Quarterly Commentary

Global Equity

The books are now closed on a tumultuous first half of 2019 that saw volatility surge thanks to trade war fears. U.S. equities advanced strongly in the quarter, despite heightened geopolitical tensions, as the Standard & Poor's 500 index climbed 4.3% in U.S. dollar terms over the second quarter. Year to date the index is up a stellar 18.5%. In Canadian dollar terms the respective change was 2.2% for the quarter and 14.5% year to date. The loonie gained 2.1% during the second quarter and it has increased by 4.1% so far this year.

The long bull market in the U.S. has now passed its tenth birthday. In the U.S., the political system appears to be dysfunctional and the government will face challenges as a new fiscal year begins in the fall with the pressing need to fund ongoing operations. Paying for all these services will require that the government debt ceiling be raised once Treasury Secretary Mnuchin has run out of tricks to keep the government funded. Despite all the negative tidings, there is the potential for deals to get done and in particular the global economy may arrive at a net improvement in trading relationships, with better protection of intellectual property rights and increased openness of Chinese markets. That being said, global trade growth is likely to be slower than in its heyday before the Great Recession.

Investors seem to believe the Federal Reserve is correct to keep interest rates unchanged for now, with expectations that rates may move lower later this year to sustain economic expansion. Fed Chair Jerome Powell deserves credit for preaching patience to an administration that seems to expect immediate results. This honeymoon could linger for a while yet but the trade war means there will be an inevitable uptick in prices for manufactured goods coming from overseas. So far though, inflation has been kept at bay as firms are reluctant to raise prices. They are afraid of losing business but have been able to keep a lid on labour costs by finding a surprisingly large number of new workers. More people are getting jobs than policymakers once thought possible and wages and prices aren't spinning out of control the way some had predicted.

Global growth has stabilized in the U.S. and China while Europe is likely to move in an upward trajectory by the end of the year. While economic data has largely normalized it does not mean that there should be an expectation for significant growth over the remainder of the year. With global inflation remaining benign, there should be opportunities for central banks to stimulate their economies as needed. However, there are still meaningful downside risks thanks to political uncertainty and weakness in the global industrial sector.

Despite a host of supportive steps since last year, China's economy is still fighting to get back on firmer ground as investors fear a longer and costlier trade war with the U.S. China's industrial output growth unexpectedly slowed to its weakest level since early 2002 and investment cooled, which should trigger additional monetary easing in the coming months. China has weathered the latest downturn so far by injecting further stimulus including hundreds of billions of dollars in infrastructure spending on road, rail and port projects, as well as tax cuts for companies.

Globally, stocks advanced by 4.0% (in U.S. dollar terms), apparently unperturbed by the worldwide turmoil over trade. European stocks led the charge gaining 4.9%, propelled by Germany's 7.8% surge; while the U.K. essentially brought up the rear by eking out a 0.9% gain. Asian stock as a whole were up 1.3%; which was led by Australia's scintillating 7.4% climb but constrained by Japan's weak 1.1% uptick and Hong Kong's small 1.0% increase. The equity market continues to show signs of late cycle angst but, while trade disputes may generate negative headlines, there may be light at the end of the tunnel. China and the U.S. will be driven to reach an agreement as the threat of not doing so becomes increasingly evident. In the meantime the underlying strength in the economy and a healthy earnings outlook should be supportive of U.S. equities.

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