QUARTERLY COMMENTARY

GLOBAL REAL ESTATE

Global real estate was not immune to the fourth quarter downturn as stocks fell 8.6%; however for the full year they were only down 1.8%. Real Estate asset pricing trends have remained relatively flat across most property types in 2018. The combination of steady economic growth will continue to create a favorable investing environment for real estate, albeit one that require increased levels of caution and prudence. So far this year, most investors have increased their activities. The office market is on an upswing. Income growth opportunities in industrial and multi-residential continue to attract investors and multi-residential properties are on pace to hit the record high valuations. Many residential real estate markets look overvalued once again, so house prices are set for a sustained period of low growth. Housing market activity has slowed since the start of the year as a combination of a lack of affordable homes for sale, moderation in house price expectations and rising interest rates has hit buyer sentiment. With the possibility mortgage interest rates are now close to a peak, this should prevent a more serious downturn from developing.

Global financial market volatility picked up in 2018 and is pointing to an expectation among some investors that deterioration in global macro conditions is increasingly likely. That suggests the outlook analysis for 2019 should be more about assessing whether underlying economic conditions allow for an extension of the global business cycle. The U.S. may well enter a cyclical slowdown in 2019 and, if so, a key question is whether the Federal Reserve can successfully engineer a soft landing for the U.S. economy. Back in September most Fed officials had predicted at least three rate increases over the course of 2019 but following the December rate announcement they are now predicting the central bank would raise rates no more than twice this year. The mention of any rate increase at all sent markets into a tailspin as many investors hoped that the the Federal Reserve was closer to the end of its hiking cycle.

The Fed's policy trajectory is critical for the extension of the current business cycle. Out of the twelve U.S. rate hike cycles since 1955, eight resulted in a recession. Achieving a soft landing may indeed be a challenge but U.S. economic growth has held up better compared with other major developed world economies thanks to bullish business and consumer confidence, which in turn has been supported by favourable employment numbers. The bigger than expected 312,000 jump in non-farm payrolls in December suggests the U.S. economy still has considerable forward momentum. The only downside in the report was that the unemployment rate increased to 3.9% from 3.7% but that increase was largely due to an enormous 419,000 increase in the labour force, As a result the participation rate jumped to a five-year high of 63.1%. It appears that higher wages are the reason why people are returning to the active labour force. Overall the equity market may have decided the Fed's work is done, but the economic data say otherwise.

A stronger economy tends to push up interest rates, which in turn puts downward pressure on stock prices. In late December the U.S. Bureau of Economic Analysis confirmed that real gross domestic product (GDP) increased at an annual rate of 3.4% in the third quarter of 2018 according to its third estimate. The very healthy real GDP number in the third quarter reflected positive contributions from personal consumption expenditures, private inventory investment and non-residential fixed investment. However headwinds, including restrictive trade policies and tighter financial conditions, are gathering. This should lead to a classic cyclical slowdown in 2019. For 2020, the current consensus forecast, as well as the Federal Open Market Committee's, suggests a soft landing.

There are signs that we are in a classic late cycle expansion as we are seeing an economy with almost full employment and slowing momentum which tends to foretell a decline in corporate profit margins, but while the U.S. may well be in the mature stage of the economic cycle, there is still time and room for equity markets to run.

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www.provisus.ca

18 King Street East, Suite 303
Toronto, ON M5C 1C4

Phone: 416-933-1111
Toll Free: 1-877-768-4787