Market Matters

MAY 2015 HIGHLIGHTS

- The US and Canadian energy sectors (which had rebounded strongly last month on stabilizing oil prices) were the weakest performing sectors on both sides of the border (see table 3).
- While oil prices moved back into a $60/barrel WTI range, energy companies had already priced in a higher range for oil prices. As a result, energy stock prices did not recover in step with oil prices in May (see table 2).
- Canadian equities declined modestly in May, while US equities managed modest gains. In the US, merger and acquisition activity in the healthcare sector boosted results and compensated for the weakness in the energy sector (see table 1).
- On balance, developed markets outperformed developing markets.
- Relative weakness in the Canadian dollar boosted the results of Canadian returns on foreign investments.
- Bond yields rose sharply through to mid-May, but then stabilized (and even declined a bit). By month's end the income generated by the bonds (slight as it may be) helped to offset the price declines experienced in the first half of the month (see table 1).
- Greece's ongoing debt problems made for challenging negotiations and numerous headlines.
- Short-term volatility in Chinese equities (as much as a 6.5% drop in a day) has yet to end the dramatic bull run that caught traction back in the fall of 2014.

Table 1
Summary of major market developments

Market returns*	May	YTD
S&P/TSX Composite	-1.4%	2.6%
S&P 500	1.0%	2.4%
- in Canadian dollars	***4.2%***	***9.8%***
MSCI EAFE	1.0%	12.2%
- in Canadian dollars	***2.0%***	***14.8%***
MSCI Emerging Markets	-2.7%	7.4%
FTSE TMX Canada Universe Bond Index**	0.2%	2.9%
FTSE TMX Canada all corporate bond index **	0.2%	2.8%

*Local currency (unless specified); price only
**Total return, Canadian bonds

Table 2
Other price levels/change

	Level	May	YTD
CAD per USD exchange rate	$0.803	-3.0%	-6.6%
Oil (West Texas)*	$60.30	1.1%	13.2%
Gold*	$1,189	0.6%	0.1%
Reuters/Jefferies CRB Index*	$223.18	-2.7%	-2.9%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	May	YTD
S&P/TSX Composite	-1.4%	2.6%
Energy	-6.3%	-1.7%
Materials	-0.8%	5.3%
Industrials	-3.5%	-5.7%
Consumer discretionary	4.9%	7.0%
Consumer staples	1.6%	1.5%
Health care	11.4%	66.3%
Financials	-1.7%	-0.6%
Information technology	0.2%	8.5%
Telecommunication services	1.7%	0.6%
Utilities	-3.2%	-0.3%

*Price only
Source: Bloomberg, MSCI Barra, NB Financial, FTSE TMX Global Debt Capital Markets Inc.

WHAT'S NEW(S) IS OLD IN ANCIENT GREECE

According to Aristotle, the Greeks developed tragedy first, with comedy following a generation or so later. And so it is that Europe awaits the Greek punchline to a problem that refuses to die on cue (or even play dead for more than a few acts).

Concerns over Greece's ability to repay debt due in June escalated with another round of tough negotiations by Greece and European banking and finance chiefs, coupled with political discussions from within the country on if it should repay at all, and if it should remain in the European Union (EU). You could be forgiven for having to date-check the newspaper, as cut-and-paste headlines about another looming debt deadline for Greece seem to be appearing on rotation every few months. However, there are a few important distinctions between previous Greek debt crises and the current situation - the most important being one of sentiment.

The idea of a Greek default (and even an exit from the EU) seems more tolerable this time around. Greece is now less than half a percent of global GDP. For all the tough negotiations, by now the International Monetary Fund and European Central Bank (owners of pretty much all Greek government bonds at risk of default) have a very good handle on the extent of the risk they are exposed to. Europe's economy, though still fragile, has begun to grow again and most importantly, the other peripheral European nations most at risk to suffer contagion from events in Greece (i.e. Ireland, Portugal, Italy, and even Spain), have also improved their financial health. A Greek default looks more palatable today than at any of the previous debt crossroads it's faced. In short, Greece is more likely to default, simply because it no longer seems so scary if they do. With new deadlines and more negotiations on the horizon, expect more 'Greek debt' headlines and market volatility over the summer months.

CHINA IN A BULL SHOP

Over the past eight months or so, Chinese stocks have defied both gravity and the conventional wisdom of the day. Initially, one could see where Chinese economic and fiscal stimulus provided a measure of fuel to the rally. However, the current thinking is that the bull is running more on fumes than fuel these days. The mere expectation of increased stimulus has been enough to build investor optimism, offsetting the mood dampening effect of the slower paced economic growth and activity in the country.

A few dramatic pull backs (e.g. May 28th when the Shanghai Composite dropped over 6% in one day) should serve as a warning of more volatility to come, but Chinese equities have continued to rise. At the end of May the Shanghai exchange was up 4% for the month, 43% for 2015, and 126% since May 29, 2014.

Of interest, India is set to outpace China this year in economic growth. In contrast to China's slowing growth rate (projected to slow to 7% this year and 6.7% in 2016), India has seen its GDP growth rate increase (now projected to growth to 7.4% in 2015 and 7.7% in 2016).

A BOND ACTION THRILLER

The month-end numbers don't show it, but the real excitement in financial markets this past month or so has been in the bond markets. A sharp rise in yields that began in mid-April carried through until the middle of May, inflicting significant losses for fixed income investors (as yields rise, bond values drop). By mid-month an increased concern over the soft-patch in US economic data put a stop to the fast climb in yields. This pause allowed time for the income generated by bonds to catch up (and offset) the drop in bond values. For fixed income investors, this can be seen through the difference in price-only returns (-0.05%) versus the total return which factors in the income generated from the bonds (+0.20%) for the FTSE TMX Canada Universe Bond Index in May. Breaking it down further, for the month of May modest gains for short and mid-term bonds (less sensitive to rising yields) helped to offset modest losses in the long-term bond sector.

OIL AND CENTRAL BANKS

American balance sheets are healthy and households have dramatically deleveraged. While there is still slack in the US job market, long-term unemployment is declining, and wage and salary inflation is finally picking up. Low oil prices are still having a negative effect on oil-related US business capital spending. Having said that, cheap energy is good news for an oil importing country (like the US) and for its consumers.

According to Andersen Economic Research Inc., the national average for retail gasoline in the US is still running more than 90 cents per gallon below where it was a year ago, making gasoline expenditures in the US on track to be the lowest in 11 years. The annual savings in gasoline costs are now estimated to be about $700 per American household, on average. Savings on heating fuel costs bring this total close to about $1000 per US household. One area of concern for the American economy is the lack of evidence that consumers are spending this 'gas dividend' and putting the money back into the economy. However on balance, the US economy seems poised for modest economic growth. This leads us to believe that the U.S. Federal Reserve can be expected to begin to tighten this year and to continue tightening in 2016, though we anticipate the pace of interest rate normalization to be relatively slow and gradual.

The Bank of Canada is headed in a different direction with Canadian monetary policy. Oil production in western Canada has been a key contributor to Canada's economic performance for a number of years, and the non-energy sectors are being counted on to step up and provide enough stimulus to revive capital spending plans and employment prospects in Canada (particularly in the energy consuming provinces). At this point in time we do not expect the Bank of Canada to cut interest rates again, but we think that economic conditions will not support an interest rate increase for quite some time and possibly not until 2017.

GREAT GREEK ADVICE

The Greeks introduced the world to '*Philosophia'* - the love of wisdom.

"Philosophy is thinking in slow motion. It breaks down, describes and assesses moves we ordinarily make at great speed - to do with our natural motivations and beliefs. It then becomes evident that alternatives are possible." **— John Campbell, Professor of Philosophy, University of California, Berkeley**

This is a wise approach indeed when building (and sticking to) your long term investment plan.