

## Commentary – Q3 2019 – Election Season



It is a given that politics will dominate the news cycle in any given quarter. During much of the third quarter of 2019, this has been the case to the exclusion of any real drama in the markets. This time though, politics has become more personal. As an example, with the Canadian election on our doorstep, the politics of race took on renewed importance. Indeed, the history of race relations in our society, and ultimately how we treat each other as people has become amongst the most salient topics of our age. And although it can be painful for the select few to recognize their inherent privilege, just as it has been painful for racial minorities to suffer discrimination at the hands of western society, it is an important conversation to have.

Perhaps even more topical during the quarter has been the emphasis on the debate over, and the politics of climate change. This was brought to the foreground in the form of massive climate change protest marches that took place in many urban centres across North America in September. The question can now be framed as how we, as a civilization, can prevent catastrophic damage to our way of life because of climate change. This is a way of life that we have become accustomed to, and as noble as the fight to reduce carbon emissions may be, preventing economic collapse in the medium term, as we transition away from fossil fuel consumption, must also be addressed. This trade off means deciding what conveniences we need to sacrifice in the fight against climate change. It also means learning to make the conveniences of a modern society that we have built for ourselves in the West, and that developing economies desperately want to experience, sustainable. Ultimately, as much as youthful enthusiasm surrounding climate protests can inspire optimism about the future for the planet, the harsh reality is that the transition to a sustainably carbon-neutral economy remains a costly work in progress that will evolve for years, if not decades, to come.

Another debate surrounds the politics of free speech, as was in evidence in the continuing demonstrations in Hong Kong. The protesters are in a dispute with their own government concerning the harmonization of extradition treaties with Mainland China. The question that surfaces as far as we are concerned, is how best to accommodate differences in other cultures without compromising values that the West has always supported: including the most fundamental of freedoms, expression. As was in evidence in China's dispute with the National Basketball Association (NBA) recently, the extent to which the Western world is supportive of freedom of speech and assembly, may only go as far as the threat to their companies' profits will allow.

Indeed, the debates surrounding how to achieve a sustainable and just society have, for a time at least, eclipsed economic concerns.

As for the direction of markets in Q3, it can be looked upon from a few vantage points. On one hand, the typical complacency that accompanies market movement in the summer months was firmly in place. But lurking beneath the surface, no shortage of geo-political tension continues to generate uncertainty as we head towards the end of the year. In Canada, there is an election coming and the results will shape policy in the short to medium term. The results may also influence how foreign investors view the Canadian business landscape, which in turn can influence capital in-flows here at home.

In the United States (U.S.) the continued trade tension between the world's two largest economies (the US and China) was enough to create significant market volatility, as was certainly the case during the first half of Q3. And now the spectre of possible impeachment of President Trump as we head into the fourth quarter (Q4) threatens to distract markets for the next few months at least. In Europe, the Brexit debate is still front and centre in the headlines. There seems to be no real solution to the impasse between the rest of the European Union (E.U.) including the Republic of Ireland, significantly, and the United Kingdom (U.K.) other than to kick the can down the road and pray for a workable solution to drop from the sky. Finally, in Asia, the conflict in Hong Kong reads, on the surface, as a challenge for local sovereignty in policy terms, as it also struggles to reconcile its place within modern China. But it is also perhaps a metaphor for the struggle for democracy that inevitably occurs within a more liberal market-based system. This makes for an uneasy fit in a system that has traditionally seen democratic ideals as dangerous to the proper functioning of the apparatus of the state and therefore considered to be subversive. To be continued.

In Q3, Canadian stocks were volatile but rose solidly to end the quarter, as concerns over a looming recession in North America abated somewhat, and Central Banks sought to engineer that ever elusive soft landing for western economies after a decade of uninterrupted growth. The S&P TSX Composite Index (TSX) rose by 2.48% and the bond market stabilized with the yield curve steepening slightly to reverse a brief period of inversion.

In the US, after a complacent second quarter, volatility returned in Q3, as investors received mixed signals from the U.S. Federal Reserve (the Fed) and the bond market. Still, stocks performed satisfactorily, with the Dow rising 1.83%, the S&P 500 up 1.70% and the NASDAQ just about break even, up 0.18% for the quarter. Curiously, if measured back to the early part of 2018, it becomes evident that the US equity markets have been in a sideways pattern, with downdrafts and sharp recoveries along the way, but with no clear direction as such. This is due perhaps to the overly optimistic environment that persisted in the weeks and months immediately following the implementation of the Tax Reform Bill that gave the domestic economy a short-term boost of energy.

With clear signals towards the end of Q3 that domestic manufacturing was experiencing a significant slowdown because of trade tensions, it is now almost certain that the Fed and other central banks will continue to ease monetary policy. And although manufacturing (precisely the sector of the economy that was meant to benefit from protectionist trade policy) is not the whole of the economy (in fact it represents roughly 10% of domestic U.S. Gross Domestic Product (GDP)), it may still be looked on as a barometer of economic conditions and turmoil can lead to a domino effect in other sectors.

It is also true that the strength of the US dollar (USD) and the Fed's short-term rate policy has contributed to the softness in manufacturing. That the Fed had, up to the third quarter, raised short-term rates nine times over the last two years, now puts it at odds with the European Union (EU) where short term rates are effectively zero, and a jaw-dropping 15 trillion dollars of investment-grade debt is now trading at negative yields. At this stage of the cycle, although

leading economic indicators like manufacturing data have been weak and generally signal caution, there is still no imminent threat of recession. For a clearer view of how the next year unfolds, the answer hinges, to some extent, on political developments here at home, including the societal struggle between energy infrastructure development and climate change activism, as well geo-political developments abroad.

For the next 12 months, politics promises to be at the front and center of the news cycle, again. In Europe, the Brexit negotiations will continue, perhaps indefinitely, and soon enough, voters in the United States will grapple with a choice at the ballot box, after having potentially followed the impeachment process to its bitter conclusion. For Canadians, political drama starts now, as the Federal election takes place at the beginning of the fourth quarter and will undoubtedly influence how markets react as the year winds down.

Best regards,

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Sources: TD Wealth – Q3/19 – Quarterly Market Review; Straight Forward – Autumn 2019; TD Economics – Dollars and Sense – September 2019; TD Economics – Quarterly Market Forecast: Living on the Edge – September 2019

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