MARKET SPOTLIGHT

GLOBAL MARKETS

Although global financial markets turned negative in August, U.S. and Canadian equities approached multi-year highs in mid-September. Trade worries alternate with central bank stimulus efforts and decent economic data to produce a mixed picture. In August, global equity markets dropped -2.1% (USD), and -0.9% (CAD), as the Canadian dollar weakened.

U.S. broad equity markets were lower by -1.8%, with the Nasdaq 100 down -1.9%. August U.S. manufacturing data confirmed suspicions of an ongoing slowdown, as it moved into "contraction" territory. However, this can be taken as not entirely bad news, as it makes a Fed interest rate cut more justifiable in September. U.S. consumer spending surprised with its strength (+0.6%), following a robust July retail sales number.

International developed equity markets fell -2.6% (USD), with Japanese equities lower by -1% (USD). Political drama continues in the U.K., as Boris Johnson attempts to ensure Brexit takes place at the end of October, and the U.K. parliament works to thwart him. German economic numbers indicated the country is close to recession, with an economic contraction in Q2. With all the uncertainty and gloomy economic signs, the ECB* introduced stimulus measures on September 12, including a restart of its QE program in November.

Emerging markets fell -4.9% (USD), while China lost -4.2% (USD). The push and pull of the trade war continues to weigh on the Chinese economy. Stimulus measures from the Chinese central bank were stepped up in early September, following downbeat export news—August shipments to the U.S. were down 16% from the year earlier. Economic turmoil in Argentina caused its currency to plummet 26% versus the U.S. dollar.

Global growth slowdown dissected

Theme	Impact	Contribution	
Global growth (2018)	3.60%	-	-1.15%
Global growth (current)	2.45%	-	
Trade war impact on China	-0.15% (on China)	13%	
China slowdown impact on rest of world (ROW)	-0.47% (Hit on US: -0.05%) (Hit ROW: -0.42%)	41%	
German recession impact on rest of Europe	-0.23%	20%	
Ex-China non-financial companies' profit recession	-0.30%	26%	

Source: CAM, Sept. 2019

The view from our Chief Investment Strategist:

LUC DE LA DURANTAYE

In collaboration with **Vincent Lépine, Director, Economic and Market Research**

IS A RECESSION COMING?

With already ultra-low interest rates and massive central bank balance sheets, can we be sure that we'll avoid a global economic downturn? What is comforting is that the efforts now being deployed are truly global. Not long ago, the most important central bank in the developed world—the U.S. Federal Reserve (Fed)—was still in tightening mode. By shifting policy into easy territory, the Fed will be providing much needed liquidity relief across the globe. The most important lesson of the last decade has clearly been never to underestimate the ingenuity of policy-makers. When conditions required it, they didn't hesitate and took action. In most cases, this led to the adoption of very unorthodox policies (i.e. sub-zero policy rates and asset purchasing programs). Looking forward, we could again be surprised by how far they are ready to go. If conditions justify it, it is not impossible that policy rates will be moved deeper into negative territory and that many central banks will adopt or resume Quantitative Easing (QE). In fact, the ECB* has announced a resumption of QE and the Fed will likely cut rates again at the September (Sept. 17-18) or October meeting.

Having said this, it has become quite clear that unorthodox policies come with significant negative side effects over time. This is very apparent when looking at interest rates across the maturity spectrum. For the first time ever, the global yield curve is inverted in the context of ultra-low policy rates and increasingly adverse economic conditions. This spells trouble for the financial sector—the longer this situation prevails, the more intense the pressure will become for global banks.

*European Central Bank

FIXED INCOME

Bond yields saw a sharp decline in August, as U.S./China trade tensions escalated, raising the odds that the U.S. economy would slip into recession. Those fears were bolstered by evidence of sluggish growth in Europe, with its growth engine, Germany, showing signs of strain with a minus sign in front of its most recent quarterly GDP figure. It also doesn't help that the U.K. may fall out of the European Union without a deal and that Italy's government was changing once again. The rally in bonds saw U.S. 30-year Treasury bond yields move below 2% for the first time in history. The Canadian 30-year bond yield moved below its prior all-time low from 2016.

CANADIAN EQUITY

Canadian equities gained 0.4% in August, countering the downside trend in most global equity markets. Following a couple of quarters of very slow growth, the Canadian economy has come roaring back. Second quarter GDP surged to 3.7%—this was above consensus expectations, and followed a revised 0.5% (0.4% prev.) advance in Q1.

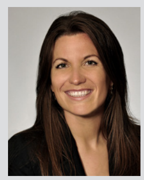
SOUND BITES—IS A RECESSION JUST AROUND THE CORNER?

Craig Jerusalim
Portfolio Manager

Look beyond the yield curve

Now that the bond market has produced a classic early indicator of recession—the inverted yield curve—every news outlet is stoking fears of an imminent recession. Just as we don't look at just one indicator when we decide whether to buy a stock, I'd advocate the same holistic view when gauging where we are in the economic cycle. The indicators I'm looking at include jobs data, housing, business and consumer confidence and credit trends. On jobs, an important leading indicator is initial and continuing unemployment claims—both are at cycle lows and only just starting to rise. On housing, one leading indicator is home permits, which has been on an uptrend and leads me to believe that falling home prices won't cause the next recession. Looking at the consumer, both confidence and spending gauges are reasonably strong.

A combination of indicators like these, which I would argue are more accurate than one simple historical gauge like the yield curve inversion, paints a pretty healthy economic picture. Regardless of whether the economy slows or strengthens, however, I'd advocate buying high quality, growing companies with strong balance sheets and a defensible competitive advantage. These should weather any type of economic environment.



Alexandra Syrnyk
Research Analyst

What the rails can tell us about the industrial sector

Weakening rail freight volumes are flashing warning signs for the health of the North American industrial sector. Rail freight volumes are an indicator we watch closely to gauge macroeconomic health. Following robust rail traffic in 2017 and 2018, U.S. rail volumes began to decline in April—attributed to cold weather, flooding and U.S. tariffs. However, business failed to rebound when weather improved and recently declined further—volume slowdown appears to be due to lower demand. When combined with weaker global manufacturing data, this indicates we could be moving into an industrial downturn, largely due to the U.S.-China trade dispute.

Canadian rail traffic is positive year-to-date but slowed dramatically in Q3, indicating that underlying economic fundamentals could also be deteriorating here. We'll closely monitor weekly freight data and commentary from rail executives to assess the probability of a deeper freight downturn in Canada. We expect continued weakness in U.S. rail stocks as Q3 volumes are coming in below expectations. Since indicators of consumer health are more favourable, we currently prefer equities with consumer-driven end markets over industrial/freight-driven end markets.