QUARTERLY COMMENTARY

CANADIAN EQUITY

The third quarter saw another wave of U.S. tariffs on China, catching investors off guard as they were expecting at least a truce or even an imminent resolution of the global trade dispute. The escalating trade war has already made history by dragging global economies to their slowest aggregate GDP growth rate in a decade. That situation also continues to undermine future growth and some global forecasters, notably Fitch Rating, have lowered their growth forecast for 2019, as well as for 2020. Nonetheless, GDP still hovers far from recessionary levels even though the Purchasing Manager Index (PMI) for 70% of the countries in the world are in contraction (a PMI below 50 for any country signals contraction). Had it not been for the resilience of consumer confidence and spending, the situation would have been much worse. In Canada, where that consumer confidence remains at historically high levels, the economy has been very resilient, creating a solid 304,000 jobs in the first eight months of 2019. That confidence translated into the financial markets and the S&P / TSX, after a blistering first half of the year, continued to be on a roll to reach an all-time high in September before retreating slightly by month end. It closed the third quarter with more than a 19% total return year-to-date, one of the best among major indices.

This outstanding performance should not overshadow the threat of persistent volatility like last August when Canadian stocks lost more than $90 billion dollars, a month which typically saw positive returns 70% of the time over the past ten years. A sector analysis reveals that Utilities, Staples and Financials led the pack during the quarter with respective gains of 9%, 7.2% and 4.2% on a total return basis. These sectors, typically described as value, are benefiting from recessionary fears. Investors seem to be rotating from growth sectors to value as corroborated by the value benchmark which outpaced growth by almost 2% during the quarter. Financials in particular rebounded decently year-to-date but continue to lag the main index by a wide margin. Eight of the largest lenders, which account for 20% of the index weight, contributed less than 10% of performance amid declining yields and continued uncertainties over household indebtedness. The laggards included Health Care with a 30% decline and Energy down 2.2%. Health Care stocks were under severe pressure as the embattled Cann Trust Holdings, once a Bay Street darling among cannabis investors, was accused of illegal production. This negative news spilled over to other high-flying cannabis producers as investors preferred to take their gains after months of outperformance.

The strong year-to-date S&P / TSX performance put it among the strongest stock markets after years of subpar relative performance. This also represents the longest rally since 2017. But the third quarter saw some inflection points as the index posted gains at a decreasing pace and many analysts started making calls for a more defensive portfolio posture.

On the economic front, Canada defied recent downward projections to grow at an annualized rate of 3.7% in the second quarter. However July unexpectedly stalled which raised concerns for the vulnerability of the nation's economy if there is a global slowdown. With slowing consumer spending still robust, and declining energy and commodity prices, it would be imprudent to predict that the Canadian economy could continue this pace in upcoming quarters. Better news is that concerns over a possible crash in the housing market have now begun to dissipate. The government's new mortgage rules enacted months ago have created a more balanced environment for homebuyers. There still appears to be some capacity for the economy to deliver decent growth in the near future, especially after the upcoming federal elections if the current or new administration respects their expansionary fiscal agenda.

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