Market Matters

Q3 2016 Highlights

- Capital markets quietly booked gains over the sleepy summer months, but woke up to a number of newsworthy events in September.
- Central bank action (and inaction):
  - The Bank of England cut rates (down to 0.25%) and boosted its quantitative easing program in an effort to allay economic concerns over June's surprise Brexit vote - the fallout from which has been less severe than expected.
  - The European Central Bank (ECB) fell short of market expectations by failing to expand their accommodative policy and lower interest rates.
  - The US Federal Reserve (Fed) held rates steady, pushing back expectations of a rate hike into December.
  - The Bank of Japan (BoJ) went further down its path of unconventional monetary policy by announcing a yield-curve control mechanism to its asset purchase program.
  - As expected, the Bank of Canada maintained its target for the overnight rate at 0.5% per cent.
- Fixed income markets were driven by a drop in yields over the course of the quarter. September was particularly active as the ECB's decision drove rates meaningfully higher, only to be followed by the Fed and BoJ's decisions reversing the course and pushing yields lower yet again.
- A surprise announcement out of OPEC caused oil prices and energy company shares to rise on hopes that global oil production would be reduced.

Table 1
Summary of major market developments

Market returns*	September	Q3 2016	YTD
S&P/TSX Composite	0.9%	4.7%	13.2%
S&P 500	-0.1%	3.3%	6.1%
- in Canadian dollars	*-0.2%*	*4.4%*	*0.6%*
MSCI EAFE	0.0%	5.4%	-4.1%
- in Canadian dollars	*0.9%*	*6.9%*	*-5.9%*
MSCI Emerging Markets	0.3%	6.9%	9.1%
FTSE TMX Canada Universe Bond Index**	0.2%	1.2%	5.3%
FTSE TMX Canada all corporate bond index **	0.4%	1.6%	5.7%

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

Table 2
Other price levels/change

	Level	September	Q3 2016	YTD
U.S. dollar per Canadian dollar	$0.762	-0.2%	-1.5%	5.4%
Oil (West Texas)*	$48.24	7.9%	-0.2%	30.2%
Gold*	$1,316	0.7%	-0.5%	24.0%
Reuters/Jefferies CRB Index*	$186.32	3.4%	-3.3%	5.8%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX sector returns*	September	Q3 2016	YTD
S&P/TSX Composite	0.9%	4.7%	13.2%
Energy	3.5%	5.4%	23.5%
Materials	2.4%	-1.4%	48.6%
Industrials	-0.4%	10.3%	15.1%
Consumer discretionary	1.1%	8.3%	7.1%
Consumer staples	-4.0%	5.9%	8.1%
Health care	-10.1%	8.7%	-70.0%
Financials	0.3%	4.8%	7.9%
Information technology	1.1%	11.9%	5.1%
Telecom services	-0.6%	1.7%	14.3%
Utilities	0.2%	-0.3%	14.3%
Real estate	-1.0%	-2.8%	5.4%

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

YOU DOWN WITH Q-Q-E? (YEAH, YOU KNOW ME)

The Bank of Japan (BoJ) isn't shying away from experimental and untested monetary policy. After making headlines earlier this year for its negative interest rate policy (NIRP), the BoJ announced Quantitative/Qualitative Easing (QQE) with yield curve control. The efforts are similar to past accommodative efforts in that the asset purchase program continues, but it shifts the ¥80 trillion (US$786 billion) asset purchases toward keeping the 10 year rate at 0%. In short, QQE allows the BoJ greater flexibility to buy or sell short or long bonds. By doing so, it suggests that the yield curve can steepen even if short-term policy rates are taken further into negative territory.

Speculation of a rate hike ran high in the weeks leading up to the US Federal Reserve (Fed) meeting, but the Fed took yet another pass at the end of September, putting off raising rates. The Fed chose instead to wait for 'further evidence of continued progress' (a well-worn Fed phrase which, by now, is surely lacking originality) and reinforced the lower-for-longer mantra that markets have grown to embrace. Global equity markets moved higher on the news, offsetting what had begun as a lackluster September (see Table 1). With the next meeting on November 2nd being only days before the US election, it's unlikely the Fed will make a move then, so all eyes are now on December's FOMC meeting for a rate hike.

Global sovereign yields had been rising in September following the European Central Bank's (ECB) failure to expand its accommodative policy as markets had expected, but the BoJ and Fed announcements reversed the course of yield movements. Bond markets were buoyed by the dropping yields and equity markets were buoyed by the lower-for-longer accommodative monetary policy (see Table 1).

GOOD INTENTIONS

OPEC (Organization of the Petroleum Exporting Countries) made headlines by announcing its intention to attempt to raise and stabilize crude oil prices through cuts to production. This has not been done by the oil cartel since 2008 and was not widely expected by market-watchers. Currently, the 14 members of OPEC have been pumping out oil supply at full (or near full) capacity. It's no secret that low oil prices have placed a strain on the finances of some member nations, which no doubt influenced the discussion. Keep in mind that actually reaching a deal remains to be hammered out in November. Past intentions by OPEC have failed to result in action through a lack of member agreement on which countries will cut, and by how much. Oil prices (and energy companies) surged on the news (see Table 2).

NEW KID ON THE BLOCK

Beginning September 19th the S&P Dow Jones Indices created an eleventh GICS (Global Industry Classification Standard) sector by separating out the real estate securities in the Financial sector, to create the new Real Estate equity sector (See table 3). The Real Estate sector (considered a defensive, yield-influenced sector) lost ground in Canada throughout its debut month on expectations that bond yields are beginning to rise.

The Health Care sector also lagged with a decline of 10.0% for the month as ongoing political rhetoric about drug pricing led to weakness. The Health Care sector is the only Canadian sector in the red (down 70%) on a year-to-date basis.

The global Financial sector has been under pressure for some time now given the 'lower for longer' interest rate environment. Adding to this are concerns over the health of banks in Europe. The latest concerns stem from Deutsche Bank – Germany's biggest bank by assets. American regulators are looking for $14 billion from the bank to settle claims for mis-selling mortgage-backed securities in the run-up to the financial crisis of 2008. This, along with news that some hedge funds have grown reluctant to deal with Deutsche Bank, have added to existing concerns about its weak capital position. Rumours have circulated that Deutsche Bank is seeking a better (i.e. significantly lower) settlement deal – keeping its stock price and sentiment toward financials vacillating, but largely down throughout the month.

Of note, despite starting the quarter with "Brexit" and ending the quarter with mounting pressure on Germany's largest bank, European equity markets have performed much better than anticipated. Fast and accommodative action by the Bank of England has helped, as has a large fall in the British Pound. There is a growing perception that the fallout from the decision will be slow to unfold and that the worst fears may not be realized.

THE BIG LEAGUES

A wild-card contender, zingers coming straight out of left field, an 11th inning push for a win - a baseball pennant or American Presidential race? Regardless, the coming month will be filled with action on both fronts.

As the presidential debates unfold, we can thus far only declare the true winner to be the media (and perhaps more specifically, comedic media) who continue to be fed better headlines, quips, quirks and revelations than they could have ever hoped for. Check out GLC's Insights: US Election for GLC's views on what the US elections do and don't mean for your investment plans.

With both events scheduled to reach their finale in early November, October will be filled with high-stakes events. So enjoy 'The Show' 'cause these are 'the big leagues' now!