Winter 2019

Looking back at 2018, it's no stretch to say that it was broadly the weakest year that financial markets have had since 2008, now more than a decade past. The market's concerns in early fall rolled on through the balance of the year as uncertainty of higher interest rates, global trade, Brexit, Italy, and U.S. President Trump's public diminishing of his own choice for U.S. Federal Reserve Chairman led the list of reasons mentioned as contributing causes of volatility. The U.S. mid-term elections were about the only thing that was resolved and not in a way that calmed market tension. The broad decline that accelerated into the year-end holiday season more than gave up the modestly positive position they had on Sept 30: S&P/TSX -8.89%, S&P 500 3.98%, U.K. London FTSE -6.4%, German DAX -15.24%, MSCI Japan -4.93%, China Shanghai Comp -22.4%, MSCI EAFE -5.78%, MSCI Emerging Markets -6.75%, and MSCI World Index ex-USA -6.09% (calendar 2018 returns in Canadian dollars). By sector, 6 of 11 S&P/TSX sectors, including financials and energy, were down double digits in Q4. Excluding healthcare, which was one of just two sectors to post positive Q4 returns in the U.S., it was a similar story for the S&P 500, with 5 of 11 declining more than 10%. Though the negative momentum accelerated into the low-volume holiday period with a historically weak Christmas Eve, the equity markets have since reversed from a technically oversold position and rallied through early 2019.

While high(er) interest rates may be a relative term defined differently by groups of investors with differing investment objectives, the direction and pace of the U.S. Federal Reserve's Federal Open Market Committee's forecast for 2019 was a contributor to the late-2018's market volatility. Add President Trump's comments about Chairman Jay Powell and the FOMC was in a tough spot going into year-end. With the clarity of hindsight, they appear to have chosen to assert their independence with the hike they had previously promised at the December meeting, but have also since backed off their forecasts for 2019 as the calendar turned. Recent speeches and their no change announcement on Jan. 30th have taken a much more dovish stance where they plan to wait and see how the economy develops. This brings the Fed Funds rates band at 2.25-2.5% and has most economists forecasting zero or one hike in 2019. While they may not be expected to change rates in a meaningful way this year, Chairman Powell will have plenty of opportunities to provide verbal guidance with press conferences now following all FOMC meetings.

With lagging economic data, the Bank of Canada hit neither gas nor brake since a move to 1.75% last October. While consumer household debt continues to be a concern, a widened gap between Alberta's heavy Western Canada Select and the U.S. lighter West Texas Intermediate in 2018 left Canada's economic growth at a lower than expected pace. The impact was sufficient enough for the Government of Alberta to impose output cuts on January 1. Despite the price gap narrowing and inventories declining faster than expected since then, the impact likely leaves the Bank of Canada on hold through their next several meetings. We believe the Bank of Canada would like to narrow the interest rate gap with the U.S., but will wait for the back half of 2019 to do so.

After spending much of the year in the red, a return to the traditional rate/risk relationship brought the FTSE TMX Canadian Universe Bond Index back into positive territory as the year ended amid heightened anxiety. The risk-off trade brought the five-year Canadian Treasury yield on a near round trip from 1.86% to 2.47% and then back to 1.89% by year's end. It was a similar story south of the border, where U.S. Treasury yields experienced a similar rise and then reversal to end the year lower, save for a 0.35% increase in the 2-year yield. On balance, there was a narrowing of the yield curve which matches the

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aforementioned data dependence of North American central banks. Given that scenario, we expect interest rates to remain range bound in early 2019.

Despite a relatively flat quarter for the U.S. Dollar Index, the Canadian dollar bucked the FX trend and declined 5.11% in Q4, with December 31st being the low point for the year. Diverging economic data and slow Canadian exports were the basis for the move. With a narrowing of the aforementioned heavy oil pricing gap, that late 2018 move has all but been reversed with the Canadian dollar gaining 3.8% in the month of January as the U.S. Federal backed off the rate hikes that the market had discounted. That move has brought the Loonie back to previous support levels of $1.326 per USD (or inversely to $0.757) and towards the middle of its almost three-year trading range of $1.22-1.36 per USD. With the U.S. FOMC on hold and our expectation that the BoC will look to narrow the interest rate differential, though not until the back-half of 2019, we view the Canadian dollar as roughly fairly valued with a modest strengthening bias over the balance of 2019.

The extreme oversold position of equities witnessed at the 2018 low on December 24th have since reversed and flipped many indicators into technically overbought territory. While trading around the holidays can be more volatile due to lower levels of volume/market participation, the rebound continued into 2019 with January posting historically positive returns. The confirmation of the initial late 2018 reversal has been based on an accommodative adjustment in central bank policies combined with 2018 Q4 financial results that relieved the worst of the market's fears. Given the contribution of better than expected earnings, we expect these overbought levels to be worked through with neutral market activity rather than another trend reversal back towards last year's lows given that we've seen a valuation reset and equity markets that remain well below their 2018 highs.

Registered Account & Tax Reporting Information

As per the Ottawa Wealth Advisory Group tax card, note that the 2019 TFSA contribution limit was increased to $6,000 and 2018 and 2019 RSP contribution limits are $26,230 and $26,500, respectively. Please note the following mandatory mailing dates for various tax reports/slips, to the degree that they apply:

T5 - February 28, 2019
T-5008 - February 28, 2019 (for reference purposes)
T3 - April 1, 2019

Sources:
Bloomberg Finance L.P. as at December 31, 2018. Total Index returns. Index returns calculated in C$.
bankofcanada.ca/rates/exchange/currency-converter/
Thomson ONE

Interest Rates as of Feb. 1, 2019

Fixed Income Securities	1 year	2 years	3 years	5 years	10 years	20 Years	30 Years
GICs**	2.65%	2.85%	2.93%	3.08%			
Canadian Treasury Bonds*	1.71%	1.84%	1.85%	1.86%	1.96%	2.12%	2.19%
U.S. Treasury Bonds*	2.40%	2.50%	2.50%	2.50%	2.69%	2.94%	3.03%

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

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