

Market Matters

Q2 2015 Highlights

- Improving economic data out of the US, Europe and Japan was juxtaposed with mounting angst over Greece's debt crisis and the sustainability of China's bull market.
- North American equity markets traded in a range, ending the quarter in negative territory, while fixed income markets were particularly volatile.
- Yields on bonds rose at home and abroad, resulting in the first negative quarterly return for the FTSE TMX Canada Universe Bond index in two years.
- The volatility in the bond market also affected North American equity markets as interest-rate sensitive industries (Utilities, REITs, Pipelines) sold off. Conversely, life insurance companies have rallied with the rise in rates.
- Despite a rebound in oil prices, energy stocks lagged as company balance sheets continue to normalize to current (lower) oil prices.

Capital markets traded in a range, ending the second quarter of 2015 in negative territory. Improving economic data out of the US, Europe and Japan was juxtaposed with mounting angst over Greece's debt crisis and the sustainability of China's bull market equity run. North American equity markets by and large traded sideways, while fixed income markets were particularly volatile.

TIME FOR CHANGE

In the final days of the quarter, amidst acrimonious Greek/Eurozone negotiations and a missed IMF debt repayment, a referendum was called for the Greek people to weigh in; vote 'yes' to accept further austerity measures from global (largely European) lenders, or vote 'no' to reject the conditions being imposed for the needed bailout loan.

Opinion polls leading up to the July 5th referendum revealed no obvious victor (contributing to market volatility at the end of the quarter), but the voting result was much more decisive. After five years of austerity measures contributing to one in four Greeks being unemployed, over 60% of Greeks voted 'no' and sent the message to creditors that they will no longer accept repeated rounds austerity. It was a clear message, but

Table 1
Summary of major market developments

Market returns*	June	Q2 2015	YTD
S&P/TSX Composite	-3.1%	-2.3%	-0.5%
S&P 500	-2.1%	-0.2%	0.2%
- in Canadian dollars	-2.0%	-1.8%	7.7%
MSCI EAFE	-4.6%	-2.8%	7.1%
- in Canadian dollars	-2.8%	-1.9%	11.6%
MSCI Emerging Markets	-2.8%	-0.2%	4.3%
FTSE TMX Canada Universe Bond Index**	-0.6%	-1.7%	2.4%
FTSE TMX Canada all corporate bond index **	-0.5%	-1.3%	2.2%

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

Table 2
Other price levels/change

	Level	June	Q2 2015	YTD
U.S. dollar per Canadian dollar	\$0.800	-0.3%	1.5%	-7.0%
Oil (West Texas)*	\$59.47	-1.4%	24.9%	11.6%
Gold*	\$1,174	-1.3%	-0.9%	-1.2%
Reuters/Jefferies CRB Index*	\$227.17	1.8%	7.2%	-1.2%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX sector returns*	June	Q2 2015	YTD
S&P/TSX Composite	-3.1%	-2.3%	-0.5%
Energy	-5.4%	-5.2%	-7.0%
Materials	-5.3%	-3.0%	-0.3%
Industrials	-3.2%	-9.8%	-8.8%
Consumer discretionary	-0.2%	1.1%	6.8%
Consumer staples	1.1%	-0.4%	2.7%
Health care	-4.8%	9.1%	58.3%
Financials	-1.5%	-1.0%	-2.1%
Information technology	-6.5%	-6.5%	1.5%
Telecom services	-0.3%	1.3%	0.3%
Utilities	-6.2%	-8.7%	-6.5%

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

revealed no clear path to resolution of their financial crisis. One could argue that a 'yes' vote would have led to a similar uncertain future of repeated negotiations, but these are uncharted waters for the eurozone. New talks, with some new and some old realities looming, will begin again and the stakes (particularly the stability of

the Greek banking system – a corner stone in any nation's economy) remain high for the citizens of Greece. Initial market reactions have been contained and less volatile than feared, but the situation remains very fluid. Some market volatility, particularly in Europe, is to be expected.

DATA-DRIVEN TIMING

Both the US Federal Reserve (Fed) and the Bank of Canada left their overnight rates unchanged during the quarter. 'Data dependence' remains the theme for North American central banks, as the US is looking for evidence of further improvements in the economy before beginning to move interest rates higher, whereas Canada is looking for evidence of economic improvement as a reason not to reduce interest rates once more.

In the interim, bond yields faced offsetting pressures resulting in volatile, sometimes reversing, trends (for example, yields continued to drop into mid-April, but then sharply reversed as stronger US and European economic news was released and the outlook improved). An array of strong US consumer spending and housing reports applied upward pressure on yields. Applying downward pressure was mounting concerns over Greece, the European Central Bank's ongoing quantitative easing program, and the Fed Chair Yellen's comments in mid-June. In referring to the first quarter's economic soft patch in the US, Ms. Yellen said that only 'part of this weakness was likely the result of transitory factors' (e.g. weather and labour disruptions at West Coast ports). The key non-transitory factor being the strong US dollar and low oil price nexus which has thus far proved to be a net negative for the US economy, and the Fed took note.

Fixed income markets experienced negative returns over the quarter as yields on bonds rose at home and abroad, resulting in the first negative quarterly return for the FTSE TMX Canada Universe Bond index in two years (see Table 1). Long-term bonds lagged the most (down 4.56%), while short-term bonds and corporate bonds fared better.

The volatility in the bond market also affected North American equity markets as interest-rate sensitive industries (Utilities, REITs, Pipelines) sold off. Conversely, life insurance companies have rallied with the rise in rates, as a group the subsector was up 3.8% on a price-only basis for the quarter.

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The industrials sector posted the second-worst performance of the quarter in Canada (see Table 3), weighed down by the railroad companies. Railroad companies have come under pressure as energy demand by rail has slowed.

After rallying sharply during the early weeks of the quarter, oil prices moved essentially sideways over the last month (see Table 2). Despite the commodity strength, stocks in the energy sector have lagged as share prices were ahead of the commodity values and therefore didn't rally in step with crude oil prices. While commodities remain a drag for the Canadian economy, the strengthening production cycle in the US should be beneficial for non-energy exports and low rates should also keep consumer spending resilient in spite of elevated debt levels.

Finally, within the Canadian health care sector Valeant Pharmaceuticals remains the darling (and giant) as it continued its strong run led by M&A activity and well-received quarterly results and forward guidance.

A MATTER OF TIME

While investors in Europe anxiously watched the unfolding of events in Greece, Asian investors held their breath as China's Shanghai Composite Index continued onward and upward during the quarter, that is until mid-June when a tipping point emerged. Growing concerns about extreme valuations and the speculative nature of the advance could no longer be set aside and prices started to decline and have continued their sharp downward decent into the third quarter of 2015.

DIFFICULT TIMES

While the outcome for Greece is unlikely to derail the global economy (the Greek economy accounts for less than 0.3% of global GDP), this doesn't diminish the difficult times the Greek people are facing. That said, the headlines and political rhetoric abroad should not derail Canadian investors' from sticking to their long-term financial plans to achieve financial well-being. In fact, a sense of financial well-being and the ability to plan for the long-term are the very things that European leaders on both sides of the negotiation table are striving to achieve. We wish them well in doing so.