MARKET SPOTLIGHT

GLOBAL MARKETS

Equity markets continued to recover from late-2018 declines and added to January gains in February. Increasing evidence that global economies are slowing and that central banks are factoring this evidence into monetary policy decisions was a positive. A postponement of new U.S. trade tariffs on China added to optimism as well. In February, global markets rose 3% (USD), and 3.3% (CAD), as the Canadian dollar weakened.

U.S. broad equity markets were higher by 3.2%, with the Nasdaq 100 rising 2.9%. A strong U.S. GDP number for the fourth quarter 2018 showed growth of 2.6% (annualized) versus expectations of 2-2.4%. This good news was somewhat dampened by more recent data that indicated a slowdown in the jobs market—February new job creation was only 20,000, although wages grew by 3.4% (year-over-year), the strongest gains since 2009, while the unemployment rate dropped to 3.8%.

International developed equity markets rose 2.6% (USD), with Japanese equities flat (USD). At its most recent meeting, the European Central Bank (ECB) announced a new lending (TLTRO) program (see page 2 for more analysis). Political issues continue to make headlines, as Spain announced a snap election for April and U.K. Prime Minister May struggles to construct a workable solution ahead of the end of March Brexit deadline.

Emerging markets rose 0.2% (USD), while China gained 3.5% (USD). Recent data has shown a pickup in Chinese credit growth—this follows several moves by the Chinese central bank to boost the economy by cutting bank reserve requirements. This may be an encouraging sign that credit is being accessed, which could stimulate the domestic economy and possibly provide some counterbalance to China's current trade issues with the U.S.

The view from our Chief Investment Strategist:

LUC DE LA DURANTAYE

WILL CANADIAN INTEREST RATES MOVE UP IN 2019?

We believe the Bank of Canada may be forced to move to the sidelines earlier than generally expected (i.e. stop raising interest rates), owing to the pronounced tightening in financial conditions.

Over the last decade, the Canadian private non-financial sector has massively increased its debt load and it's not just Canadian households that are heavily in debt. The debt load of Canadian non-financial corporations now amounts to 114% of GDP, one of the highest ratios in the developed world. To meet their financing needs, non-financial corporations have not only borrowed much more from Canadian banks, but also issued large quantities of bonds domestically and in the U.S. This means they are vulnerable to rising policy interest rates in Canada as well as tightening credit conditions in Canada and the U.S.

Credit spreads in Canada and the United States started widening in late 2018. At this point the tighter credit conditions are not great enough to be a concern. However, if credit conditions continue to tighten in 2019, the hit on Canadian non-financial corporations could be too difficult to manage. The energy sector is particularly at risk as it already has to cope with the plunge in oil prices.

FIXED INCOME

In February, longer-term bond yields moved modestly higher, thanks mainly to good performance from the U.S. economy over the past few months. Short-term yields were stable, owing to a less hawkish stance from the Bank of Canada and U.S. Federal Reserve. Lower commodity prices and a lack of resolution on the USMCA resulted in Canada's economy almost stalling in the final quarter of 2018. The U.S. and Canadian economies are growing more slowly than a year ago, and it's expected that the Bank of Canada will step to the sidelines for the next couple of quarters, at a minimum.

CANADIAN EQUITY

Canadian equities gained 3.2% in February. Higher oil prices again benefited some energy stocks, lifting the energy subsector to a gain of 4.8%. Canadian banks released quarterly results—the impact of volatile financial markets in the last months of 2018 was evident in the performance of the capital markets divisions. However, four of the six major banks raised their dividends and the financial sector rose 3% for the month. All subsectors except materials (-0.7%) were higher for the month.

SOUND BITES

Which Equity Sectors Look Interesting Right Now?

Chase Bethel
Equity Analyst, Consumer Sector

In the current economic climate, one widespread theme across many of our equity portfolios is that we are defensive and favour businesses that serve the lower income group in North America. This point of view comes from our conservative expectations for a number of factors that drive the 'wealth effect' (e.g. stock market valuations, housing resale prices). These factors ultimately feed into consumer confidence, especially for well-to-do households. As a result, we expect affluent consumers will rein in spending to a greater degree than low income consumers, assuming that current strong employment conditions persist.

Given this premise, what are some industries or sectors that could benefit? First, grocery, dollar and discount stores represent fertile ground for investment ideas. Companies in these industries offer products that are shopped frequently and meet everyday consumer needs. Second, convenience and gas retailers also fit with this theme. However, keep in mind that total miles driven will often rise when economic growth rises and decline when growth slows. Third, there are also interesting "pockets of defensiveness" even within certain consumer discretionary segments. We look for companies that offer products or services that either 1) have a low average transaction total 2) have strong, well-known and well-regarded brands and pricing power and/or 3) offer some clear value relative to the competition.

ECB Takes Action to Fortify the European Economy

Vincent Lépine
Director, Multi-Asset & Currency Management

European monetary authorities will be ending their quantitative asset purchase program (QE) in early 2019—not a trivial development. It is important to understand that the ECB monetary boost was not just provided via QE, but also through its long-term refinancing programs (TLTROs). In fact, TLTRO lending accounts for a very big chunk (24%) of the ECB's monetary base. In 2019, the ECB will be ending its QE program just as TLTRO loans mature. In the absence of new TLTRO lending, the eurozone monetary base would shrink considerably. We forecasted that the ECB would launch a new TLTRO program in early 2019—this did occur at the ECB meeting on March 7. Unfortunately this will only attenuate, not eliminate, the contraction in the ECB's balance sheet.