Spring 2019

Since the U.S. Federal Reserve's about-face on short-term rates in late 2018, it has been off to the races for equities through the first quarter of 2019 (Q1). Combined with Q4 2018 corporate results that were not as bad as expected and seemingly positive momentum in U.S./China trade dialogue, there's been a meaningful shift in market sentiment. The pace of the first quarter's gains left investors who turned away from equities in 2018 feeling whipsawed while rewarding those that stayed the course or added into the late-2018 decline. Correlations between global equity markets have been high as the Q1 gains had broad participation: S&P/TSX 13.29%, S&P 500 11.32%, U.K. London FTSE 9.58%, German DAX 4.82%, MSCI Japan 4.66%, China Shanghai Comp 24.28%, MSCI EAFE 7.87%, MSCI Emerging Markets 7.72%, and MSCI World Index ex-USA 8.34% (Q1 2019 returns in Canadian dollars). The entry point for the year-to-date market performance leaves the returns looking somewhat inflated as most markets were still below their 2018 highs. While the cannabis heavy health care sector led the way in Canada, it was a broad based rally with 8 of 13 sectors, including the S&P/TSX's largest sectors, posting double digit gains over the first three months of 2019. Canadian equities have been able to start the year ahead of the U.S. thanks to the U.S. financial sector lagging and a modest currency based gain.

The U.S. Federal Reserve's Federal Open Market Committee's (FOMC) late-2018 move to a wait and see approach has evolved into "watchful waiting" as characterized by Chair Powell following their March meeting. The broad interpretation of recent Fed-speak is that there will not be any rate changes until economic data pushes the committee one way or the other. They seem broadly positive on the U.S. economy, but will be waiting for clarity on how global economic growth and trade relations play out. While it is no foregone conclusion that President Trump's most recent nominees for the Federal Reserve's empty seats will make it through the nomination process, it would be very surprising if they were to disagree with the President's recent comments about rates being too high. Given that, we do not expect the FOMC to push against the President’s administration and lean towards the current targeted range of 2.25-2.50% being the high-point of the current rate cycle.

While not a follow of the FOMC's lead, the Bank of Canada finds itself in a similar position, albeit at a lower level. They maintained an overnight rate at 1.75% following their most recent meeting, as expected, and removed the previously included references to higher rates from their communique. More meaningfully for the bond and foreign exchange market was a significant reduction in 2019 GDP forecast, down to 1.2% growth from 1.7%. TD Securities maintains an overnight rate forecast of 1.75% until "at least the end of 2020" following this updated outlook. This seems too far off to us and while we would be surprised if the Bank of Canada went that long without a change, more time and data will be required before which directionality of the next move can be determined.

Despite both the FOMC and Bank of Canada being on hold, the details of their respective communiques has us preferring the U.S. dollar relative to Canada’s. The immediate reaction to the BoC’s Canadian GDP expectations bounced the CAD/USD exchange rate out of its recent $1.325-1.345 ($0.744-0.745) range. This has occurred despite oil trading at its highest level of the year. Looking out beyond this immediate reaction, there remain concerns about the U.S.-Mexico-Canada Agreement with the U.S. Congress yet to vote for the deal's ratification. While President Trump's office claims they have the votes, it's Democrat and speaker of the U.S. House of Representatives Nancy Pelosi who needs to bring it to the floor and we'd be surprised if this were done without some political theatre/delays.

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Beyond the U.S. dollar's relationship with the Loonie, it has also moved higher relative to the rest of the world, as measured by the U.S. Dollar Index. The further the U.S. dollar goes, the more likely it is to become an active target of Presidential tweets. We believe that while it seems a long ways off and there are geopolitical issues that will need resolution first, the rhetoric around the U.S. election will start ramping up over the balance of the year and we see a lower U.S. dollar as a tool President Trump will look to use as a stimulant of U.S. growth leading into his 2020 re-election campaign.

Without the expectation of central bank hikes on the horizon, short and medium-term rates have trended lower since the beginning of 2019. In the U.S., it occurred to the extent that the 10-year Treasury briefly traded with a yield lower than the mid-point of the aforementioned Fed Funds target range of 2.25-2.50%. While a non-traditional measurement of an inversion, it did elicit some concern about the direction of the economy. We disagree that this “inversion” was reflective of the bond market discounting a forthcoming recession as the widening of the spread between the 2 and 10-year Treasury bonds over the same period is not reflective of flight to safety. Without directionality being provided by central banks, our expectation is that Treasury rates, both in Canada and the U.S., will be range-bound in the coming months.

In the weeks since the end of March 31, equities have continued their move higher with many of most widely followed large cap North American indices approaching their 2018 (and historical) highs. Though trading in lock step with S&P 500 and carrying lower earnings based valuation metrics, we believe the overhang of household debt concerns and stagnation within the Canadian energy sector and the resulting slower expected economic growth, will weigh on Canadian focused equities. Our preference within Canada is towards Canadian companies with relatively larger exposure to the U.S. economy and looking towards the U.S. market for growth. While participating in a similar way in year-to-date performance, unadjusted for currency effects, many of non-North American indices remain below their comparable highs. It is towards these markets, including emerging, where we would look for valuation gains. More so than other U.S. Presidents in recent memory, Trump seems to measure his administration’s success in part by the growth of the U.S. equity market. And while the pace of market growth witnessed to start the year is expected to wane, we expect market friendly policy to provide economic and thereby equity market support as the election cycle starts to ramp up.

New Address

As noted below and while remaining at 360 Albert St., you can now find us on the 16th floor.

Ottawa Little Theatre - November 23rd

Mark your calendars for a viewing of *Miss Bennett: Christmas at Pemberley* at our annual client appreciation event.

Sources:
Bloomberg Finance L.P. as at March 31, 2019. Total Index returns. Index returns calculated in C$.
bankofcanada.ca/rates/exchange/currency-converter/

Interest Rates as of May 1, 2019

Fixed Income Securities	1 year	2 years	3 years	5 years	10 years	20 Years	30 Years
GICs**	2.41%	2.47%	2.52%	2.72%			
Canadian Treasury Bonds*	1.65%	1.58%	1.59%	1.62%	1.73%	1.97%	2.00%
U.S. Treasury Bonds*	2.31%	2.32%	2.34%	2.33%	2.50%	2.76%	2.90%

* Rates provided by TD Securities
** Rates provided by TD Wealth

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