date basis, the S&P/TSX Composite Index is up +1.1%. The anticipation of the implementation of more corporate-friendly policies from the Trump Administration is supportive of higher equity prices. Recent quarterly U.S. corporate earnings results have been largely better than expected, but more mixed in Canada. Among large-cap stocks, the market leaders in the month were Restaurant Brands International, which is buying U.S.-based Popeyes Louisiana Kitchen restaurant chain, Canadian Tire and Pembina Pipeline.

"Sound Bites"

Strong Showing for Canadian Bank Earnings

Natalie Taylor
Equities - Financials

"Canadian banks reported a strong quarter, exceeding "softer" analyst expectations. Earnings beats averaged 7%, driven by strong capital markets, expense control and a continued improvement in credit losses. The strong results generated robust capital levels. With the exception of capital markets earnings, which are highly volatile and market dependent, expense and credit improvement trends are expected to drive earnings growth in 2017.

Strong capital markets results and expense improvement drive positive operating leverage

Canadian banks benefited from increased market volatility following the U.S. election, delivering trading revenues that were the highest in the past five years and ahead of elevated consensus expectations. Strong trading revenue results and disciplined expense control drove positive operating leverage (revenue growth outpaced expense growth). While trading revenue can be volatile, we believe the theme of expense control will continue to play out over the next couple of years—Canadian banks have taken over $2 billion CAD in collective restructuring charges over the last two years. In our view, Bank of Nova Scotia will benefit the most from the expense control theme—it has been aggressive in managing costs, taking nearly $600 million CAD in restructuring charges. Our analysis indicates that the bank has room to improve productivity as it narrows the gap with best-in-class peers. CIBC should benefit from productivity improvements; however, the bulk of the benefit should come in 2018 and beyond. While Royal Bank has chosen not to take a restructuring charge, it will manage expenses on an ongoing basis. As such, meaningful progress on expenses in 2017 could surprise the market.

Credit metrics remain resilient

With energy-related losses likely having peaked in fiscal Q2/16, the market has shifted its focus to the Canadian consumer as a driver of potential credit deterioration. Macroeconomic factors such as elevated consumer debt levels and "overheated" housing markets drive this view. However, the Canadian consumer has remained resilient. In Q1/17, banks reported a fourth consecutive quarter of declining credit costs while mortgage credit metrics remained strong. With no notable deterioration in consumer credit and energy companies continuing to improve their balance sheets, we believe provisions for credit losses have peaked in the near term and expect credit stabilization to continue in 2017. In our view, CIBC stands to benefit most from the resilient credit trends, as the market is concerned with CIBC's mortgage growth."