CIBC Asset Management

Market Spotlight

June 2016

Global Markets

Global equity markets fell 0.56% in U.S. dollar terms in May but gained 5.02% in Canadian dollar terms, as the Canadian currency dropped about 4% against the U.S. dollar. Attention is focused on sluggish global recoveries, monetary policy moves, especially in the U.S., and upcoming political developments.

Emerging markets registered the weakest global markets performance in May. However, China's equity market was an area of relative strength and experienced smaller losses than the overall emerging markets index. Brazil was a trouble spot, losing almost 8%.

International equity markets were slightly lower. The June 23 referendum on whether the U.K. will stay in the EU remains a focus. The issue of a bailout for Greece made headlines in May; however, the IMF and eurozone finance ministers worked out terms that would allow bailout funding to continue. Japan released better-than-expected first quarter GDP numbers that showed a slight positive growth, reversing the negative growth experienced in the last quarter of 2015.

U.S. equity markets returned about 2%, with the Nasdaq Composite gaining more than 4%. Various U.S. May economic releases indicated some improvement in home sales and a slight pickup in headline inflation. The last Federal Reserve meeting minutes revealed a leaning toward interest rate tightening this summer, if certain conditions are met. But disappointing May labour market numbers have "thrown cold water" on a June rate hike.

Canadian equities experienced modest gains in May, with major indices rallying about 1%. Canada's economy showed solid growth in the first quarter; however, the Alberta wildfires pushed the Bank of Canada (BoC) to forecast negative growth for the second quarter.

Current Asset Allocation Outlook*

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

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

"Sound Bites"

Luc de la Durantaye

"Wide global imbalances in the oil market remain, raising questions about the sustainability of recent strengthening in oil prices.

The Canadian dollar's recent appreciation against the greenback is significant enough to compromise the BoC's hoped-for recovery in non-oil exports. True, Canadian non-oil exports to the U.S. started recovering in late 2015. However, this happened because weakness in the Canadian dollar allowed for a significant decline in Canadian unit labour costs (in U.S. dollar terms)—that is, below U.S. labour costs for the first time in eight years. Unfortunately, since the start of the year, the Canadian dollar has recouped a lot of the ground it lost in 2015. As a result, when expressed in U.S. dollar terms, Canadian unit labour costs are back above U.S. costs."

Fixed Income

Bond yields moved lower in the month as Canada's economy showed signs of downshifting after solid first quarter growth. The fires at Fort McMurray only exacerbated concerns and led the BoC to chop its forecast for second quarter growth into negative territory; however, it also expects growth to snap back in the next quarter. The U.S. economy is showing evidence that it bounced back in the second quarter after a sluggish start to the year. That raised the odds for a second increase in the fed funds rate, with the futures market seeing the Fed moving at its July meeting as the most likely scenario.

Canadian Equity

The Canadian equity market returned +1.0% in May, bringing the year-to-date return of the S&P/TSX Composite Index to +9.5%. The Canadian market had positive return participation from a broader number of sectors than in previous periods. Actual or feared oil supply disruptions in Western Canada, Nigeria and Venezuela, and lower trending U.S. energy inventories contributed to the change in the commodity price outlook. A number of Canadian banks announced results that were, in general, better than expected; however, there was clear evidence that non-performing loans and provision for credit losses, especially from the energy sector, were on the rise.

"Sound Bites"

Equity Insight

Jennifer Law, CFA,
Small and Mid-Cap Equities

Why have Canadian small cap stocks risen so much this year?[1]

"Canadian small caps have greater exposure to commodities relative to Canadian large caps and global small cap peers. With oil prices rebounding 80% from February's bottom and gold bullion up 17% year-to-date, Canadian small caps have outperformed strongly both in Canada as well as on a global basis. Mining stocks, after going through a downturn in the last four years, have rebounded, with a year-to-date return of 60% for gold equities and 39% for base metals stocks while energy equities are up 18%, on average."

Overall, what are some benefits of investing in small caps?

"With less attention from sell-side research as well as a large pool of capital chasing ideas, the small cap market is less efficient with more frequent mispricing, which creates opportunities for those who specialize in the area. While smaller companies within Canada have large exposure to different commodities, such as oil and natural gas, gold, copper, zinc, diamonds and lithium, its non-commodity companies are quite diverse, many with revenue generated outside Canada—truly making them North American or global businesses. We believe that investors can build greater diversification in their equity portfolio by including some smaller, higher-growth companies that have very different business models as those included in the S&P/TSX 60."

What differentiates your team's stock-picking process?

"With the market fairly short-term focused, one differentiation of the small cap team is our willingness to take a longer view, say 3+ years, on our target company. We invest in the 'people', its management team, and we invest in strong business models that compete effectively in attractive industries. By taking a longer view, we pay a reasonable price for these businesses, oftentimes before the market starts to pay full price or overpay for their growth prospects.

Another area that differentiates our team is our participation in commodity investments whereas a large number of our competitors have opted out of the commodity square citing volatility. We believe that by understanding a commodity's supply and demand dynamics, we can reduce the risk profile of investing in resource stocks."

[1] Canadian small cap stocks have performed very well year-to-date (as at May 31, S&P/TSX Small Cap +22% vs. S&P/TSX Composite +9.5%).