Quarterly Commentary

North American Equity

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 market had a strong first half with a 16.2% total return, 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. Additionally, the housing market no longer appears to be highly vulnerable after months of decline.

Halfway through the year most of the TSX sectors continue to impress by posting double-digit returns; a rare occurrence after last year's beating. Technology was the clear leader gaining 43.8% followed by Health Care at 35.5% and Industrials at 20.3%. In particular, Technology and Health Care have been posting strong gains for some time. The latter due to the legalization of cannabis last year, which significantly boosted cannabis related stocks. Investors' interest in rotating into Information Technology seems to indicate that that bull run is far from over. On the downside Energy has lagged over the first half of 2019. Though prices improved considerably since the first quarter due to mandatory production cuts by Alberta's government, the trajectory has been very noisy. Investors wary of trade tensions between the U.S. and China embarked on a technical selloff of the commodity. The sector fell into bear territory in the second quarter after peaking in April and as result it returned an anemic 1.1% for the first six months. One notable development in recent years is that the sector has been out of favour with International players who have been selling their Canadian energy assets. Canadian players jumped on the opportunity and it is estimated that they spent about $37.4 billion consolidating assets in the oil sands in an effort to become more efficient.

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. 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.

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.

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