CIBC Asset Management

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MARKET SPOTLIGHT

GLOBAL MARKETS

After a downbeat end to 2018, financial markets took a turn to the upside in the first month of 2019. It wasn't optimism about better growth prospects that prompted some enthusiasm for stocks. Rather, increasing evidence that global growth is slowing led central bank pronouncements to take on a slightly more dovish tone. As a result, investors were somewhat reassured that interest rate increases could play out at a slower pace. In January, global markets rose 7.8% (USD), and 3.6% (CAD), as the Canadian dollar strengthened.

U.S. broad equity markets gained 8%, with the Nasdaq 100 higher by 9.2%. Headlines around the partial closure of the U.S. government dominated the news—a decline in both business and consumer confidence seemed at least a partial reaction to the impasse. However, strong job numbers for both December and January showed the U.S. economy remains in fairly good shape. By month's end, a temporary solution to the shutdown paved the way for U.S. equities to register the best January returns in 30 years.

International developed equity markets rose 6.6% (in USD), with Japanese equities higher by 6.1% (USD). In December, Italian budget proposals for 2019 got the green light from the European Commission—a positive step. However, Italy remains a major risk for Europe as European banks hold a lot of Italian debt, including a large exposure from France's BNP Paribas and exposure from German and Belgian banks. Brexit uncertainty continues ahead of a looming deadline for a U.K. exit from the European Union in late March.

Emerging markets rose 8.8% (USD), while China gained 11.1% (USD). In early January, the Chinese central bank once again cut banks' reserve requirements in an effort to boost the slowing domestic economy. While Chinese GDP still outpaces most other global economies, the most recent reading of 6.4% annual GDP growth is the weakest pace of growth since 1990.

The view from our Chief Investment Strategist:

LUC DE LA DURANTAYE

DID DECEMBER'S VOLATILITY CREATE A BUYING OPPORTUNITY?

One silver lining to the recent turbulence in financial markets is an improvement in the valuation of most asset classes—with the exception of developed market sovereign bonds. Strictly from a valuation point of view, equities are currently more attractive than government bonds. Emerging sovereign bonds and corporate bonds are also becoming more attractive under the assumption of continued growth. However, these valuation advantages may not materialize in the near term until the economic slowdown stabilizes and geopolitical risks recede. The timing of an increased allocation to risky assets is tricky in this volatile environment. However, cautiously building positions could prove rewarding over the long term.

In addition to slowing growth, emerging markets (EM) are facing rising interest rates, a strong U.S. dollar, the U.S.-China trade war and idiosyncratic shocks in countries like Argentina, Turkey and Brazil. These headwinds are expected to fade in 2019. The Fed is expected to pause, which implies limited upside for long-term interest rates and the U.S. dollar. Turbulence in some troubled EM countries seems to be contained for the moment. Emerging markets have become more resilient over the years but remain cyclical and higher octane assets. Given attractive valuation, they should be one of the better performing asset classes once the dust settles.

FIXED INCOME

The bond market started the year on good footing, with yields declining across the yield curve and credit spreads falling as investor demand returned for riskier assets. The catalyst was a more dovish U.S. Federal Reserve that now sees the fed funds rate near the neutral level. It has indicated that its next move could be to either raise or lower its rate depending on how the economic data unfolds.

The Bank of Canada (BoC) is also more dovish, acknowledging that the economy slowed in the fourth quarter due to the impact of low oil prices and a slowing in the housing market. The futures market now sees the odds that the BoC raises its rate in 2019 at less than 50%.

CANADIAN EQUITY

Canadian equities gained 8.7% in January, as all sectors moved higher following the year-end 2018 pullback. The tiny health care sector (2% weight in the S&P/TSX index) rose 43% as marijuana stocks recovered some of the ground lost in late 2018. Higher oil prices benefited some energy stocks, pushing the energy subsector to a gain of 10.7%. All subsectors scored positive gains for the month, with the heavily-weighted financial sector higher by 8.5%, materials higher by 6.7% and industrials up 7.4%.

SOUND BITES

Brian See
Portfolio Manager, Global Equities

Oil prices were extremely volatile in the last three months of 2018, moving up to $75/bbl early in the quarter only to fall below $45/bbl a few months later. Prices have now recovered to about $50-$55/bbl, but we believe we'll see more volatility in 2019 because so many different factors are driving the oil price.

In terms of forecasting oil supply, we're mainly looking at three things. The first is OPEC cuts. Last year, OPEC implemented a 1.2 mb/d* production cut, which took effect January 1st 2019. This will obviously take supply off the market, drain oil inventories and help keep the oil markets in balance. The second big factor is the Venezuela situation. The country is in social and economic chaos and has been since President Maduro took over the country. Oil production has fallen continuously and currently sits at just over 1 mb/d—off a peak of 2.4 mb/d. In late January, the U.S. administration announced economic sanctions that target Venezuela's oil sector. U.S. entities and other countries dealing with Venezuela must halt oil purchases from the country or be subject to U.S. sanctions. This is similar to the sanctions the U.S. placed on Iran and impedes Venezuelan oil from getting to market, potentially removing supply.

We are also considering the situation for U.S. shale producers. These companies are now preparing budgets and allocating for capital spending with oil prices around $50-$55. Contrast this with budgets created last year in an environment of $60-$65 oil. Weaker oil prices will prompt lower capital spending and ultimately less oil production.

On the other side of the equation, oil demand is effectively a wild card. Global GDP growth is decelerating and will likely continue to slow throughout this year. One important statistic we'll track is consumption of diesel fuel and everyday consumer products such as gasoline. We need to see those inventory levels come down to confirm that demand remains well supported.

Overall, when we combine the supply and demand factors, we believe oil will trade in a range of about $50-$60 for most of 2019. Obviously this is a moving target and many variables can change. However, we believe this is a realistic range that balances most of the main factors currently affecting supply and demand.

*million barrels/day

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