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Market Matters

Summary for March 2018

Highlights

Volatility returned to capital markets after 2017 hiatus.

A number of trade-related economic risks arose, dampening investor sentiment.

Canada's energy sector continues to face headwinds, in spite of strengthening oil prices.

Bond yields fell in March in response to monetary policy and economic risks.

Q1-2018 marks return of market volatility

Capital markets and investor mood changed quickly over the quarter, bringing back volatility after its 2017 hiatus. The year started out strong, but after a sharp pull back in February, equity markets stayed on edge through the remainder of the quarter. For the quarter, the S&P/TSX Composite saw 9 days of 1%+ market swings. The S&P 500 saw 23 days of 1%+ market swings (compared to 8 days for all of 2017). Point to point, the major North American stock markets finished the quarter in negative territory (the first quarterly loss for the S&P 500 since September 2015).

Interest-sensitive sectors, such as utilities and telecom, did poorly in the face of rising bond yields. The Canadian energy sector once again struggled, in spite of oil prices rising. Canadian oil and gas companies have been hampered by high supply levels coupled with pipeline capacity challenges. Like the utilities and telecom sectors, Canada's dividend-paying pipeline companies also faced headwinds from rising interest rates. Information technology stocks led the S&P 500 and S&P/TSX Composite results for the quarter as a whole.

The return of market volatility was brought on largely by three key themes weighing on investor sentiment: trade talks; monetary policy risks; and tech-related corporate controversies.

Trade talks, tariffs and tweets elevate investor uncertainty

One of the key causes of the market volatility was a significant increase of trade-related economic risks. The common thread was the strong protectionist stance of President Trump. Markets responded, mostly to the negative, as a number of interesting developments, headlines and tweets came to light.

Market Summary

Canadian Fixed Income[1]	MTH	QTR	YTD
FTSE TMX Canada Universe Bond Index	0.8%	0.1%	0.1%
FTSE TMX Canada All Corporate Bond Index	0.5%	0.3%	0.3%
Canadian Equities[2]	**MTH**	**QTR**	**YTD**
S&P/TSX Composite	-0.5%	-5.2%	-5.2%

	MTH		QTR		YTD	
Global Equities[2]	Local	CAD	Local	CAD	Local	CAD
S&P 500	-2.7%	-2.0%	-1.2%	1.7%	-1.2%	1.7%
MSCI EAFE	-2.7%	-1.7%	-4.9%	0.6%	-4.9%	0.6%
MSCI Emerging Markets	-2.0%	-1.4%	0.4%	4.0%	0.4%	4.0%

Currencies and Commodities (in USD)	Level	MTD	QTD	YTD
CDN $	0.78	-0.5%	-2.5%	-2.5%
Oil (West Texas)	64.94	5.4%	7.5%	7.5%
Gold	1,325.48	0.5%	1.7%	1.7%
Reuters/Jeffries CRB Index	195.36	0.7%	0.8%	0.8%

Canadian Sector Performance[2]	MTH	QTR	YTD
Consumer Discretionary	0.3%	-3.4%	-3.4%
Consumer Staples	-1.7%	-6.2%	-6.2%
Energy	1.3%	-10.4%	-10.4%
Financials	-1.2%	-4.2%	-4.2%
Health Care	0.2%	-13.7%	-13.7%
Industrials	-2.4%	-3.0%	-3.0%
Information Technology	-1.3%	10.1%	10.1%
Materials	0.1%	-4.6%	-4.6%
Real Estate	1.7%	-0.7%	-0.7%
Telecom	-1.3%	-7.8%	-7.8%
Utilities	1.6%	-6.9%	-6.9%

Local currency unless otherwise stated. | [1]Total return [2]Price only return
Source: Bloomberg

An undertone of unrest over the renegotiation of the North American Free Trade Agreement (NAFTA) prevailed throughout the quarter (as it had in the second half of 2017). However it was the U.S. President signing new tariffs on steel and aluminum that caught markets by surprise. Extensive political pressure (both from within the U.S. and from abroad) led to a number of country exemptions, most of which are temporary while further trade negotiations continue. President Trump proposed upwards of USD 60 billion in tariffs on Chinese imports and instructed the U.S. Secretary of the Treasury to issue limits on China's ability to invest in U.S. technology firms. In response, and as anticipated, China proposed retaliatory tariffs on U.S. products, including soy beans, corn and pork – products strategically chosen to hit at the Republican-based heartland of America. Both countries have left the door open for further negotiations and talks, but the idea of a trade war does not sit well with investors - equities fell, investor sentiment weakened, and bond yields dropped.

Bond yields respond to monetary policy and economic risks

Bond yields rose early in the quarter spurred by signs of percolating U.S. wage growth as global economic growth continues to show strength. Central banks positioned themselves to ease off stimulative monetary policies and/or deploy monetary tightening plans. In January the Bank of Canada raised interest rates by 0.25% and the U.S. Federal Reserve, under the new leadership of Jerome Powell, raised interest rates 0.25% in March, bringing the Federal Funds rate to 1.75%.

The trend of steadily rising rates was broken in February as lower-than-expected inflation and global growth expectations were hampered by trade fears. As a result, bond yields fell and bond returns turned positive in March (and year-to-date). While we continue to caution fixed income investors to have muted return expectations, this is a good time to remind investors that, while rising yields are a headwind, the Canadian bond market has only witnessed three negative calendar years since 1983, with the worst being –4.3%. Fixed income remains a powerful tool for risk mitigation.

Tech-related market darlings faced challenges late in the quarter

Tech-related companies have been the poster child of the current bull market run, but late in the first quarter of 2018 they lost their shine. Sentiment turned sharply on companies such as Facebook, Alphabet (Google) and Twitter over data privacy concerns. On top of that, safety concerns arose over self-driving vehicle technology due to separate crashes involving Uber and Tesla. Add in President Trump railing on Amazon, and investors are being reminded that set-backs and failures can happen, along with worry that costly and growth-hampering government regulations could be in the offing.

Market volatility serves as a reminder to reset investment portfolios

Increased market volatility is common in the later stages of the market cycle, where we believe we are today. What's also common is the strong tendency for investors to take on risky positions and chase the recent strong performers of the current bull market run. Things can change quickly. Now is not the time to over-reach with outsized positions in high-growth, high-credit risk holdings. Let the recent market volatility serve as a good reminder that it is time to ensure investment portfolios are well diversified and adjusted to be within risk tolerances.

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VP Marketing and Communications, has more than 15 years of investment industry experience and has been writing the monthly Market Matters for over 10 years.

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