April 2014

Market Matters

Q1 2014 HIGHLIGHTS

- The S&P/TSX Composite index posted its ninth-straight monthly gain in March. All ten sectors of the Canadian market made gains.
- The S&P500 had a weak start to the year, but recovered into positive territory as the first quarter drew to a close.
- New and ongoing emerging market woes (economic as well as political) continue to create weakness and volatility in their capital markets and currencies.
- After a stellar 2013, Japan's Nikkei 225 declined 9% as faith in their economic rehabilitation wavered. The effect of a tax increase beginning in April will be closely watched. While the fiscal tightening is expected to benefit Japan's long term economic health, the short-term pain of tax hikes risks derailing a fragile economic recovery.
- Fixed income markets benefited from geopolitical uncertainty within emerging market regions (such as the Ukraine) and weaker-than-expected economic data from the U.S. and China.
- The Canadian dollar weakened against the U.S. dollar in January in response to global growth concerns, but stabilized around 90cents USD in February and March.

Table 1
Summary of major market developments

Market returns*	March	YTD
S&P/TSX Composite	0.9%	5.2%
S&P 500	0.7%	1.3%
- in Canadian dollars	***0.6%***	***5.2%***
MSCI EAFE	-1.0%	0.0%
- in Canadian dollars	***-1.1%***	***3.9%***
MSCI Emerging Markets	1.8%	-0.9%
FTSE TMX Canada universe bond index **	-0.2%	2.8%
FTSE TMX Canada corporate BBB bond index ***	0.3%	3.8%

*local currency (unless specified); price only
**total return, Canadian bonds, previously known as DEX universe bond index
***total return, Canadian bonds, previously known as DEX corporate BBB bond index

Table 2
Other price levels/change

	Level	March	YTD
CAD per USD exchange rate	$0.905	0.1%	-3.9%
Oil (West Texas)*	$101.58	-1.0%	3.2%
Gold*	$1,287	-2.7%	6.8%
Reuters/Jefferies CRB Index*	$304.67	0.7%	8.7%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	March	YTD
S&P/TSX Composite	0.9%	5.2%
Energy	4.8%	8.7%
Materials	-5.9%	9.2%
Industrials	-0.6%	1.8%
Consumer discretionary	2.7%	3.7%
Consumer staples	1.9%	6.9%
Health care	-6.7%	12.6%
Financials	1.5%	1.9%
Information technology	-4.4%	5.6%
Telecommunication services	1.0%	3.0%
Utilities	3.9%	7.5%

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

PARSED AND PARCELLED

Capital markets were choppy in the first quarter of 2014. Bouts of volatility arose when economic data out of the U.S. and China disappointed, and political unrest in regions such as Libya, Venezuela and Ukraine contributed to investor anxiety. Late in the quarter, investors were rattled by U.S. Federal Reserve (Fed) Chairperson Janet Yellen who, when put on the spot by a reporter at her inaugural press conference, suggested a shorter-than-expected timeframe in which rate hikes might begin. Having each word parsed and parcelled simply comes with the territory when you're the head of the Fed.

A FROSTY BITE OUT OF U.S. RECOVERY

Weak employment numbers out the U.S. started the trend of soft economic data, which persisted for much of the quarter. Weather was a contributing factor to the weaker than expected numbers, but to what degree did winter conditions take a (frost) bite out of the U.S. economy? Only time and upcoming economic data releases, will tell for sure. For now, what we know is that corporate earnings in the U.S. remain strong, and near the end of the first quarter some economic figures e.g. U.S. manufacturing survey results, U.S. auto sales) showed some improvement.

CANADA LEADS THE WAY IN Q1

The S&P/TSX Composite ended March as one of the best performing markets among its peers so far this year (see Table 1). The main driver of outperformance was the strength in the materials sector (see Table 3), and gold company stocks in particular. Investors were drawn to the safe-haven qualities of the yellow metal. Both gold bullion (see Table 2) and the shares of gold-related companies traded higher as weaker-than-expected economic data emerged from the U.S. and China, and geopolitical tensions grew in Libya, Venezuela, and most notably Ukraine.

The Canadian bond market also had a strong first quarter of 2014, with most of the gains booked in January. Like gold, investors moved to the safety of fixed income as global economic and political uncertainty grew. Provincial bonds performed best overall this quarter, boosted by strong demand in January. As the quarter progressed corporate bonds did particularly well in February and March. The attraction of a higher-income alternative to Government of Canada bonds supported strong demand in what is still a historically low-yield environment.

Canada's economic backdrop may be better than feared, as there are signs of positive momentum. Although Bank of Canada Governor Stephen Poloz was cautious on the outlook, he did say “we continue to believe that the world economy is healing, and that Canada will benefit in the form of stronger exports, which should fuel more investment and new business creation.” While the evidence is not uniformly positive, during the quarter signs of an improving Canadian economy did emerge, including better than expected GDP growth and retail sales, along with evidence that a weaker Canadian dollar is beginning to help - noting the first trade surplus since the fall of last year.

It is worthwhile noting that many market patterns reversed in March (note changes from positive to negative for a number of data points in Table 1, 2 and 3). The concerns for US-Russian relations over the Crimea dispute settled down towards the end of March as diplomatic negotiations progressed without tempers escalating. And it would seem that we (North Americans who lived through the extra-long, extra-harsh winter) were quite sympathetic and willing to accept the weather-related justifications for the weak economic results. Furthermore, at the end of the quarter, the Fed went out of its way to comfort markets with reassurance that rates would not be raised in haste.

STYLE DIVERSITY

Figuring out capital markets isn't easy. Its core functioning revolves around one person selling at the same time and price as another person is buying. Both want to make money. Neither wants to lose money. And both think they're smart.

How can this be? Each investor will apply his or her own lens through which they will view their investing landscape - placing more value or emphasis on one given characteristic over another. Ironically, this very discord in how investors view the world is one of the great moderators of markets conditions. It is also why maintaining a portfolio that incorporates various investment styles can enhance the long-term stability of your overall portfolio. That's because it is not when investors don't agree that you get market volatility, it is when too many investors are seeing things the same way (nervous and risk averse or optimistic and confident) that volatility tends to hit hardest.