Market Matters

Q2 2017 Highlights

- The Canadian equity market was held back by weakness in the resource and financial sectors. Most other global equity markets moved higher.
- By and large a focus on company profits and earnings prospects supported higher equity values. This was in spite of politics and global events capturing headlines.
- Bond markets sold off late in the quarter. Market participants struggled with central bankers' views shifting toward sooner-than-expected tightening in monetary policy.
- Emerging markets outperformed their developed market peers, benefitting from both global growth prospects and a weaker US dollar.
- Oil prices dipped to USD$42/barrel - crossing over into bear market territory (i.e. 20% down from recent highs) before modestly rallying back to the mid-$40s by the quarter's end. Ample supply and high inventories have kept downward pressure on prices.
- The Canadian dollar strengthened on better than anticipated economic results and the shifting bias from the Bank of Canada toward interest rate hikes.
- The euro found relief in the definitive presidential election win by French centrist, Emmanuel Macron, and comments from eurozone central bankers that tilted their policy bias away from more easing.
- In contrast, the US dollar and British pound weakened in part due to greater political uncertainty and central bank officials' comments which seemed to conflict over the future path of monetary policy.

Table 1
Summary of major market developments

Market returns*	June	Q2 2017	YTD
S&P/TSX Composite	-1.1%	-2.4%	-0.7%
S&P 500	0.5%	2.6%	8.2%
- in Canadian dollars	*-3.4%*	*0.2%*	*4.6%*
MSCI EAFE	-1.0%	1.7%	5.7%
- in Canadian dollars	*-4.2%*	*2.6%*	*8.0%*
MSCI Emerging Markets	1.2%	5.8%	13.7%
FTSE TMX Canada Universe Bond Index**	-1.2%	1.1%	2.4%
FTSE TMX Canada all corporate bond index **	-1.0%	1.0%	2.9%

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

Table 2
Currency and Commodities
(in USD, % change)

	Level	June	Q2 2017	YTD
CDN$	$0.771	4.1%	2.7%	3.7%
Oil (West Texas)	$46.04	-4.7%	-9.0%	-14.3%
Gold	$1,242	-2.1%	-0.6%	8.2%
Reuters/Jefferies CRB Index	$174.78	-2.8%	-6.0%	-9.2%

Table 3
Sector level results for the Canadian market

S&P/TSX sector returns*	June	Q2 2017	YTD
S&P/TSX Composite	-1.1%	-2.4%	-0.7%
Energy	-4.4%	-9.1%	-14.7%
Materials	-4.2%	-6.7%	-1.3%
Industrials	0.0%	5.7%	10.8%
Consumer discretionary	-0.4%	4.3%	11.0%
Consumer staples	-3.2%	1.4%	3.7%
Health care	13.5%	13.0%	1.4%
Financials	2.2%	-1.8%	0.7%
Information technology	-4.4%	2.1%	9.1%
Telecom services	-3.7%	1.4%	5.3%
Utilities	0.1%	1.5%	7.7%
Real Estate	-1.2%	0.0%	3.3%

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

IT'S MY PARTY, AND I'LL CRY IF I WANT TO.

As Canada celebrated its 150th birthday, the Canadian equity market remained one of a sad few developed markets in negative territory on a price only basis year-to-date (the S&P/TSX Composite was slightly positive on a total return basis year-to-date factoring in dividends).

At the mid-way point in the year, markets have tempered both the enthusiasm over the pro-business agenda of the new US Republican administration and the trepidation over European politics (Brexit and French elections). While these and other global events dominated the news wires, capital markets followed the fundamentals (such as current and prospective corporate earnings growth), which have been largely supportive of stronger equity prices. The majority of global equity markets saw strong market gains. The Canadian market was the exception.

Canadian economic data remains robust, including G7-leading GDP growth for the first quarter of 2017 and a string of solid monthly job gains. However, Canada's resource sectors find themselves in negative territory, dragged down by a drop in oil and gold prices. The low price of oil was the most obvious culprit. Excess supply continues to dog the energy sector, in spite of improving demand. Gold prices also dipped, weighing down the materials sector. The Canadian financial sector (another large sector in Canada) has only just begun to show improvement by way of positive returns. June tailwinds for the sector came by way of growing prospects for higher interest rates, as well as some concern over Canada's hot real estate market (primarily in Vancouver and Toronto) modestly cooling.

The health care sector (which makes up only 0.7% of the S&P/TSX Composite) was buoyed primarily by the rebound of a single stock, and was a small but bright spot for Canadian investors. The S&P500 health care sector was also the top performing sector this past quarter. In the US, the sector has responded to the US presidential administration's efforts to "repeal and replace" Obamacare. As the odds of "adjust" appear better than "repeal" or "replace," investors took comfort in the current status quo representing less uncertainty than would an immediate wholesale change to Affordable Care Act.

SHE SAID/HE SAID. AND WE HAVE TAPES!

The most dramatic market action came from global bond markets. For most of the second quarter bond yields dropped as inflation figures softened and US growth expectations were lowered. The final week of June brought surprise 'hawkish' comments from many central bankers. In a series of comments, speeches and interviews given by global central bank figures, a noted shift in sentiment took hold - from 'accommodative and neutral' to 'neutral and hawkish'. In short, rate hikes and a tapering of accommodative policy appear to be coming sooner than had previously been priced in.

- **Canada:** In a mid-June speech by Bank of Canada (BoC) Senior Deputy Governor Carolyn Wilkins (our BoC number two person) said "As growth continues and, ideally, broadens further, Governing Council will be assessing whether all of the considerable monetary policy stimulus presently in place is still required." The comments sparked a radical repricing of BoC rate hike odds. BoC Governor Poloz corroborated Deputy Governor Wilkins' comments and contributed some more in a CNBC interview on June 28, filling in the details that has everybody thinking the hike is coming soon (with odds now in favour of a summer 2017 hike).

- **United States:** Also in mid-June, US Federal Reserve (Fed) Chair Janet Yellen elaborated more on the details of their plan to shrink the Fed's balance sheet. She also talked down the recent softness in inflation, something they had previously taken a close look at. The Fed continues to signal at least one more rate hike in 2017.

- **European Union:** European Central Bank (ECB) President Draghi wasn't overtly hawkish, but did sound confident that eurozone inflation will eventually firm. He also expressed optimism over Europe's growth and political backdrop. Market watchers felt he was giving a nod toward further tapering of the ECB's huge quantitative easing program.

- **Britain:** Bank of England (BoE) Governor Carney indicated that tolerance for above-target inflation is wearing thin and "Some removal of monetary stimulus is likely to become necessary…". The comments are an about-face from a week earlier when he said that uncertainty over the UK's prospects meant now wasn't the time to begin lifting borrowing costs. In addition, the BoE tightened bank capital requirements, removing one piece of its current stimulus program.

Global bond yields bounced meaningfully off their recent lows and bond returns withered. The whipsaw effect cut the year-to-date Canadian bond market gains by a third.

A MILESTONE. A STEPPING STONE.

Canada's 150th anniversary marks neither a beginning, nor an end to our nation's history. It's a time to take stock and reflect on a history that is rich with both achievements and struggles. It's also a time to look forward with enthusiasm and experience, and set upon a new history in the making.

As you enjoy the summer season, we hope you find time to take stock of your own milestones and stepping stones in life - to celebrate, reflect, and look forward to whatever the future may hold. Have a wonderful summer full of warmth, happiness and good fortune!