glc asset management

Market Matters

Summary for March 2019

Q1/2019 Highlights

Stock markets start the year soaring high.

Oil prices rise, helped by easing trade fears, lower supply growth and optimism for China's growth prospects.

U.S. Federal Reserve surprises the market by abandoning their rate hike plan.

The U.S. yield curve (10-year/3-month) inverts as longer-term interest rates drop below the very shortest-term levels.

In like a lion. Markets take off in 2019.

Stock markets capped off a stellar first quarter after a dismal end to 2018. In fact, every major global equity market is in positive territory so far in 2019. Fixed income markets also had strong quarterly performance. While equity markets tend to do well when investors are feeling optimistic about the economic outlook, fixed income markets tend to do well when investors are worried about the economic outlook. Given that inverse relationship, we know that one of these results is an anomaly and unlikely to continue in the same direction for long. Unfortunately, the jury is still out on which asset class will prevail when markets make their next move.

For North American equity markets, most of the quarter's gains arrived in January and February. A near-flat March result (only 0.6%) partly reflected an exhausted response after two months of steep climb back from 2018's market sell-off. Highlights included: mega-tech companies regaining their footing after December's stumble; soaring oil prices helping to boost our Canadian energy sector; and, emerging-industry players (like cannabis stocks) getting a 'Lyft'* from speculative investors willing to take the chance on a bright future despite little in the way of earnings to show for it.

**Uber rival, Lyft, became the first in the ride-hailing industry to come to market with an initial public offering amid much hype (and large operating losses).*

Mixed signals

There are a lot of mixed signals driving capital market returns right now.

The U.S. Federal Reserve (Fed) does an about-turn on rate hike plans

Markets don't like surprises, and central bankers tend to avoid them too. But that wasn't the case this quarter when the Fed took a 180-degree turn from a clear

Market Summary

Canadian Fixed Income[1]	Month	QTR	YTD
FTSE Canada Universe Bond Index	2.4%	3.9%	3.9%
FTSE Canada All Corporate Bond Index	2.0%	4.0%	4.0%

Canadian Equities[2]	Month	QTR	YTD
S&P/TSX Composite	0.6%	12.4%	12.4%

	Month		QTR		YTD	
Global Equities[2]	Local	CAD	Local	CAD	Local	CAD
S&P 500	1.8%	3.4%	13.1%	10.9%	13.1%	10.9%
MSCI EAFE	0.8%	1.7%	9.6%	7.0%	9.6%	7.0%
MSCI Emerging Markets	1.2%	2.3%	9.5%	7.5%	9.5%	7.5%

Currencies and Commodities (in USD)	Level	Month	QTR	YTD
CDN $	$0.749	-1.3%	2.2%	2.2%
Oil (West Texas)	$60.14	5.1%	32.4%	32.4%
Gold	$1,293.42	-1.7%	0.9%	0.9%
Reuters/Jeffries CRB Index	$183.75	0.6%	8.2%	8.2%

Canadian Sector Performance[2]	Month	QTR	YTD
Cons. Disc.	-1.4%	9.3%	9.3%
Cons. Staples	3.1%	10.2%	10.2%
Energy	-0.9%	14.4%	14.4%
Financials	-1.4%	9.4%	9.4%
Health Care	1.9%	48.9%	48.9%
Industrials	3.3%	14.8%	14.8%
Info Tech	5.0%	25.2%	25.2%
Materials	2.2%	8.2%	8.2%
Real Estate	3.4%	16.3%	16.3%
Comm. Services	1.4%	8.8%	8.8%
Utilities	4.3%	14.7%	14.7%

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

interest rate-hiking plan for 2019 to an indefinite pause in raising rates (i.e., moving from a hawkish to dovish stance, in central banker lingo). The move drove bond yields down, particularly for longer maturity bonds. Falling yields meant better returns for bond investors, but it also signaled concern over the Fed's expectations for economic growth. With longer-term interest rates dropping faster than shorter-term interest rates, it caused the yield curve to invert – sparking much consternation and creating yet another mixed signal for investors.

It happened – the dreaded 'inverted yield curve'

Late in March, financial media lit up with word the yield curve had 'inverted'. Sober and sullen-faced, market pundits hit the air to fulfill their self-appointed civic duty and issue dire warnings for days ahead. Parents rushed home from work to hug their children a little tighter and family pets lay stoic and loyal by their master's side – ready for anything.

Okay, seriously, what's the big deal? And what's an inverted yield curve anyway?

Specifically, an inverted yield curve is a downward sloping, plotted line between the yield levels of a shorter-term bond and a longer-term bond. Traditionally, economists have suggested that an inverted yield curve is a pre-emptive signal that an economic recession is on the way, although the signal's track-record in forecasting the timing of the onset of a recession is foggy. In isolation, the inverted yield curve gives us reason to pause, but more optimistic outlooks in China and the U.S. give us reason to believe that the inverted yield curve is more a symptom of current central bank policy, and less a cause for recessionary outcomes. In our view, an inverted yield curve is not reason alone to call the end of a business or market cycle.

China's pro-growth moves

After three years of reigning in credit expansion in China, the slowing Chinese economy spread to the rest of Asia and Europe, and now Chinese policymakers have shifted into pro-growth mode for 2019. The unleashing of a substantial set of economic policies aimed at stimulating Chinese growth leaves us optimistic about the Chinese economy and its ability to reinvigorate global growth and trade.

We know policy changes like this take time to translate into the economy and markets, and we recognize at least a partial dependency on a positive trade resolution between the U.S. and China. With North America, Europe and Japan all showing signs of slowing, the timing couldn't be better for China's economy to exit its slowdown sooner rather than later, and we believe it could help lift equity markets and bond yields in the latter half of 2019.

Stock markets still have room (and reason) to grow

We believe equity markets still have room to grow. While economic growth has slowed in the U.S. and Canada, we're still seeing good credit flows (i.e., lending and borrowing hasn't dried up); and while consumer sentiment/spending is softening, it remains decent. While Q1 2019 corporate earnings growth will face a high hurdle as the first quarter of year-over-year comparisons under the tax-incented bump of U.S. corporate tax cuts, expectations for full-year earnings growth generally remain constructive. Likewise, we expect that the eventual resolutions to nagging uncertainties, like Brexit and trade negotiations, will lift sentiment, if only out of relief for more clarity.

Bottom line: Proceed with caution

Today's market backdrop supports our view that a neutral or balanced stance within a long-term investment portfolio is most appropriate. That doesn't mean we think all investors should be equally positioned between equities and fixed income. Rather, investors with a longer time horizon and higher tolerance for market volatility would naturally hold a higher proportion of equities, and the reverse would be true for less risk tolerant investors. The inverted yield curve that occurred late in March is not a flashing red stop signal for equity markets, or the economy. It's more like an amber light to investors on the road to long-term investment goals saying 'proceed, with caution'.

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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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