Quarterly Commentary

U.S. Equity

The Standard & Poor's 500 index skyrocketed 9.1% in U.S. dollar terms over the fourth quarter. In Canadian dollar terms the index was up a healthy 7.0%. For 2019 as a whole the U.S. equity benchmark climbed 31.5% in U.S. dollar terms and was up 26.5% in Canadian dollars. The stellar 2019 performance is partly explained by a relatively low starting point as one year earlier the index lost 13.5% in U.S. dollar terms over the final quarter of 2018. At the time there was an expectation for an ongoing deterioration in global macro conditions and regulators responded in the U.S. by cutting interest rates. Strong employment numbers and low interest rates have been very supportive for U.S. equities. The S&P 500 share index is now in the eleventh year of its bull market expansion.

The U.S. unemployment rate is the lowest it has been in 50 years at 3.5%. Initial jobless claims, a measure jobs lost, fell at the end of 2019 to near post 2008 recession lows. Challenger, Gray & Christmas, a company that tracks employment trends, said the number of announced layoffs fell in December to its lowest level in a year and a half. The fourth quarter announced layoffs were the smallest since the autumn of 2018, reversing an uptrend that began earlier last year, and only a few of the job losses were attributed to the U.S. / China trade war.

The rise in the stock market was largely driven by institutional investors as retail investors remained on the sidelines, focused on trade war headlines. As a result 2020 could be another strong year for stocks as many retail investors are expected to shift from bond funds into equity funds, as was last seen in 2013. Extremely cautious retail investors are now seeing bond yields that are quite a bit lower following a series of central bank rate cuts. Years of high bond flows, such as 2012 and 2017, and now 2019, have typically been followed by weak bond fund flows. 2019’s strong equity market, driven by institutional investors, may now see retail investors following the equity market’s strength.

One of the main causes of concern is the ongoing trade war between China and the United States with both sides taking damage. Investors are hoping for the de-escalation of economic hostility between the two largest economies in the world. Phase one of the deal that the Trump administration has put together has brought calmness to the markets, which has helped propel the stock market to new highs. The trade dispute had caused reductions in capital expenditures across the globe so any positive announcements by either the U.S. or China will provide stability for investors. The market will continue to rally if the optimism of the phase one trade deal acts as a building block for economic relations between the two countries.

We may be on the cusp of a recovery through the first half of this year thanks to central bank easing, the de-escalation in the trade war and tentative green shoots in global manufacturing. 2019 has seen the largest amount of central bank easing since the 2008 financial crisis and the central bank easing of 2019 may prolong the aged cycle. The main reason for the longevity of this cycle has been the persistence of economic slack. This has allowed the U.S. and other developed economies to grow without generating significant inflation pressure and has deterred central banks from lifting interest rates. The trade war has been a cycle extending global deflationary shock, in that it forced central banks to reverse previous tightening before monetary policy became restrictive.

The U.S. economy grew a respectable 2.1% in the third quarter of the year. While the U.S. economy is not rising as fast as its surging stock market, evidence suggests that economic growth has stabilized and moderate growth is expected to be maintained for the foreseeable future. There are signs that we are in a classic late cycle expansion as we are seeing an economy with almost full employment and slowing momentum which tends to foretell a decline in corporate profit margins, but while the U.S. may well be in the mature stage of its economic cycle, there is still time and room for equity markets to run.

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