CIBC Asset Management

May 2019

MARKET SPOTLIGHT

GLOBAL MARKETS

Two themes continue to propel equity markets in 2019—central banks staying on the sidelines and trade war developments between the U.S. and China. In April, optimism won out, as global growth seemed modestly healthy but not robust enough to warrant higher interest rates. Trade talks also seemed to be going smoothly until early May, when President Trump decided China was not playing fair and implemented additional tariffs. China then retaliated with tariffs on U.S. goods. In April, global markets rose 3.6% (USD), and 4.3% (CAD), as the Canadian dollar weakened.

U.S. broad equity markets were higher by 4%, with the Nasdaq 100 rising 5.5%. Preliminary estimates on first quarter U.S. GDP pointed to higher-than-expected 3.2% annualized growth. Purchasing Managers Indices also indicated an expanding but not runaway economy in both the manufacturing and services sectors. Labour markets are also improving, with the U.S. unemployment rate for April falling to the lowest level since 1969.

International developed equity markets rose 2.8% (USD), with Japanese equities higher by 1.4% (USD). The European Central Bank (ECB) left interest rates unchanged at its April meeting and, as previously announced, intends to keep them unchanged throughout 2019. Italy, one of Europe's most challenged economies, saw its rating affirmed at two levels above junk by a major rating agency—a widely expected result, but a relief for investors nonetheless. The extension of the Brexit deadline to October 31 was another positive.

Emerging markets rose 2.1% (USD), while China gained 2.2% (USD). Chinese industrial production improved in March, but a resolution of the trade talks with the U.S. remains a primary issue. Argentina and Turkey have experienced political and economic instability in recent months, and the currency of each country is reflecting these problems, falling substantially against the U.S. dollar.

The view from our Chief Investment Strategist:

LUC DE LA DURANTAYE

IS THIS THE RIGHT TIME TO INVEST IN U.S. STOCKS?

Corporate profit margins in the U.S. are high, but are not under immediate threat. Wage inflation is slowly increasing but not accelerating, and is partly offset by higher productivity. This results in a small impact on unit labour costs. Last year's tax cuts provided a one-time boost to earnings growth but, as expected, this impact has faded. Going forward, earnings growth will have to rely mostly on revenue growth.

Our fair value for U.S. equities suggests a P/E just below 21 (based on cyclically-adjusted earnings) while the market is trading above 24. This fair value is expected to drift lower as potential growth slows and interest rates move back to neutral. The bottom line is the U.S. may outperform from time to time, but valuation should remain a headwind.

FIXED INCOME

Short-term yields were unchanged in April, while longer-term yields moved a little higher as investors responded to better economic data that reduced risks that a recession was at hand. The steeper yield curve is a welcome development for central bankers who may have acted early enough to extend the current cycle by reducing their efforts to tighten monetary policy. The Bank of Canada and U.S. Federal Reserve (Fed) reinforced the view that both central banks are on hold for the balance of 2019. However, futures markets continue to see a meaningful chance that the Fed will cut its rate by year-end.

CANADIAN EQUITY

Canadian equities gained 3.2% in April. Equities were higher despite the fact that Canadian GDP growth prospects are subdued—something the Bank of Canada acknowledged in April by lowering its 2019 GDP forecast to +1.2% from the +1.7% forecast in January. However, the Canadian jobs picture improved in April, showing a surprising gain of 106,800 new jobs and a rise in the workforce participation rate. Canada's housing market is also showing renewed strength.

SOUND BITES

"Medicare for All" Back in the Spotlight

Michal Marszal
Senior Equity Analyst, Healthcare

Healthcare will be a key issue for the American public heading into the 2020 presidential election. Recent proposals by Democratic contenders, particularly the idea of "Medicare for All", have created considerable volatility in global healthcare equities. As investors reduce exposure to the potential regulatory risks, U.S. managed care stocks have experienced the greatest impact.

Far left elements of the Democrats are advocating for a fundamental overhaul of the U.S. healthcare system, but the initiative faces immense challenges given its scale and implications. Most of the proposals generate more questions than answers—they don't properly address issues such as the administrative architecture, funding sources or the extent of private enterprise involvement. With the current federally funded Medicare program already facing fiscal challenges in the coming decade, any substantial expansion would need to incorporate vast savings mechanisms. A variety of options are available, but many would face significant pushback from different segments of the industry. If implemented, some options could even lead to a significant deterioration of the globally dominant U.S. position in healthcare innovation. For the foreseeable future, modest adjustments to the current healthcare law are considerably more likely than more radical alternatives.

Healthcare equities remain an attractive option for investors, given favourable demographic trends in both developed and emerging markets. The industry also continues to add significant value through innovation. Managed care companies will continue to play a key role with more vertically-integrated business models, as the U.S. healthcare market places greater emphasis on outcomes-based delivery of care. Companies with particularly strong positions include UnitedHealth, Anthem and CVS.

U.S.-China Trade War

Éric Morin
Senior Analyst, Multi-Asset & Currency Management

China exports much more than it imports from the U.S., so trade tariffs have a much larger effect on the Chinese economy—about 3 times greater. Spillover effects will mostly hit Asian economies, commodities exporters and European economies. However, the eurozone is the most at risk because it has insufficient policy (monetary and fiscal) leeway to cushion the effects of negative spillovers in a context of already weak growth prospects. Overall, this environment would bring upward pressure on the U.S. dollar against most currencies.