Market Matters

Q1 2017 HIGHLIGHTS

- Capital markets had a good quarter, including notable record highs for the S&P/TSX Composite, S&P 500, NASDAQ and Dow Jones Industrials indices.
- Much of the gains happened early in the quarter as global equity markets paused in March when the 'Trump trade' rally gave way to disappointment in the US administration's ability to execute on key legislative initiatives.
- Bond yields were volatile, with US and Canadian 10 year yields hitting both their highs and lows for the year. Ultimately yields ended the quarter down from where they started as investors moved to a 'risk off' stance.
- The US Federal Reserve raised their target interest rate from 0.75% to 1% in the middle of March. Other major central banks (i.e. Bank of Canada, European Central Bank, Bank of England and Bank of Japan) held rates and monetary policy steady in Q1-2017.
- Canada's energy sector lagged as oil and natural gas prices weakened. Rising US oil production and warmer than usual winter temperatures depressed fuel prices.
- Britain's Prime Minister Theresa May, triggered Article 50 to begin the two-year divorce negotiations with the European Union.

MARCH MADNESS

The banner first quarter of 2017 threatened to derail in March. The March madness included a myriad of potentially market-moving events, such as:

- Political strife from many corners of the world.
- A US Federal Reserve interest rate hike.
- The triggering of Article 50 to officially begin Britain's divorce negotiations with the European Union.
- Geopolitical tensions and terror attacks. (It is a sad commentary that markets now show little reaction to these attacks).

We can't ignore that capital market sentiment continues to take cues from President Trump's progress, or lack thereof. While optimism surrounding President Trump's proposed policies boosted investor sentiment (and market results) early in the quarter, a sobering reality check is unfolding. With the executive orders on immigration twice quashed by courts, and legislation to "repeal and replace" the Affordable Care Act failing due to lack of sufficient support from the House of Representatives, the seeds of doubt over Trump's ability to pass income tax reform, one of the most market-supportive campaign promises, have been planted.

Table 1
Summary of major market developments

Market returns*	March	YTD
S&P/TSX Composite	1.0%	1.7%
S&P 500	0.0%	5.5%
- in Canadian dollars	***0.1%***	***4.4%***
MSCI EAFE	1.9%	4.0%
- in Canadian dollars	***2.5%***	***5.3%***
MSCI Emerging Markets	1.8%	7.5%
FTSE TMX Canada Universe Bond Index**	0.4%	1.2%
FTSE TMX Canada all corporate bond index **	0.4%	1.8%

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

Table 2
Other price levels/change

	Level	March	YTD
CAD per USD exchange rate	$0.751	-0.1%	0.9%
Oil (West Texas)*	$50.60	-6.3%	-5.8%
Gold*	$1,250	-0.5%	8.4%
Reuters/Jefferies CRB Index*	$185.88	-2.5%	-3.4%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	March	YTD
S&P/TSX Composite	1.0%	1.7%
Energy	0.7%	-6.2%
Materials	0.6%	5.8%
Industrials	2.8%	4.9%
Consumer discretionary	3.5%	6.5%
Consumer staples	4.5%	2.3%
Health care	-11.3%	-10.3%
Financials	-0.4%	2.6%
Information technology	5.2%	6.9%
Telecommunication services	2.0%	3.8%
Utilities	4.8%	6.1%
Real Estate	-0.6%	3.4%

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

It is important to keep in mind that before the 'Trump trades' came and went, there were genuine economic improvements taking hold around the world. Europe is showing pockets of economic strength and recovery, while long-awaited stabilization in key economic indicators is appearing in Asia. The US economy continues to perform well with persistently strong results in consumer confidence, manufacturing, jobs, and GDP growth. Even US inflation results are beginning to come back to life. Early 2017 Canadian GDP growth results surprised to the upside, but our Achilles heel remains in the energy sector, where depressed oil and natural gas prices have created pockets of significant regional weakness.

A GOLDEN BALLAST

For most of the quarter bond yields moved higher but, as the 'Trump trade' unwound, bond yields dropped again and finished the quarter lower. Canadian corporate, municipal and provincial bond yields fell further than Government of Canada bonds and the additional income those sectors earn above their federal counterparts helped them to outperform in the quarter.

Broadly speaking the risk-off tone at the end of the quarter caused a sector rotation in which cyclical stocks paused, while defensive sectors found renewed strength. Energy stocks in particular did not have a good quarter. Natural gas prices were depressed due to a warmer than expected winter, and bloated US oil stockpiles and rising US production continue to put downward pressure on oil prices. Canada's energy stocks were much weaker than their US counterparts. There was some stock-specific news behind the divergence between US and Canadian energy company results (e.g. Canada's Cenovus Energy Inc. stock fell over 13% when their announcement of a $17.7 billion deal to buy assets from ConocoPhillips was poorly received by investors), but speculation surrounding Trump's proposed border-adjustment tax is also weighing on Canada's energy producers.

Canada's other resource sector provided a ballast in Q1-2017. Gold prices continue to rally and boost Canada's materials sector. So far gold has been making gains on both the 'risk-on' trade (in anticipation of rising inflation and interest rates), and the 'risk-off' trade (benefitting from political uncertainty coming out of the US and pending European elections). Hope does not spring eternal for gold prices and we don't anticipate this 'everything is working' scenario for gold prices to continue indefinitely.

WILL APRIL RAIN ON GAINS?

Political uncertainty will likely remain front and center in the coming months. It is our experience that political promises tend to take longer than expected, and frequently end up as diluted versions of their original proposal. While the new US administration is believed to want a friendlier business environment (deregulation, tax cuts, infrastructure spending) investors may grow impatient waiting for progress. As a result, we anticipate some shorter term volatility will ensue, but solid global economic data and strong corporate earnings are what lead us to a constructive fundamental outlook for equity markets in 2017.