Q4 2018

Quarterly Commentary

International Equity

During 2017 synchronized global growth and prevalent calm were main reasons for bullishness. However, last year volatility returned to the global markets in a very big way indicating expectations of ominous signs appearing on the horizon. While several early warning signs are starting to flash, none are consistent with an imminent collapse in world growth. The pace of growth is shifting to a lower gear, which is consistent with late cycle dynamics and should not choke off growth, despite less supportive monetary policy.

The European economy enjoyed its strongest performance for a decade in 2017 but cooled off in 2018. Quite simply, Europe's economy disappointed and lingering concerns remain. At first sight, alarm bells should be ringing, however the slowdown in Europe can be explained in large part by the disruption to the auto sector caused by the rollout of new emissions tests. Growth in much of Central and Eastern Europe has chugged along at a decent pace. Of course, there are issues: the winding down of the central bank's asset purchase program and the potential for rising interest rates; the U.K. stumbling toward agreement with the European Union over Brexit; trade tensions and the challenges posed by Italy's acute fiscal difficulties. Europe is fundamentally solid and while growth is moderate, it is not anywhere close to a recession.

Economically, Japan is in decent condition. Consumers are enjoying a historically tight labour market, while company margins are buoyant and cash balances are high. Japan is dead set on raising its consumption tax again. The last time Japan pursued this course the economy fell into a recession. Though economic conditions are stronger today, a tax increase will still likely lead to slower growth. The disruption should be temporary as the central bank remains committed to its accommodative stance.

On paper, the Chinese economy looks fine. Officially its economy grew 6.5% for 2018. But beneath the surface, China's economy has slowed in recent months and gauging the magnitude of the slowdown is difficult. Consumers and businesses are losing confidence. Car sales have plunged. The housing market is stumbling. However, China could successfully withstand the negative impact of U.S. tariffs and stimulate the private sector by ramping up an assortment of government led spending initiatives to bail out its economy as it has done in the past.

Emerging Markets are highly sensitive to global market conditions and many countries, such as Brazil, Argentina, Turkey and South Africa face unique headwinds that could be inflamed by the impact of developed market interest rate decisions and a stronger U.S. dollar. A sharp rise in inflation could be triggered if international interest rates are hiked significantly, which would likely hurt those countries, companies and sectors that operate with high leverage and have delicate liquidity needs. As well, there are several upcoming elections that have the potential to disrupt major markets like India, Indonesia and Argentina.

Last year was not kind to international stocks as they declined 12.5% in the fourth quarter and 13.4% for the year (all returns are in U.S. dollar terms). Europe, by a very small margin, was the worst culprit falling 13.0% in the quarter and 17.3% for the year. Not to be outdone, Asian stocks as a group declined by 11.5% during the last three months and 15.0% for the year. Surprisingly, Emerging Market stocks appear to have suffered most of their declines earlier in the year, as they were only down 7.4% in the quarter, but had a big annual decline of 14.2%.

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