Market Matters

JANUARY 2015 HIGHLIGHTS

There were few places to hide from market volatility in January, and investors took a cautious ‘risk-off’ approach to start 2015.

- Central bankers made headlines with a flurry of surprising announcements in January:
  - January 15th the Swiss National Bank (SNB) abruptly ended its policy of pegging the value of its currency to the euro.
  - January 21st the Bank of Canada (BoC) surprised virtually all market watchers with a 25 basis point cut to interest rates.
  - January 22nd the European Central Bank (ECB) announced the details for its quantitative easing program. While the program itself was anticipated, both the size and duration of the asset purchase program were greater than expected.
- Oil prices continued their slide downward by another 9.4%. Oil companies scrambled to cut their 2015 capital expenditures and earnings estimates continued to be revised downward. At some point, supply and demand will need to come into play, though the timing of that turn remains uncertain.
- The Canadian dollar dropped 8.7% versus the US greenback. That’s the worst monthly decline since October 2008 when the global financial crisis was unraveling. The currency effect of the dropping Canadian dollar helped offset most (if not all) weakness in foreign markets for Canadian investors, including a 9% boost to the S&P 500 returns.
- The FTSE TMX Canada Universe Bond Index jumped a gigantic 4.63%. Long-term municipal bonds rose a whopping 8.74% (just 0.1% shy of 2014’s full year return for the broad bond index).
- Not to be forgotten, geopolitical uncertainty (Greece, Ukraine, Middle East) added its measure of volatility to capital markets as well.

LET’S GIVE ’EM SOMETHING TO TALK ABOUT

Think central bankers are the boring, pontificating academics of the capital market world? Nope.

Feel that monetary policy is only considered ‘news’ for the financial papers? Not anymore.

Remember when forward guidance principles (made popular in the aftermath of the financial crisis) meant central bank policy action would be slow and expected? Forget that.

Bank of Canada (BoC) Governor Poloz called forward-guidance principles for central banks ‘addictive’ in October of last year. Had investors become hooked? Was it diminishing the effectiveness and impact of central bank

Table 1
Summary of major market developments

Market returns*	January	2014
S&P/TSX Composite	0.3%	7.4%
S&P 500	-3.1%	11.4%
- in Canadian dollars	***6.1%***	***21.7%***
MSCI EAFE	3.0%	3.2%
- in Canadian dollars	***10.0%***	***1.3%***
MSCI Emerging Markets	1.4%	2.5%
FTSE TMX Canada Universe Bond Index**	4.6%	8.8%
FTSE TMX Canada all corporate bond index **	3.6%	7.6%

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

Table 2
Other price levels/change

	Level	January	2014
CAD per USD exchange rate	$0.786	-8.7%	-8.6%
Oil (West Texas)*	$48.24	-9.4%	-45.9%
Gold*	$1,284	8.4%	-1.7%
Reuters/Jefferies CRB Index*	$218.84	-4.8%	-17.9%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	January	2014
S&P/TSX Composite	0.3%	7.4%
Energy	-2.2%	-7.8%
Materials	15.4%	-4.5%
Industrials	-1.0%	20.0%
Consumer discretionary	0.0%	26.4%
Consumer staples	3.0%	46.9%
Health care	18.8%	30.2%
Financials	-5.9%	9.8%
Information technology	5.5%	34.0%
Telecommunication services	5.8%	10.5%
Utilities	6.3%	11.3%

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

actions? Regardless of where you stood on the issue before, global central bankers staged some 'tough-love' interventions in January. Three notable surprises within a week of each other included:

1. Without a hint that it was coming, the Swiss National Bank (SNB) dropped its cap of 1.20 Swiss francs-per-euro, pointing to the increasing costly burden of the currency peg given the depreciating euro. The Swiss franc was left to soar against other currencies and gained as much as 29% in value versus the euro and 28% against the US dollar shortly after the announcement. The sudden currency and equity market volatility exacted heavy losses for banks and currency brokers, along with Switzerland's many export-reliant companies.
2. No one saw the BoC's 25 basis points interest rate cut coming. The Loonie and bond yields dropped sharply on the news. Citing the need for 'insurance' against the negative economic impact of falling oil prices, the ultimate impact of the move for the overall Canadian economy remains a lively debate. On the one hand, the resulting drop in the Canadian dollar may provide the needed boost for non-resource manufacturing and exporting industries, while on the other side the move leads some to believe that the fallout from dropping oil prices is spilling over much further and wider than current data suggests (i.e. what warning signs are the BoC seeing?). As it stands now, the BoC's 2015 GDP growth expectations sit at 2.1% compared to 2.4% previously, sluggish growth for sure, but growth none-the-less.
3. Europe's underlying problems of stagnant growth, high debt and stubbornly high unemployment rates remain. With official interest rates near zero and low inflation, the European Central Bank (ECB) was left with few options but to start its widely anticipated quantitative easing program. Even so, ECB president Mario Draghi was able to provide a surprise of his own for capital markets with a larger (by 10 billion euros/month) and longer (to September 2016) than expected asset purchasing program. Mr. Draghi also signaled that the asset purchases could go on longer if the ECB isn't meeting its inflation target of just below 2%. Bond and stock markets rose, while the euro plunged on the news. Essentially, European political leaders gained some economic breathing room within which to establish the fundamental changes and reform to fiscal policy needed for self-sustaining economic growth in the region. As Mr. Draghi noted, this step alone is no silver bullet to restoring prosperity to Europe, 'What monetary policy can do is create the basis for growth. But for growth to pick up, you need investment; for investment you need confidence; and for confidence you need structural reform.'

HEAR ME ROAR

The Canadian bond market roared into 2015 like a lion. No matter what maturity or investment grade credit category, investors saw exceptional gains in January. In fact, the broad universe index return of 4.6% was the strongest since February 1995. For some perspective on how different interest rate conditions were, in February of 1995 the 10-year Government of Canada bond yields dropped 0.7% to end the month at 8.52%. Compare that to the 0.65% drop in January 2015, with 10-year Government of Canada bonds ending the month yielding a mere 1.25%.

The S&P/TSX Composite ended the month about where it started. A rise in gold bullion drove gold stock prices higher, boosted the materials sector and offset declines out of the energy and financial sector (both hurt by lower oil prices and weakening outlook). Meanwhile in the US, the S&P 500's 17-month streak of achieving at least one new intra-month market high was broken. The uncertainty around oil prices, and the impact of the stronger US dollar on American exports has begun to flow through to weaker earnings, and equally important, lower expectations for 2015 earnings.

SHAKE IT OFF

Today's asset price fluctuations (commodities, currencies, stocks and bonds) speak to the significant uncertainty within capital markets, global economies and geopolitical conditions. We don't think we've seen the last of volatility and surprises to affect capital markets in 2015. But if your portfolio is built with your personal risk tolerance and goals in mind, and is sufficiently diversified to mitigate market volatility when surprises do happen, then you'll be in a much better position to shake it off, and carry on with reaching your financial goals.