Market Matters

Q2 2014 Highlights

- The world's cup seemed half full in the second quarter of 2014, as equity markets performed strongly in spite of geopolitical and economic challenges (see Table 1).
- The Canadian stock market stampeded its way to the front of the line among world equity market peers. Strength in commodity prices gave the S&P/TSX Composite the push ahead (see Table 3).
- A weather-induced grand slam to US Q1 GDP growth results (-2.9%, the worst reading in five years) didn't stop the rise of the S&P 500 to new all-time highs as the index concluded a sixth straight quarter of gains (a streak not seen since Q2 1998 when it reached 14 quarters of consecutive gains).
- Continued robust demand for bonds and stubbornly low rates helped the Canadian bond market post a strong 2% quarterly return. Short-term federal bonds performed worst at 0.5%, while long-term provincial bonds returned 4.0% to take the yellow-jersey position for this leg of the ride.

Table 1
Summary of major market developments

Market returns*	June	Q2 2014	YTD
S&P/TSX Composite	3.7%	5.7%	11.2%
S&P 500	1.9%	4.7%	6.1%
- in Canadian dollars	*0.2%*	*1.2%*	*6.4%*
MSCI EAFE	0.0%	2.3%	1.3%
- in Canadian dollars	*-0.9%*	*-0.5%*	*3.3%*
MSCI Emerging Markets	2.0%	4.2%	3.3%
FTSE TMX Canada Universe Bond Index**	0.3%	2.0%	4.8%
FTSE TMX Canada Corporate BBB Bond Index***	0.4%	2.2%	6.1%

*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	June	YTD
U.S. dollar per Canadian dollar	$0.937	1.6%	-0.4%
Oil (West Texas)*	$105.37	2.6%	7.1%
Gold*	$1318	5.8%	9.4%
Reuters/Jefferies CRB Index*	$308.22	0.9%	10.0%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX sector returns*	June	Q2 2014	YTD
S&P/TSX Composite	3.7%	5.7%	11.2%
Energy	5.0%	9.7%	19.2%
Materials	10.0%	5.8%	15.5%
Industrials	4.5%	9.0%	11.0%
Consumer discretionary	1.3%	4.0%	7.8%
Consumer staples	2.7%	2.5%	9.5%
Health care	-4.4%	-6.6%	5.2%
Financials	2.4%	4.7%	6.6%
Information technology	7.3%	6.1%	12.0%
Telecom services	-2.7%	-0.3%	2.7%
Utilities	1.1%	0.2%	7.7%

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

WHAT? ME WORRY?

If equity market results are any indication, what truly worried investors in the second quarter of the year was the worry of not being in the market and losing out on potential gains. Investors managed to see through the woes of geopolitical unrest (such as the Ukraine/Russia and Iraq conflicts) and shrug off weaker Q1 economic data, particularly out of the US and China. All major equity markets were positive for the quarter and both the Canadian S&P/TSX Composite and the US S&P 500 hit new highs in June. What remains encouraging is that the market gains had broad participation with eight out of ten sectors positive for both Canada and the US.

WINNING WAYS

A number of factors have contributed to global markets continuing their winning ways so far this year:

Central banks globally remain in a stimulative mode.

- The Bank of Canada (BoC) left rates at 1% for its 30th consecutive meeting spanning more than a three year period. With the Canadian dollar already firming due to a rise in oil prices and inflation (1.7% - still below the BoC's target of 2%), the BoC is less likely to add upward price pressure by raising rates (see Table 2).
- US Federal Reserve Chairperson Janet Yellen's recent comments suggest she is determined not to jeopardize the recovery by tightening monetary policy too soon or removing quantitative easing stimulus too quickly.

- The recent European Central Bank (ECB) move to reduce all three of its administered rates highlights how very accommodative the ECB wants to be. The ECB even imposed a negative rate on its deposit facility to encourage banks to lend money instead of keeping it on deposit at the ECB.

On the surface, the latest US GDP number is unnerving as the economy in the first three months of this year was far weaker than expected. But the most recent data highlights that much of this was a weather-related slowdown and more recent results show consumers are feeling better as job opportunities improve and business orders are picking up. Furthermore, North American merger and acquisition activity has ramped up as corporations begin to put their massive cash balances to work. Inflation has begun to show rumblings of acceleration (though still low on an absolute level) but this metric is also a reflection of improvements in forward growth expectations.

Specifically driving the Canadian market has been strength in energy shares. Unrest in Iraq has driven oil prices higher on the back of worries over the potential for supply disruption. The increase in transport of crude oil by rail has also helped to narrow oil price differentials for Canadian producers, and the cold weather boosted the natural gas supply/demand picture and has kept prices elevated. The Canadian Materials sector also saw strong returns as gold and gold equities caught a flight to safety bid amid the geopolitical uncertainty and the tick up in inflation.

SOME CHEAP MONEY

Perhaps the biggest surprise this year has been the decline in global bond yields. In what seems to contrast with the positive economic outlook being reflected by equity markets, bond yields have remained stubbornly low. This is much to the chagrin of the numerous portfolio managers who find themselves positioned with a shorter duration (i.e. positioned advantageously for a rising rate environment that just hasn't showed up yet).

While we continue to believe that rates will begin to creep up as economic conditions strengthen and stabilize, we can't deny that the continued demand for bonds at such low rates has been surprisingly strong. Consider that this past quarter the Government of Canada issued its first Ultra-long Bond maturing in 50 years (Dec 1, 2064). Originally the issue was announced as a $750 million deal, but amazingly the demand to lend money to the government for half a century to earn a mere 2.75% was so great that the issue was up-sized to $1.5 billion. That's some cheap money for 50 years!

CARPE DIEM

Whether on the pitch, ring, tour, court or otherwise, the athletes we love to watch tend to possess an infectious 'seize the day' attitude. Yet we know that their success is dependent upon the days, months and years of development and training they've put in before that moment.

If 'seize the day' reflects how you want to approach the day you reach your financial goals, then today is the day to ensure your long-term financial plan is in place. For most investors that means a diversified combination of dividend and non-dividend paying equities, government and corporate bonds, and cash – striking a comfortable balance (defined by your personal risk tolerance) between your need for capital growth, income and capital preservation.

And just like athletes, even the most talented among them look to the advice of a trusted coach (a.k.a. your advisor) to guide you through the ups and downs of each season, and right to the day when you reach your GOOOOOAAAAAALLLLLLLL! (who doesn't love the enthusiasm of the World Cup play-by-play announcers!)