Provisus Wealth Management

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QUARTERLY COMMENTARY

NORTH AMERICAN EQUITY

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 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.

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.

The Standard & Poor's 500 index lost 13.5% in U.S. dollar terms over the fourth quarter and in Canadian dollar terms the index has fallen 8.1%. For 2018 as a whole the U.S. equity benchmark dropped 4.4% in U.S. dollar terms but was up 4.4% in Canadian dollars as the loonie came under pressure. The S&P 500 share index hit a rough patch which was not all that surprising given that we were in the tenth year of a bull market and economic expansion.

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 Federal Reserve was closer to the end of its hiking cycle.

Given the sell-off in expensively priced tech shares in October and the trend to higher interest rates, it's not surprising that warning signals began to flash for some traders. In December retail outflows picked up, unlike in the October sell-off, as mutual funds were cashed in and stocks in e-trade accounts were sold which would indicate that relatively inexperienced investors headed for the sidelines. The volatility indicators such as the VIX index don't yet suggest the big money is ready to be swept off the table. It's not the summer of 2008.

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