CIBC
Asset Management

Market Spotlight

February 2016

Global Markets

The year 2016 began with enormous volatility, taking global equity markets mostly lower with several sharp rebounds. Global markets appeared to be reacting to several factors. In particular, volatility in the Chinese equity and currency markets and a continuing sharp decline in the price of oil produced fallout in many international markets. Global equity markets fell -5.98% in U.S. dollar terms in January and -4.75% in Canadian dollar terms.

Emerging markets were sharply lower, led by steep declines in the Chinese equity market. Equity market circuit breakers, designed to decrease volatility, were triggered early in the month. Unfortunately, these measures seemed to have instead increased investor anxiety and volatility. Chinese regulators have since deactivated this mechanism.

U.S. equity markets fell sharply, in line with the sharp declines in global markets overall. The U.S. Federal Reserve (Fed) met for the first time since it raised interest rates in December. Although not expected to move in January, Fed comments were seen as more dovish. This led to lowered expectations for U.S. interest rate increases this year.

International equity markets in both Europe and Japan also declined. The ECB did not provide additional monetary stimulus at its January meeting, but commented that additional stimulative action will be considered in coming months. Bank of Japan (BOJ) action near month-end (adopting negative interest rates) produced an exuberant rally.

Canadian equities overall fared much better than U.S. and international. The Canadian market plunged along with other global markets early in the month. However, Canada stood out as the "turnaround kid" in the second half of the month when oil prices recovered modestly off mid-month lows.

Current Asset Allocation*

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

**For balanced portfolios, as at January 31, 2016.*

"Sound Bites"

Luc de la Durantaye

"Inflation remains a long way from the BOJ's 2% objective, and the yen's deep undervaluation has failed to boost Japanese exports. Despite the yen's freefall, Japan's non-energy trade surplus is not widening. This is essentially owing to weakness in Chinese demand. It's not just that Japanese exports to China aren't picking up—even worse, growth in Japanese exports to China is now in negative territory.

This is problematic for Japanese authorities because a sizable increase in net exports is required to more than offset the hit from the tax hike on domestic demand and avoid a recession. In short, Japan's fiscal and monetary credibility are now on the line. Japan has the heaviest government debt load of the developed world (246% of GDP)."

Fixed Income

Bond yields moved lower as investors responded to China's shaky efforts to stabilize its equity market and evidence that the U.S. economy is experiencing a soft patch. The Bank of Canada left its administered rate at 0.50% after much speculation that it would reduce rates further as oil and other commodity prices moved lower. Governor Poloz acknowledged that it was a close call, but preferred to wait and see how the federal stimulus package will impact the economy. He also expressed concern about the impact from a further rapid depreciation in the Canadian dollar that could push inflation higher relatively quickly.

Canadian Equity

The S&P/TSX Composite Index dropped -9% at mid-month but recovered by 8.3% off the bottom to return -1.2% by month end. The equity market reacted to negative global growth sentiment, further depreciation of the Chinese renminbi and a modest recovery in oil prices and the loonie near month end. Major developments included: Progressive Waste Management was the target of a reverse takeover by U.S.-based Waste Connections; Corus bought Shaw Media for $2.65 billion; Suncor increased its takeover offer for Canadian Oil Sands and both TransAlta and Potash cut their dividends.

"Sound Bites" *Why is gold rallying?*

Equity Insight

Scott Vali, *Equities*

"Even though the gold standard was abolished in 1976, many central banks still use gold to diversify reserve holdings while some investors use it as a store of wealth. Due to its limited industrial applications, demand generally comes from central banks, investors and jewelers.

Today, approximately one-third of gold supply is derived from recycling existing stocks and two-thirds from new mine supply. It is this new supply that is becoming more challenged. Following the recent decline in the price of bullion and the high cost of extraction, many miners are having an increasingly difficult time growing primary supply. In addition, the lack of new discoveries in recent years, along with the short life of existing mines, challenges future production. Barclays Capital recently wrote that it expects new mine supply to peak in 2017.

If gold mine supply starts to decline on a go-forward basis and investment demand re-emerges in a significant way, the market for bullion may tighten very quickly and gold could reach new highs. In that scenario, companies with strong balance sheets and assets could be in high demand. Goldcorp and Detour Gold could benefit from a stronger price of bullion over the next year. Royalty companies such as Franco Nevada could also see the value of its royalty streams improve and may provide strong future returns in a rising gold price environment."

Vincent Lépine,
Asset Allocation and Currency Management

"Gold prices have been trending lower for four consecutive years – the longest and most severe gold bear market since the early 1980s. The weakness in gold prices has essentially been a mirror image of the strength of the U.S. dollar.

On an effective basis, the U.S. dollar has broken above the cyclical highs reached in 2002 and seems to be on its way to reach its all-time high established 30 years ago. At these levels, it is not clear whether the U.S. economy will be able to cope much longer with the ongoing U.S. dollar strength. The side-effects are already very apparent. The U.S. ex-energy trade deficit has recently reached record highs and will most likely widen further. As a consequence, activity in the U.S. goods-producing industries has been substantially slowing and the risk of spill-over effects to the service-providing industries has been rising materially.

What are the implications for gold? A peak in the U.S. dollar would likely coincide with a trend reversal in gold prices. The 1985 and 2002 cyclical USD peaks coincided with a cyclical bottom in the price of gold. Over the following year, gold gained significant ground."

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