

Market Matters

Q3 2015 Highlights

- Declines were widespread across all major global indices as the outlook for global growth weakened while uncertainty over monetary policies grew (particularly in regard to the U.S. Federal Reserve action).
- The Chinese bull market ended. The Shanghai Composite is down over 40% from its June 12th highs to September 30th, 2015. Stock markets in virtually all emerging markets sank alongside China into bear market territory.
- North American and European stock markets were not spared volatility and they too corrected meaningfully.
- Commodity prices buckled under the weight of a stronger U.S. dollar and global growth worries leading to depressed demand expectations.
- There was beauty in the boring stability of fixed income. In spite of significant swings in bond prices, the steady (albeit modest) income generated by bonds helped the broad Canadian bond index end flat for the quarter.
- The Canadian dollar hit a fresh 11-year low in September amid the persistent weakness in oil prices and U.S. dollar strength.
- For Canadian investors, fixed income and foreign equity exposure helped offset declines.
- Beyond the macro view, a number of stock-specific stories also chipped away at stock values. Volkswagen's carbon dioxide emission scandal hurt parts and automakers across the world. The public shaming of pharmaceutical companies by presidential candidate Hillary Clinton added insult to injury for the Health Care sector, which was already getting dragged down by the higher cost of debt making future M&A prospects less attractive.

WAKE ME UP WHEN SEPTEMBER ENDS

No sense in sugar-coating it - the third quarter of 2015 was ugly and there were few places to hide (see Tables 1 and 2). What's weighing on financial markets? The issues are many, but we believe two key factors present in the third quarter contributed significantly to poor investor confidence and market volatility:

1/ DOWNWARD PRESSURE ON SLUGGISH GLOBAL GROWTH

Concerns over China hit global growth expectations this summer. Disappointing Chinese economic data was met with a

Table 1
Summary of major market developments

Market returns*	September	Q3 2015	YTD
S&P/TSX Composite	-4.0%	-8.6%	-9.1%
S&P 500	-2.6%	-6.9%	-6.7%
- in Canadian dollars	-1.3%	-0.1%	7.6%
MSCI EAFE	-5.0%	-9.5%	-3.1%
- in Canadian dollars	-4.0%	-4.2%	6.9%
MSCI Emerging Markets	-2.0%	-12.8%	-9.0%
FTSE TMX Canada Universe Bond Index**	-0.3%	0.1%	2.5%
FTSE TMX Canada all corporate bond index **	-0.1%	-0.2%	2.1%

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

Table 2
Other price levels/change

	Level	September	Q3 2015	YTD
U.S. dollar per Canadian dollar	\$0.751	-1.3%	-6.1%	-12.7%
Oil (West Texas)*	\$45.09	-8.4%	-24.2%	-15.4%
Gold*	\$1,115	-1.7%	-5.0%	-6.1%
Reuters/Jefferies CRB Index*	\$193.76	-4.1%	-14.7%	-15.7%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX sector returns*	September	Q3 2015	YTD
S&P/TSX Composite	-4.0%	-8.6%	-9.1%
Energy	-9.3%	-18.0%	-23.8%
Materials	-9.8%	-24.9%	-25.1%
Industrials	1.1%	-2.5%	-11.1%
Consumer discretionary	0.3%	-4.1%	2.4%
Consumer staples	2.6%	7.6%	10.5%
Health care	-21.8%	-15.6%	33.6%
Financials	-0.3%	-4.0%	-6.0%
Information technology	-2.8%	2.6%	4.1%
Telecom services	1.1%	1.5%	1.8%
Utilities	0.4%	1.2%	-5.4%

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

decision from Chinese policymakers to devalue the Chinese Yuan in August. The surprise decision was seen as a panicked reaction to an economic growth trajectory that was slowing much faster than they would like. The Shanghai Composite, largely seen as having risen on investor speculation that far exceeded fundamental and economic realities, extended losses that began in mid-June and slid 28.6% further during the quarter. To address the sell-off, Beijing introduced a slew of initiatives which were, by and large, fruitless and did more to undermine confidence than stabilize stocks. Several emerging

markets are oil-exporting nations, as well as having heavy U.S. denominated debt loads. As the U.S. dollar strengthens and low oil prices persist, avoiding default will become a growing challenge for these nations. We remain cautious on emerging markets in the near to mid-term as ongoing volatility is expected. Not surprisingly, global growth concerns weighed on the resource sectors around the world (see Table 3).

2/ AFFECTING DESIRED CHANGE THROUGH MONETARY POLICY

The global growth gap has manifested itself in divergent central bank policy. Each nation appears to be faced with the struggle of wanting to support/reassure the confidence of their nation's investors, while at the same time desiring a return to a more "normal" interest rate environment so as to be adequately positioned to address future economic cycles and inflation/deflation concerns. This lack of a clear path around central bank actions has shouldered much of the blame for financial market volatility this past quarter.

Despite slow but steady economic expansion in the U.S., the U.S. Federal Reserve (Fed) left short-term interest rates unchanged at their highly anticipated mid-September meeting. The Fed noted deflation worries and concerns over global financial and economic conditions (the aforementioned troubles in China likely serving as a tipping point). Unfortunately, leaving rates unchanged was initially interpreted as a lack of faith in the U.S. economy (i.e. what is the Fed seeing that the rest of us aren't?). That uneasy question translated into sharp market declines in the initial days following the Fed decision.

In contrast to the U.S., the Bank of Canada responded to the effects of lower oil prices (along with the disappointment in non-energy exports) by trimming its benchmark interest rate in July for the second time this year. The good news is that Canada is finally seeing signs of a growth turnaround after a weak first half of 2015. The available June and July GDP data results show Canada moving back into positive economic growth territory as the effects of a low Loonie and a strengthening U.S. economy filter through the Canadian manufacturing segment.

Several emerging markets are cutting interest rates in the hopes of boosting economic growth and devaluing their local currencies to vie for U.S. demand. Meanwhile Europe and Japan's quantitative easing strategies are in full swing to combat low inflation and stimulate economic activity.

ON THE PLAYING FIELD

We do anticipate that markets will remain volatile as global growth worries and central bank actions remain key issues to watch. With that said, the resilience of the U.S. economy provides a measure of reassurance as the outlook for corporate profits remains positive overall. A disciplined investment approach and astute stock selection are increasingly important, as select companies and sectors are poised to benefit from the strengthening U.S. economy and the relative weakness of the Canadian dollar aiding non-resource exports.

In support of the Blue Jays' playoff run for the World Championships (*#cometogether*), and in memory of the late baseball great Yogi Berra, who would tell it to you straight, some timely and sound investment advice from one baseball fan to another might sound something like this:

It's what you do before the season even starts that makes you a champion. Markets are going to throw you a few curve balls, and now and again something is going to come right out of left field. So what are you going to do? Lose your focus? Grandstand? Swing for the fences and risk striking out? Say it ain't so! Remember, the game ain't over 'til it's over.

Of course you won't always be batting 1000. That's okay, because it may be offence that sells tickets, but it's defence that wins championships. Cover your bases, get your ducks on the pond one base at a time, and you'll be standing ready to knock it out of the park when opportunity comes your way. Now you're in our wheelhouse - we stick to the game plan and play like a team, because the next thing you know, it's a brand new ball game out there folks!

"Little League baseball is a very good thing because it keeps the parents off the streets."

Yogi Berra (May 12, 1925 - September 22, 2015)
Professional baseball catcher, manager and coach.

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