Quarterly Commentary

International Equity

The darkening outlook for global trade is starting to become discouraging. The U.S./China trade war has led to new tariffs on hundreds of billions of dollars worth of traded goods. There is minimal expectation of a pending resolution which will likely continue to impair economic growth. In fact, further rounds of tariffs and retaliation, especially between the U.S. and Europe, could reinforce the destructive cycle of recrimination. Britain's uncertain exit from the Eurozone is also adding to uncertainty for businesses. Still, investors for the most part have looked past these near-term troubles and as a result have earned meaningful returns this year.

The European Central Bank has begun to take aggressive steps to stimulate the economy and head off any potential downturn. Since 2014, they have imposed negative interest rates on deposits to encourage commercial banks to lend more. In a bid to increase lending, the bank increased this de facto penalty to -0.5% from -0.4% to free up the hoarded cash. As well they have re-started the quantitative easing program to buy government and corporate bonds, a move that pumps newly created money into the economy. This package of measures is also aimed at raising inflation which has been slipping further below targets. The threat of an escalating European/U.S. trade conflict is significantly impacting German consumer spending, which in turn is contributing to weakness in other European economies like Spain and Italy. The German economy is teetering on the edge of recession, as its traditionally export-reliant economy has become particularly vulnerable.

Ever since Britain set Brexit in motion through a referendum in 2016 confusion has reigned. The situation today is even more uncertain. With weeks to go before the deadline, the situation is bewildering. Britain could crash out of the European Union without a deal governing future trade. A no-deal Brexit would entangle trade in bureaucratic and logistical chaos, with a potential election or constitutional crisis on the horizon. This quagmire is not good for business and has burdened the British economy. Business investment has been weak as the economy contracted in the second quarter for the first time since 2012. It is extremely likely that the world's sixth largest economy is heading into recession.

Japan has shown surprising strength but the country faces its most serious economic challenges in years. Trade wars and slowing exports are negatively impacting growth. Plus the pending increase in the national consumption tax could derail a promising growth streak and possibly throw the country into recession. Japan still has significant strengths; its consumers are spending and its businesses are investing, and they have so far managed to avoid the worst of President Trump's tariff threats.

International stock markets did not produce positive performance in the third quarter as the weakening world economy, trade wars and fears of a potentially tumultuous Brexit have combined to depress markets. As a whole, stock markets declined 1.0% in the quarter (all figures in U.S. dollar terms); however, they were able to hold onto most of their year-to-date returns, climbing 13.3%. Europe lead the quarterly decline falling 1.8%; while Asia eked out a 0.8% return for the period.

The pronounced deterioration of global trade reflects the dangers that have been growing in recent months and are now beginning to weigh heavily on investors' minds. Fortunately central banks around the world are cutting interest rates and trying to encourage borrowing in order to stage an economic resurgence. The only questions are will it be enough and is it in time to overcome the prevailing headwind?

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www.provisus.ca

18 King Street East, Suite 303
Toronto, ON M5C 1C4

Phone: 416-933-1111
Toll Free: 1-877-768-4787