CIBC Asset Management

Market Spotlight

May 2017

Global Markets

Global financial markets were higher again in April. Global equities rose 1.5% in U.S. dollar terms, 4% in Canadian dollar terms. Results from the first round of the French elections appeared to calm fears that the global populist movement was unstoppable. Centrist Emmanuel Macron achieved a strong showing in the first round and won the election decisively in the second round on May 7.

The Canadian equity market pushed slightly higher, to post a total return of +0.4% for April. Trade issue anxiety resurfaced following comments by U.S. President Trump over possible trade actions on dairy products and lumber. Concerns over falling oil prices also hurt both Canadian equity and currency markets. The Canadian dollar fell 2.5% against the U.S. dollar.

U.S. broad equity markets rose about 1%, with the Nasdaq 100 higher by 2.8%, establishing a new all-time high during the month. The beginning of U.S. earnings season showed some fairly robust corporate results and industrials were a notably strong group. In many cases, companies increased full year earnings guidance. The U.S. employment picture is also showing a pickup in jobs.

International equity markets rose about 2.5% (USD). European equity market gains (ex UK) registered closer to 2.7% in local currency, with a stronger euro producing 4.3% gains in USD. Investors cheered the result from the first round of French elections and better EU economic data. The second round of voting in France served to confirm the win for Macron's centrist party.

Emerging markets gained 2.2% (USD), 2.3% in local currency, with China higher by 2.7% (USD). To this point in 2017, emerging markets as a group are demonstrating the best global equity performance (in USD).

Current Asset Allocation Outlook*

Asset Class	Weighting
Canadian Bonds	Overweight
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, 2017.*

"Sound Bites"

Luc de la Durantaye

"European financial markets should take comfort from the French election results and the win by independent centrist Emmanuel Macron. Recent European economic data could also provide a tailwind to the new prospective coalition government. Business sentiment is improving, with the latest Purchasing Manager Indices scoring multi-year highs. Unemployment, supported by a still accommodative European Central Bank, looks set to fall further in the coming months. Overall, the political risk premium may continue to dissipate. The German election in September is not expected to become a roadblock, as the two parties leading in the polls are both pro-European and financial market friendly.

In summary, the positive French election results should reassure financial market participants that the threat of populism from Brexit and Trump administration results has been stopped at the door of Europe. This adds to the cyclical upswing underway on the European continent. More friendly market reforms should support the continued outperformance of European equity markets, which form part of our international equity overweight stance."

Fixed Income

Bonds rallied as economic data indicated sluggish U.S. growth in early 2017 and escalating geopolitical tensions. An added boost came from the realization that President Trump may face meaningful obstacles to some of his signature policy changes. Canada's economy continued to show signs of resilience, but many question the sustainability of the recovery given the unknowns that the Trump presidency creates. As a result, the Bank of Canada (BoC) continues to exercise patience in managing monetary policy. The BoC is expected to remain on hold even though the U.S. Federal Reserve continues to guide investors to expect two more rate hikes this year.

Canadian Equity

The Canadian equity market rose +0.4% in April, bringing its year-to-date return to +2.9%. Towards the end of the month, certain trade issues with the U.S. reemerged—the Canadian supply management system in dairy and the reinstatement of U.S. tariffs on Canadian softwood lumber. The outlook for the Canadian housing market and the stability of the banking system were also in focus following developments at Home Capital Group. Concerns remain regarding the increase in U.S. oil production and whether or not the production accord by OPEC and major non-OPEC members would be extended. Oil prices remained under pressure as a result.

"Sound Bites"

Vincent Lépine
Vice-President
Asset Allocation and Currency Management

"Although Canadian economic numbers have been surprising on the strong side, we have a strong conviction that this energy-led Canadian cyclical recovery will prove to be short-lived. For one thing, at current production and oil price levels the Canadian energy sector remains under pressure. For another, oil prices found renewed support when OPEC countries struck a deal to cut production in late 2016. Let's not forget that this agreement ends in July. Doubts about a possible deal extension could resurface, potentially capping the upside for oil prices."

NAFTA uncertainty is another headwind for the loonie

Éric Morin
Assistant Vice-President
Asset Allocation and Currency Management

"President Trump's trade stance on Canada turned more protectionist in recent weeks, contributing to further declines in the loonie. The U.S. President enacted a 20%-average duty tax on imports of Canadian softwood, stating that Canadian lumber and dairy industries have been unfairly competing with their American counterparts. He also mentioned that he had previously considered a complete withdrawal from NAFTA.

The market share of Canadian dairy and softwood industries in GDP and exports is small. The main concern is that the change of tone by the U.S. ahead of NAFTA renegotiations has opened the door to a potentially bad deal for Canada.

Industries that post the highest trade surpluses with the U.S. are the most vulnerable, although we view the risks for the oil and motor vehicles sectors as being contained. The approval by President Trump of the controversial phase four of Keystone XL is a mitigating factor for the energy sector. Deeply integrated cross-border supply chains in the motor vehicle industry make U.S.-headquartered car producers vulnerable to trade barriers. This vulnerability limits the scope of tariffs or quotas that Washington can impose. However, other sectors with an elevated trade balance, such as manufactured goods, metals and food products, are more vulnerable given the absence of mitigating factors.

While the outcome of NAFTA 2.0 is highly uncertain, one thing is more certain—the loonie will remain negatively impacted by any change in protectionist stance by Washington ahead of and during trade negotiations. Along with low oil prices and monetary policy divergence with the U.S., this presents another headwind for the currency."