Market Matters

MAY 2013 HIGHLIGHTS

- Remarks from U.S. Federal Reserve Chairman Ben Bernanke raised concerns over a reduction of their stimulus programs beginning sooner than expected.
    - Both equity and bond markets lost ground further to the remarks (though most equity markets still managed a positive result for the month).
    - Improving U.S. economic data and the potential unwinding of quantitative easing programs has boosted U.S. dollar strength (and in turn weakened the Canadian dollar).
- After rising more than 30% earlier in the year, Japan's Nikkei 225 pulled back in May with a handful of sharp daily declines.
- The Euro-zone remains in a recessionary state, but investors appear more optimistic than economists as European equity markets have shown resilience thus far in 2013.
- Slowing growth out of China and growing U.S. production of oil and gas has dampened Canada's export prospects and continues to weigh on commodity prices overall.
- Canada's equity market experienced a sector rotation in which January to April's leading sectors (defensive sectors like Telecommunications and Utilities) became May's laggards, and vice versa.

Table 1
Summary of major market developments

Market returns*	May	YTD
S&P/TSX Composite	1.6%	1.7%
S&P 500	2.1%	14.3%
- in Canadian dollars	*4.9%*	*19.0%*
MSCI EAFE	0.0%	13.3%
- in Canadian dollars	*-0.2%*	*10.5%*
MSCI Emerging Markets	0.4%	-0.8%
DEX Universe Bond Index**	-1.5%	0.4%
BBB Corporate Index**	-1.1%	2.3%

*local currency (unless specified); price only
**total return, Canadian bonds

Table 2
Other price levels/change

	Level	May	YTD
CAD per USD exchange rate	$0.964	-2.9%	-4.4%
Oil (West Texas)*	$91.97	-1.6%	0.2%
Gold*	$1,396	-6.0%	-16.7%
Reuters/Jefferies CRB Index*	$281.85	-2.2%	-4.5%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	May	YTD
S&P/TSX Composite	1.6%	1.7%
Energy	0.8%	2.8%
Materials	3.0%	-20.6%
Industrials	5.3%	16.3%
Consumer discretionary	4.4%	17.1%
Consumer staples	0.4%	10.6%
Health care	11.5%	40.0%
Financials	0.7%	4.1%
Information technology	-1.4%	27.8%
Telecommunication services	-1.4%	8.5%
Utilities	-4.1%	-1.6%

*price only
Source: Bloomberg, MSCI Barra, NB Financial, PC Bond

COME WHAT MAY

When pressed for clarity, in May the U.S. Federal Reserve (The Fed) Chairman Ben Bernanke alluded that a tapering of the Fed's asset purchasing plan could begin as early as the fall if economic data supported such action. As though tripping over Chairman Bernanke's words, both the equity and bond markets stumbled in May.

IF THE DATA SUPPORTS IT

While couching his words, Chairman Bernanke expressed his view that if evidence unfolds of self-sustaining economic recovery, such as stronger labour markets, plans to ease off the bond buying program (a component of their economic stimulus plan) could begin as early as the fall. No matter how many 'ifs' and 'whens' he stated, his response created concern that a pull-back in stimulus could begin sooner than anticipated and equity and bond markets reacted quickly.

Specific to the bond markets, a potential reduction in the bond purchasing program resulted in bond yields rising more or less across the board. In Canada, 10-year Government of Canada bonds rose 0.37% to end the month yielding 2.06%, a month-end level not seen in over a year. With the rise in yields came a drop in bond prices, and that wiped away most of the year's gains in Canada. The DEX Bond Universe Index was down 1.5% in the month – the worst monthly return since September 2008. The declines in the Canadian fixed income market were widespread, with Long-Term Government of Canada bonds being the worst performing sector, and corporate bonds overall faring better – though still posting a negative return overall for the month (see Table 1).

REVERSAL OF FORTUNES

Within North American equity markets, the reversal of fortunes was more of a sector rotation than a sell-off. Table 1 shows that both the S&P500 and the S&P/TSX Composite indices managed to gain ground in May. Of note, the S&P500 posted its seventh consecutive month of gains - a milestone not seen since March-September 2009. Having said that, most sectors which led the market in the first four months of the year became the laggards in May and vice versa. Putting pressure on dividend-focused investment strategies, the more defensive sectors like the Utilities and Telecommunications sectors weakened in both Canada and the U.S. (see Table 3).

Japan's Nikkei 225 had a stellar rally between January and April (and into the start of May as well), but was among the global market laggards for the month following a handful of sharp daily declines. In spite of dramatic headlines, it is important to note that with a year-to-date return in the +30% range, a pullback was expected. The pull-backs were precipitated by a cool reception to their country's economic turnaround plan, disappointing manufacturing data out of China, and The Fed's comments on the eventual withdrawal of economic stimulus.

Within Europe, it is interesting to note that while many European countries find themselves in an economic recession, investors in their stock markets are showing much more optimism – apparently taking the recent 'less bad' news on the economic front as the closest thing they've seen to 'good news' in a long time.

LOSING SOME SWAGGER

Canada's domestic economy is losing its swagger. While economic improvements in the U.S. tend to spill over into Canada – giving us good reason to cheer their success - the current pace of economic acceleration in the U.S. is faster than here at home. As a result, Canada's economy will need to adjust, including hopes for improvement in our export sectors to offset a weaker domestic picture. Still, as the only G7 country to have not required quantitative easing measures, and with economic growth by and large meeting our 'slow-growth' expectations, Canada is well positioned to move forward - just maybe with less of a swagger than in recent years.

THIS IS GOOD NEWS, RIGHT?

As we approach mid-year, we can put aside many of the worries that we started the year with. The U.S. economy has shown resilience in its recovery in spite of tax increases and forced spending cuts. The American fiscal cliff has so far turned out to be a non-event, as private sector spending has proven to be stronger than expected and is providing an offset to the government cuts.

When considering the big picture, we believe that capital markets are better served with improved economic activity and higher interest rates, than by weak growth necessitating a continuation of quantitative easing and stimulus programs. Having said that, a knee-jerk reaction to the eventual slowdown of government-sponsored economic support and spending is likely to create some volatility for both bond and equity markets in the short term.

TENNIS LESSONS

When markets are volatile, it can be tempting to abandon well thought-out long-term plans, but be wary; it can quickly turn out to be an investor's equivalent to the tennis player's unforced error.

"The serve was invented so that the net could play."
Bill Cosby