asset management

Market Matters

Summary for February 2018

Highlights

The month started with a sharp equity market pullback. The S&P 500 experienced first correction of 10%+ in 2 years.

Central banks are on a path of reducing extraordinary accommodative monetary policy.

While economic growth and corporate earnings remained strong, fears of rising inflation and interest rates grew.

A stronger U.S. dollar and higher than expected inventories weighed on oil prices and the energy sector.

February markets brought no bouquet of Valentine roses, especially after months of delivering proverbial rainbows and unicorns!

Market volatility returned with a jolt in early February. The snap correction saw the S&P 500 drop more than 10% over the course of 9 days (beginning January 29 and ending February 8). To varying degrees, all global equity markets were negatively impacted. Markets recouped some losses as the month progressed, but month-end results remained solidly in the red.

Why the quick pullback after months of record low volatility?

Strong U.S. employment results and an uptick in wage inflation caused investors to grow concerned about rising inflation and interest rates. It is important to note that inflation and interest rates are moving higher for good reason – a stronger economy. While the speed of the sell-off has been often blamed on passive investment strategies and algorithm-triggered selling, the ball got rolling because of jittery investors who'd grown overly accustomed to highly accommodative monetary policies. Using the common 'punchbowl' analogy to refer to easy lending conditions…there was an air of urgency that swept through the party guests when the host (in this case, the U.S. Federal Reserve (Fed)) indicated the time had come for the punchbowl to be removed.

As capital markets recalibrated to the current mix of market pros and cons, heightened volatility continued throughout the month. To the plus side, stock prices remain supported. Recent corporate earnings reports remain solid and forward-looking guidance from company management has been better than expected (in general). Economic data continues to point to growth; and consumer confidence remains strong, in particular in the United States where consumers are anticipating a double boost from increasing wages and tax savings. The known risks include the much talked about high

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Canadian Fixed Income[1]	Month	YTD
FTSE TMX Canada Universe Bond Index	0.1%	-0.7%
FTSE TMX Canada All Corporate Bond Index	0.0%	-0.2%

Canadian Equities[2]	Month	YTD
S&P/TSX Composite	-3.2%	-4.7%

	Month		YTD	
Global Equities[2]	Local	CAD	Local	CAD
S&P 500	-3.9%	0.0%	1.5%	3.8%
MSCI EAFE	-3.5%	-0.9%	-2.3%	2.3%
MSCI Emerging Markets	-4.0%	-0.9%	2.5%	5.5%

Currencies and Commodities (in USD)	Level	Month	YTD
CDN $	0.779	-4.1%	-2.0%
Oil (West Texas)	61.64	-4.8%	2.0%
Gold	1,319.31	-1.5%	1.3%
Reuters/Jeffries CRB Index	193.95	-1.7%	0.0%

Canadian Sector Performance[2]	Month	YTD
Energy	-6.4%	-11.5%
Materials	-4.0%	-4.6%
Industrials	1.3%	-0.6%
Cons. Disc.	-3.3%	-3.7%
Info Tech	5.8%	11.5%
Health Care	-10.1%	-13.8%
Financials	-3.3%	-3.0%
Cons. Staples	-2.7%	-4.6%
Telecom	-2.1%	-6.6%
Utilities	-4.1%	-8.4%
Real Estate	-1.1%	-2.3%

Local currency unless otherwise stated.
[1]Total return [2]Price only return
Source: Bloomberg

stock valuation levels and rising interest rates that are expected to dampen corporate investment and slow down consumer spending.

Interest rate hikes – not if, but how often

Globally, central banks are on a path of reducing extraordinary accommodative monetary policy. Consensus data points to the U.S. Fed raising rates at least three times in 2018. The increased expectations for four rate hikes in 2018 came about when the new Fed Chair, Jerome Powell, surprised market watchers with hawkish comments about the strength of the U.S. economy. Meanwhile in Canada, we expect the Bank of Canada to remain on the sidelines until the second half of 2018. While the Canadian economy remains solid, there is greater uncertainty due to a mix of ongoing trade negotiations and tenuous Canadian oil prices. As NAFTA and more of President Trump's protectionist views on trade get debated, the dance between expectations and outcomes means equity markets will remain particularly susceptible to shocks and surprises in the near term.

U.S. dollar and oil inventories weigh on oil prices and energy sector

Oil prices dropped in February as investors moved to risk-off trades, the stronger U.S. dollar pressured commodity prices, and higher than expected U.S. oil inventory reports were released at the end of the month. Lower oil prices weighed down energy stocks in both Canada and the U.S. Canada's worst performing sector, healthcare, was brought down by disappointing corporate guidance from Valeant Pharmaceuticals, as company management reported that Valeant's turn-around back to growth is now expected to take longer than had been previously forecasted.

While there wasn't much to smile about in equity-land, Canada's tech sector was a noted exception. The Canadian tech sector is small, relative to the U.S. tech sector, but it still includes fast-growing, cash flow generating companies – and it does so at a significant discount when compared to its mega-sized American peers. Furthermore, Canada's info tech sector is a natural draw for growth-seeking investors who are currently shying away from Canada's troubled resource sectors.

Canada's bond market saw mixed results

Over the course of February, the Canadian yield curve steepened. During the early days of February, the flight to safety drove bond yields lower. As the month went on yields crept back up. Only longer dated (30yr+) bonds ended the month with yields lower than where they had started. While rising rates are expected to be a headwind for bond returns, February was a good reminder of their ability to provide a counterbalance to equity market volatility – doing so by preserving capital and smoothing investment results when included within a balanced portfolio.

Life is like a box of chocolates, you never know what you are going to get

While risks were never absent, recent market performance had made investors complacent. February brought realities around rates, trade, politics and inflation back into focus. We don't control the markets, but we can control the actions we take. If you have a disciplined investment plan that is well diversified and designed to see you through short-term market uncertainty (as we do), we suggest you stick to it – because as Forrest Gump famously declared, "life is like a box of chocolates. You never know what you are going to get."

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VP Marketing and Communications, has more than 15 years of investment industry experience and has been writing the monthly Market Matters for over 10 years.

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