Market Matters

JULY 2015 HIGHLIGHTS

A number of global events moved markets this July.

- Greece reached an agreement with its creditors.
- Iran and six major world powers struck an agreement on nuclear power, ultimately reducing sanctions against Iran (such as oil exports).
- Chinese equity markets continued their fall into July and remain volatile.
- The U.S. Federal Reserve (Fed) Chairperson, Janet Yellen prepared markets for a possible 2015 rate hike, while Bank of Canada (BoC) Governor Stephen Poloz cut rates again.
- The Canadian dollar weakened substantially and Canadian bond yields dropped across the board in July. Fixed income markets benefited, with longer duration bonds faring best.
- Commodity prices dropped. Gold hit a five-year low, while oil prices fell 21% in the month.
- Most developed equity markets performed well and Canadian investors got a substantial currency boost on their foreign investments.
- The S&P/TSX Composite was the exception among developed market peers as very weak energy and material sector results pressured returns into negative territory.

AT THE BOTTOM OF A BARREL

The price of oil extended its slide into July and fell below $50 USD (WTI) for the first time in over three months. Many of the same global events noted above (see July 2015 highlights) came into play and contributed to market uncertainty and volatility, plus the strength of the US dollar (boosted further by the prospect of the Fed forecasting that rising rates are on their way). In addition, specific oil supply/demand factors kept oil prices depressed (along with many investors).

Ample supply:

- Current U.S. inventory levels are running approximately 100 million barrels above the fiver-year average.
- The Organization of the Petroleum Exporting Countries (OPEC) indicated that the latest drop in prices won't stop them from maintaining their output at high levels to defend their market share.
- The nuclear agreement between Iran and six major world powers could mean that the United States, European Union, and United Nations would reduce sanctions, including those on oil exports. Of note, Iran is estimated to have the ability to add up to 500,000 barrels/day to OPEC's production.

Table 1
Summary of major market developments

Market returns*	July	YTD
S&P/TSX Composite	-0.6%	-1.1%
S&P 500	2.0%	2.2%
- in Canadian dollars	***6.5%***	***14.7%***
MSCI EAFE	3.5%	10.8%
- in Canadian dollars	***6.6%***	***18.9%***
MSCI Emerging Markets	-4.7%	-0.6%
FTSE TMX Canada Universe Bond Index**	1.4%	3.8%
FTSE TMX Canada all corporate bond index **	0.9%	3.1%

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

Table 2
Other price levels/change

	Level	July	YTD
CAD per USD exchange rate	$0.764	-4.6%	-11.3%
Oil (West Texas)*	$47.12	-20.8%	-11.5%
Gold*	$1,096	-6.5%	-7.5%
Reuters/Jefferies CRB Index*	$202.57	-10.8%	-11.9%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	July	YTD
S&P/TSX Composite	-0.6%	-1.1%
Energy	-6.6%	-13.1%
Materials	-14.7%	-15.0%
Industrials	4.9%	-4.3%
Consumer discretionary	2.9%	9.8%
Consumer staples	7.3%	10.2%
Health care	18.4%	87.4%
Financials	0.1%	-2.0%
Information technology	8.1%	9.6%
Telecommunication services	2.6%	2.9%
Utilities	2.7%	-4.0%

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

Slower demand expectations:

- The economic growth rate in China has been slowing for some time, and fresh turmoil in China (which came amid the plummeting Chinese stock market and their government's intervention to prop it back up), added to existing worries about the pace of China's economy, and thus its future energy needs.
- On the broader global economic front, data continues to be mixed, but overall indicative of a lower growth environment.

A NOT-SO-HOT CANADIAN SUMMER

The weakness in oil prices has significantly impacted the Canadian economy. May's GDP number fell by 0.2%, the fifth consecutive monthly decline, and a larger decline than expected. Weakness in the oil sector was anticipated, but more troublesome was the absence of evidence showing that the hoped-for transition and pick-up in non-resource manufacturing is materializing. Results put out in July showed that manufacturing output declined 3.6% on a year-over-year basis.

Longer term, sustained low energy costs are a benefit to global economic growth, which should be a positive for central Canada's manufacturing sector and the country's transportation, agricultural, and tourism industries. But on a nearer-term basis, the question that remains is whether Canada's economy can pick up in the second half of the year on the back of an improving US economy. Right now, the two economies are clearly headed in different directions.

It wasn't just oil markets that melted in July. Gold hit a five year low during the month and closed the month out at $1,096 /oz USD. The move in gold supported a selloff across most of the precious metal space with silver (-6.1%), platinum (-8.9%) and palladium (-9.4%) also dropping lower. The move has largely been attributed to the recent strong run in the greenback and the prospect of a Fed rate liftoff and with attention moving back to the Fed after recent events in Greece and China.

When it was all said and done the S&P/TSX Composite was down a modest 0.6%. The significant drag from the resource sectors was nearly completely offset by strength in the other eight industry sectors of the index, and thankfully the stock values of Canada's energy companies didn't plummet in lock-step with the oil prices in July (primarily because they hadn't rallied when the oil prices were moving up the last few months either). While the non-resource sectors have solid underlying fundamentals, valuations have become extended. In short, market volatility and diverging sector results mean pockets of stock-specific opportunities, favouring active versus passive portfolio management.

US equities have essentially been range bound since late November of last year, and a strong US dollar remains a headwind for companies with global operations and/or reliance on exports. The sector results for the S&P 500 were similar in direction to those in Canada – weak resource sectors, with strength in the consumer sectors, health care and technology.

BANK OF CANADA IN THE RE-INSURANCE BUSINESS

It appears the BoC is getting into the reinsurance business. Following a series of disappointing GDP and trade results, the BoC chose to further trim interest rates, cutting its key overnight lending rate 25 basis points to just 0.50% (leaving it only a quarter of a percent above the all-time low reached during the depths of the 2009 recession). The first cut in January was portrayed as economic "insurance" to counter the possible effects of an oil price shock. July's rate cut was clearly billed as a response to the very real effects of that shock, along with disappointment in non-energy exports. Fuelled by the ongoing Greek debt problems, the Chinese equity market weakness, and increasing of the BoC easing further, bond yields subsequently headed down. The FTSE TMX Canada Universe Bond Index returned 1.4% in July, bringing the year-to-date net gain to a substantial 3.8% in spite of ultra low interest rate levels.

MAKING PROGRESS

Dramatic progress was made on a number of diplomatic fronts in July. To name a few, Greece averted a financial calamity; an agreement on nuclear power with Iran was made; and the United States and Cuba reopened embassies in each other's capitals after each having been closed since 1961. While each are important and historic moments in time, progress can never be static and the edge of a rut should not be mistaken for the horizon - much work remains. As with all great accomplishments, there are obstacles, challenges and setbacks, but progress was (and will be) made through persistent, open and ongoing discussions.

Likewise, if market volatility is presenting you with an obstacle, challenge or setback, an open and ongoing dialogue about your long term investment goals can help keep your progress on track.

And if you are looking for inspiration, look no further than our remarkable Pan Am and Parapan Am athletes. Obstacles, challenges, and setbacks are now milestones on the way to having reached their great achievements. Congratulations to all our Canadian Pan Am and Parapan Am athletes – you've made us proud.