MARKET SPOTLIGHT

GLOBAL MARKETS

Following a period of higher volatility in February and March, equity markets started April in an apprehensive move, focusing on trade wars and potential inflation. However, volatility began to decline in mid-April—some speculated this was related to the April 15th U.S. tax filing deadline—and many international markets finished the month with gains. A strong U.S. dollar again lowered the foreign equity returns in U.S. dollar terms (USD). In April, global equities gained 1.2% in USD, and 0.6% in Canadian dollar terms, as the Canadian dollar gained slightly.

U.S. broad equity markets rose 0.4% while the Nasdaq 100 rose 0.4%. Corporate earnings reports were a big focus during the month and results were upbeat in many cases. With two-thirds of S&P 500 companies reporting (as of April month-end), earnings growth has averaged +27%, with a contributing boost from tax cuts in evidence. However, uncertainty over simmering trade wars and the potential for increased tech regulation (following privacy concerns surrounding Facebook and others) held stock prices in check.

International developed equity markets gained 2.3% (USD), with Japanese equities up by 0.7%. Returns in local currency terms were several % points higher, highlighting the impact of a strong U.S. dollar in April. Eurozone reports show an improving labour market but little inflation. This increases investors' conviction that the European Central Bank does not need to hurry and can continue to move cautiously as it removes monetary policy stimulus.

Emerging markets fell 0.4% (USD), with China close to unchanged (USD). China showed robust growth in the first quarter, with GDP +6.9%. The National People's Congress recently lifted the two-term tenure limit for the office of the Chinese President, allowing President Xi Jinping to stay in office indefinitely. While this will allow Xi to impose his political and economic objectives beyond the next five years, it may or may not result in greater political stability over time.

CURRENT ASSET ALLOCATION OUTLOOK*

ASSET CLASS	WEIGHTING
Canadian Bonds	Underweight
International Bonds	Underweight
Canadian Equities	Market Weight
U.S. Equities	Underweight
International Equities	Overweight
Emerging Market Equities	Overweight

* For balanced portfolios, as at April 30, 2018.

SOUND BITES

Luc de la Durantaye

"In ongoing trade negotiations, we are troubled by the U.S. administration's narrow view on trade. First, by focusing on increasing exports and decreasing imports, the administration assumes that exports are good and imports are bad. However, if a country can buy goods from abroad at a cheaper price than they can manufacture them at home, imports provide a benefit to the country. Too much of a narrow focus on the trade balance is unproductive. Also, ironically, while the administration is trying to reduce the U.S. trade deficit through its trade policies, its other policies (such as the implementation of tax cuts and infrastructure investments) are likely to lead to larger trade deficits. Excess U.S. demand, at a time when the economy is running close to full capacity, will produce the need to import a number of goods and services. This will likely lead to a deterioration of the trade balance."

FIXED INCOME

The bond market gave up some ground in April as global trade tensions eased somewhat and as higher commodity prices raised risks that inflation could accelerate. The Bank of Canada (BoC) updated its forecast for the Canadian economy, dropping it slightly for 2018. The BoC noted that higher imports of machinery and equipment have raised the country's productive capacity, helping to mitigate upward pressure on inflation. The U.S. bond market saw a similar rise in yields in the month, resulting in the 10-year Treasury yield poking briefly above the 3% level near month-end. Like Canada, the potential for higher inflation and elevated issuance of Treasury bonds added to the pressure and pushed yields higher.

CANADIAN EQUITY

The Canadian equity market gained 1.8%. An important factor that pushed Canadian equities to outperform several international equity markets was a substantial rise in crude oil prices (up over 5% in April)—the energy subsector gained almost 7%. After evaluating mixed Canadian economic data, the Bank of Canada chose to hold interest rates unchanged at its April policy meeting. Business sentiment indicators declined slightly while Canadian jobs numbers showed some improvement. NAFTA talks continue to drag along without tangible developments for now. Investors are looking ahead to the second half of May for some potential progress.

SOUND BITES

Jonathan Mzengeza

Equity Analyst

Cloud computing *is the delivery of computing services—servers, storage, databases, networking, software, analytics, and more—over the internet ("the cloud").*

Hyperscale *is the ability of a system to scale appropriately as increased demand is added to the system.*

Shift to the cloud is accelerating rapidly and benefiting the whole IT* landscape

"Hyperscale cloud providers continue to benefit from robust demand for cloud services. All three major providers—Amazon (Amazon Web Services), Microsoft (Azure) and Google (Google Cloud Platform)—recently exceeded analysts' expectations for both revenue and earnings, driven largely by their cloud businesses. Amazon Web Service growth accelerated by 4% to 48% year-over-year and Microsoft's Azure revenue continues to average over 90%+ year-on-year growth. Google Cloud Platform is now tracking at over $1B a quarter in revenue, from close to nothing about two years ago.

These results demonstrate that the long-term shift from on-premise computing and storage consumption to the cloud is accelerating. This trend is driven by several factors. These include the updating of IT infrastructure, initiatives designed to reduce costs and an enterprise focus on usage based on consumption (i.e. pay only for what you use).

Furthermore, cloud utilization allows enterprises to access specialized computing services that would otherwise be too expensive—machine learning, analytics, big data and security are some examples. The hyperscale vendors should continue to benefit from the growth of the cloud and will continue to increase their service offerings. The estimated total cloud market is expected to be anywhere between $150B and $1T. Global enterprises are currently spending $42B on cloud services, with total IT spending at $3.5T.

Major hyperscale cloud providers are responding to the demand for their cloud services by increasing capital expenditures, which are up significantly from last year. First-quarter cloud capital expenditures were 22% above consensus for the hyperscale cloud providers that have reported so far. Expenditures are up 40%+ from last year as compared to consensus expectations of 30%. This rapid increase in capital investment is positive for the IT supply chain, particularly providers of computing and networking infrastructure and equipment. For example, chipmakers Intel, AMD and Broadcom reported robust results for their datacenter businesses, exceeding consensus expectations—results were driven primarily by strong demand from the hyperscale cloud providers. The general expectation is that this elevated spending environment should continue for sometime to come as demand for cloud services remains robust."

*Information technology

*all dollar figures in USD