Quarterly Commentary

Global Real Estate

The second half of the year saw a fragile world economy amid the exacerbating trade war between the U.S. and China. The International Monetary Fund acknowledged that in its April report and cut global growth for 2019 from 3.5% to 3.3%. The agency also downgraded the growth outlook of the Canadian economy in 2019 to 1.5%; down four-tenths of a percentage point from its previous level. That appears consistent with Statistics Canada's findings of an anemic 0.4% annualized Canadian GDP growth mainly due to falling exports. In spite of that prognosis, the second quarter started with strong GDP numbers against a backdrop of surging oil output and seemed to signal a rebound after sluggish growth in the previous two quarters. The job market continues to defy economists as April added more than 106,000 jobs; the biggest one month job gain in more than 40 years.

The Canadian stock market had a strong first half with a 16.2% total return, which is out of sync with a sluggish economy but in line with improving corporate earnings and higher energy prices. Strong domestic demand driven by government and business spending has counterbalanced the trade drag in terms of affecting Canadian growth.

During the second quarter of 2019 the Canadian FTSE TMX Universe Bond Index gained 2.5% and has risen 6.5% so far this year. Bonds have rallied as expectations for future central bank interest rate hikes have fallen dramatically. Canadian interest rates are almost certainly on hold until at least 2020. The Bank of Canada published a revised outlook that showed that the economy stalled at the end of 2018 but the bank's 2019 Financial System Review also found that progress has been made on two key factors, household debt and housing affordability. The challenges associated with high household debt and imbalances in the housing market have declined modestly. The share of Canadians falling behind on their debt payments remained relatively low while housing resales and price growth have slowed significantly in Toronto and Vancouver over the past two years. These factors are alleviating some of the policymakers' concerns over inflation. Their policy announcements do not suggest that interest rates would rise in the foreseeable future.

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 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. 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.

Globally, stocks advanced by 4.0% in U.S. dollar terms, apparently unperturbed by the worldwide turmoil over trade. 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. 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.

The further maturity of the global business cycle is likely to increase uncertainty. As the cycle matures, tighter labour conditions tend to put upward pressure on wages and generate headwinds for corporate profit margins. On the other hand, consumers seem healthy as strong job markets and rising wages have led to decent spending rates. Global growth will remain in expansion mode, but the outlook is deteriorating and may have passed its peak. Looking forward, the world will continue to muddle through especially if all major economies once again prioritize supportive monetary policies.

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