Market Matters

JANUARY 2016 HIGHLIGHTS

- There were few places to hide from market volatility in January, and investors took a cautious 'risk-off' approach to start 2016.
- The year opened with poor Chinese economic data, triggering a sharp sell-off on China's stock markets that spread across equity markets throughout the globe.
- Oil prices dropped as prospects for higher supply and fears of lower demand continued, falling just below $27USD at one point in the month.
- The rocky start to 2016 caused bond yields to drop and move with vigour throughout the month, inciting a flight to quality. Higher grade fixed income indices outperformed riskier assets. Long-dated government bonds in particular performed strongly.
- Toward the end of the month trading started to get back to US economic fundamentals and away from the stat-by-stat global trades of oil. This reduced the peak inter-month declines from double digits to low-to-mid single digit declines.
- The bounce from oversold prices helped oil prices to rise nearly 27% by the end of the month from the lows on January 20th (still down over 9% for the month). Equities in Canada were key beneficiaries of the rally in crude oil prices toward the month-end.
- Overall, higher-quality, defensive and dividend-focused strategies performed better.

NO MARKET WAS AN ISLAND

In a recent nation-wide conference call to financial advisors at the end of January, Ron Hanson, GLC's Chief Investment Officer, got right to the point in his opening remarks, "It's hard to imagine a worse start to the year for global markets."

Hard to imagine because, for some markets, it hadn't happened before. The S&P 500 (down 5.96% in the first week) was the worst opening week ever! There were few places to hide (absent a few safe-haven trades into the US dollar or gold). No market was an island in January (see table 1).

THE ROUGH START

Investor anxiety carried over from the end of 2015 into 2016, beginning the year with concerns over disappointing Chinese economic data and compounding those worries with lower oil prices (as prospects for higher supply and fears of lower demand continued), large currency swings, and corrections in certain overpriced areas of the market.

Table 1
Summary of major market developments

Market returns*	January	2015
S&P/TSX Composite	-1.4%	-11.1%
S&P 500	-5.1%	-0.7%
- in Canadian dollars	***-3.7%***	***18.2%***
MSCI EAFE	-5.9%	2.7%
- in Canadian dollars	***-5.9%***	***15.1%***
MSCI Emerging Markets	-5.3%	-8.0%
FTSE TMX Canada Universe Bond Index**	0.4%	3.5%
FTSE TMX Canada all corporate bond index **	0.0%	2.7%

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

Table 2
Other price levels/change

	Level	January	2015
CAD per USD exchange rate	$0.716	-1.0%	-16.0%
Oil (West Texas)*	$33.62	-9.2%	-30.5%
Gold*	$1,118	5.3%	-10.6%
Reuters/Jefferies CRB Index*	$166.75	-5.3%	-23.3%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	January	2015
S&P/TSX Composite	-1.4%	-11.1%
Energy	0.5%	-25.7%
Materials	-2.0%	-22.8%
Industrials	-3.1%	-12.5%
Consumer discretionary	-6.5%	-3.5%
Consumer staples	1.8%	11.0%
Health care	-9.3%	-15.8%
Financials	-1.6%	-5.5%
Information technology	-3.6%	14.8%
Telecommunication services	3.5%	-1.0%
Utilities	5.8%	-7.8%

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

The first headline to greet markets re-opening from the holidays was the Chinese Manufacturing Index for December declining for the 10th consecutive month. Chinese stocks fell hard and fast, triggering a new 'circuit breaker' designed to control exactly that kind of acute market action (with interesting timing, Chinese policy-makers put this new stop-gap measure into effect just a few days earlier on Jan. 1, 2016). The circuit-breaker mechanism ultimately resulted in the Chinese stock market suspending trading twice in four days. Chinese officials later abandoned the market-suspending circuit breaker mechanism, learning the hard way that shutting down a market doesn't quell investor anxiety. This Chinese market plunge would ultimately be the start of a month of market turmoil and declines around the globe.

With the sell-off underway, it's hard to quantify the impact of other news on the markets, but suffice it to say that the following didn't help matters:

- North Korea detonated either a hydrogen bomb (as the country says) or an atomic bomb (as is believed by the US).
- There was a political fight between Saudi Arabia and Iran. Oil prices fell to 12 year lows, falling below $27USD/barrel at one point.
- The International Monetary Fund reduced its 2016 global growth forecast to 3.4% from 3.6% (it was the third cut in the past one-year period).
- The International Energy Agency released a negative outlook report, citing persistent global oversupply of oil.

The rocky start to 2016 caused bond yields to move with vigour. Market volatility in January incited a flight to quality, driving up the values of safe haven assets. As such, higher grade fixed income indices outperformed riskier assets. Long-dated government bonds in particular performed strongly.

Investors looked to lighten up on credit products by selling what they could, instead of what they wanted. There was particular selling pressure from international investors as they sought cover from the radical currency moves that took place during the month. As evidence of investors' demand for the safety of government debt, consider the sheer magnitude of government bonds that are now trading at a negative yield globally. In less than two years the amount of outstanding debt that has a negative yield has gone from basically nil to over US $5 trillion. Investors are increasingly seeking the safety of government debt, and are willing to pay-up for the privilege. Is paying someone to lend them your money senseless or sensible? It's tough to argue for it, but more than US $5 Trillion are doing exactly that!

BETTER ENDING

It wasn't like the month was devoid of positive news. The US December employment report came in much stronger than expected, and hopes were high for a positive corporate earnings quarter in the US. The broadly negative month did end on a higher note, reducing the peak intermonth declines from double digits to single low to mid-single digits as trading started to get back to US economic fundamentals and away from the stat-by-stat global trades of oil. The bounce from oversold prices helped oil prices to rise nearly 27% by the end of the month from the lows on January 20th. Equities in Canada were key beneficiaries of the rally in crude oil prices toward the month-end. At a sector level, utility companies performed well, benefitting from lower rates and seen as "safer" during the current difficulties. Overall, higher-quality, defensive and dividend-focused strategies performed better.

HAPPY YEAR OF THE MONKEY!

As millions around the world celebrate Chinese New Year and the start of the Year of the Monkey, we send along our best wishes for happiness and good fortune!

The Chinese use two brush strokes to write the word "crisis". One brush stroke stands for danger; the other for opportunity. The idea being that in a crisis, one must be aware of the danger, but also recognize the opportunity. The same concept could apply to the benefits of professional portfolio management. When markets are volatile, the experience and discipline to manage risk while being ever watchful for the opportunities is the combination that will ultimately define long-term investment success.