Market Matters

Summary for May 2019

Highlights

- Trade tensions push investors to safe-haven assets
- Equity markets hurt by sharp one-month slide
- Strong bond returns and another yield curve inversion
- Autos, banks and energy sectors take brunt of losses

Trump's two-front war on trade

No other topic in May – not even the series finale of *Game of Thrones* – provided as much drama as President Trump's trade policy actions. Tough talk, halted negotiations and tariffs were among the weapons used by the White House in May, with China and Mexico being the prime targets (although it was equity markets and investor confidence that took the hit). Equity markets in both the U.S. and Canada responded by dropping 6.6% and 3.3% respectively. A sharp one-month slide, although year-to-date returns for both markets remain in double digits.

It's about global growth

Tit-for-tat tariffs can cut deep into specific industries and significantly change the cost of various goods, but their greatest impact is on the global economy. Investors, not surprisingly, retreated to safe-haven assets such as gold and fixed income. The Canadian bond universe returned a very strong 1.7% on the month, benefitting from a steep drop in yields that followed smoldering concerns over the global economy and fanned by increasing trade war tensions. The uncertainty that comes with escalating political tensions eats away at investor confidence, slows business investment and stifles growth.

With escalating trade tensions… a flight-to-safety investment mindset came to the fore.

Market Summary

Canadian Fixed Income[1]	**Month**	**YTD**
FTSE Canada Universe Bond Index	1.7%	5.6%
FTSE Canada All Corporate Bond Index	1.3%	5.7%

Canadian Equities[2]	**Month**	**YTD**
S&P/TSX Composite	-3.3%	12.0%

	Month		**YTD**	
Global Equities[2]	**Local**	**CAD**	**Local**	**CAD**
S&P 500	-6.6%	-5.8%	9.8%	9.0%
MSCI EAFE	-5.3%	-4.6%	7.0%	4.9%
MSCI Emerging Markets	-6.9%	-6.7%	4.4%	2.6%

Currencies and Commodities (in USD)	**Level**	**Month**	**YTD**
CDN $	$0.740	-0.9%	0.9%
Oil (West Texas)	$53.50	-16.3%	17.8%
Gold	$1,304.65	1.6%	1.8%
Reuters/Jeffries CRB Index	$175.36	-4.8%	3.3%

Canadian Sector Performance[2]	**Month**	**YTD**
Energy	-5.0%	12.4%
Materials	-4.5%	0.8%
Industrials	-0.8%	18.5%
Cons. Disc.	-8.7%	6.8%
Info Tech	4.3%	38.9%
Health Care	-13.8%	31.0%
Financials	-5.1%	9.3%
Cons. Staples	2.7%	14.0%
Comm. Services	1.8%	9.8%
Utilities	2.9%	18.5%
Real Estate	-0.3%	12.6%

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

Autos, banks and energy hit hard by trade tensions

With escalating trade tensions – starting with failing trade negotiations with China (U.S. tariffs on Chinese imports rose to 25%, from 10% previously) and exacerbated by new tariff threats against Mexico – investors' risk appetite evaporated, hitting the S&P 500 hard with a dramatic downturn in May. After closing out April at all-time highs, the S&P500 decreased in all four weeks (an event not seen since October 2014) and delivered its worst May performance since 2010.

Canadian markets did better than their American counterparts largely due to Information Technology (IT) – the bright spot for the month on the back of a surging Shopify (up 14%). The company's increase was due to a first quarter above-expectations earnings report and increased financial guidance. Beyond the one-stock story in IT, defensive sectors like Utilities and Consumer Staples did best, while the more cyclical sectors were at the heart of the equity market declines in May. The Consumer Discretionary sector was down 8.7%, with auto parts suppliers being a notable area of weakness. The Materials sector dropped 4.5%, although things would have been worse had gold stocks not been lifted by flight-to-safety trade. The Financials sector was down 5.1% due to lackluster bank earnings results and pressure from dropping yields. And, the Energy sector, pressured downward alongside dropping oil prices, was down 5.0% for the month. U.S. WTI oil prices plummeted 16.3% in May, with growing concerns of slowing global growth and higher U.S. inventories fueling fears of excess supply.

Yield curve inverts again

After U.S. and China trade talks halted early in the month, bond yields collapsed across the board (10-year U.S. treasuries fell 38 basis points, while 10-year Government of Canada bond yields fell 22 basis points over the course of the month). With President Trump's surprising tariff threat against Mexico late in May, capital markets further priced in expectations of a U.S. Federal Reserve rate cut (perhaps President Trump's goal all along). The 10-year U.S. treasury bond yield dropped below the three-month yield once again, repeating the yield curve inversion witnessed in March of this year. (For more on what an inverted yield curve is, see GLC's 'Pro Tips' section in the latest GLC Insight article.) Within Canadian fixed income, government bonds performed best, whereas corporate bonds were weaker as investors moved away from credit-risk exposure.

When reality looks like fiction

It's months like May that cause people to remember the value of fixed income in moderating capital market volatility, especially during times of rising economic uncertainty. As this past month demonstrated, the value of maintaining risk-appropriate exposure to fixed income within a diversified portfolio grows as market uncertainty increases. We suggest leaving the 'run for safety' and knee-jerk reactions to market gyrations to those less prepared to stick to their long-term investment goals. With tweets and trade tactics playing out like a popular fiction TV series, we suspect the unpredictability of the Trump administrations' actions on tariffs, trade and policy changes will keep markets volatile for some time to come.

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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.