Quarterly Commentary

Canadian Equity

Global leading economic indicators continued to lose momentum in the final quarter of 2018 against a backdrop of trade uncertainties, deteriorating manufacturing data in Asia and Europe, as well as record debt levels. Globally there have been many regional differences with the U.S. still on a solid growth trend, albeit with some downward revised expectations. The Canadian equity market came under pressure due to the decline of Energy prices and NAFTA trade issues which dominated headlines for most of the year. The slowdown cut severely into global markets as almost all regions around the world posted negative returns.

The breadth of the underperformance encompasses virtually all assets classes and 2018 could be rated as one of the worst years in history for investors. In Canada, despite the economy being far from worrisome and at near full employment, the equity market had a challenging year. The sectors that form the backbone of the S&P/TSX index, Financials and Energy, dragged the index to an 8.9% loss on the year; its worst performance in a decade.

In 2018 all but two sectors of the Canadian equity market were in negative territory and most of the drop occurred in the erratic fourth quarter. The Energy sector was the worst performer with a 28.6% plunge in value on a total return basis over the year It was followed by the Consumer Discretionary sector which fell 17.7% and Financials which declined 12.5%.

Canada's oil price discount, which is the difference between the Canadian oil benchmark the Western Canadian Select (WCS) and its American counterpart West Texas Intermediate (WTI), has been historically impacted by heavy oil but spread to light oil and was becoming costly for producers. During October the dollar amount of the discount was estimated to be about $50 million per day, or more than US$52 per barrel. It's no wonder that the returns for the energy sector were very poor. As for Financials, despite rising rates and reassurance from credit rating agencies such as Fitch, investors continue to be wary.

On the positive side, the Consumer Staples sector returned a marginal 0.7% for the year while the most positive contributor was Information Technology which rose 11.7%. In early 2018 Health Care, and in particular marijuana stocks, skyrocketed but over the course of the year investors grew more cautious as the sustainability of their valuations began to be questioned. The subsequent correction was swift and severe for marijuana stocks which caused the Health Care sector to post a negative return.

With growth taking a breather in major economies around the world during 2018, some analysts have predicted that global growth has peaked and a few have even made recessionary calls citing the flattening and then temporary inversion of the U.S. yield curve. The inversion in December was the first occurrence in a decade. Our view is that rather than a recession, the synchronized global growth that the world experienced a few years ago will be slower in 2019. Pockets of deceleration will still exist and weigh negatively on global momentum. But overall growth, although subdued, is likely to be decent. That argument seems especially compelling for Canada with an economy that faced many headwinds in 2018 including NAFTA, the bear market in Energy and numerous geopolitical issues.

The negative sentiment and mass exodus of capital from some sectors like Energy in 2018 has created attractive valuations as the S&P/TSX is now trading at around a 15 times P/E multiple, its long term average. Canada's oil price discount has subsided as efforts from OPEC and provincial governments to stabilize Energy prices through production cuts have come into effect. Furthermore the new United States-Mexico-Canada Agreement (USMCA) trade deal should help improve sentiment toward Canada and its markets in the months ahead.

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