Provisus Wealth Management

Q3 2019

Quarterly Commentary

Total 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. 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. 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.

The U.S. Standard & Poor's 500 index rose 1.7% in U.S. dollar terms over the third quarter of 2019 and 2.9% in Canadian dollar terms. Year-to-date the benchmark is up 20.6%, its best performance in the first three quarters of a year since 1997. In Canadian dollar terms the benchmark was ahead 17.6%. The U.S. economy grew at an annual rate of 2.0% in the second quarter as consumer spending rose at a 4.3% clip. However business investment, which was supposed to be juiced by President Trump's tax cut, fell by 5.5% and exports declined 5.2%. That means consumer spending accounted for all of the economy's overall growth. Weak business investment cut 1 full percentage point from the rate the economy would have otherwise achieved. This was mostly due to declining inventories from reversing some anomalous inventory buildups in previous quarters. Net exports shaved another three quarters of a point but that was offset by higher government spending.

American manufacturers posted their biggest contraction in September since the end of the 2007-2009 recession, reflecting a slowdown in the U.S. and global economies made worse by a tense trade war with China. The chief reason the economy slowed was a big drawdown in inventories. The Institute for Supply Management said its manufacturing index fell to 47.8% in September from 49.1%, marking its lowest level since June 2009. Manufacturers at home and abroad have faced waning demand and are struggling to cope with a global economic slowdown, exacerbated by the trade war between the U.S. and China, the world's two largest economies. Manufacturing is a much smaller part of the U.S. economy than it used to be and so far the damage appears to be contained but there is a worry that it will get worse unless the U.S. and China ratchet down tensions.

The U.S. 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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