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Asset Management

Looking Back

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Equity and Bond Market Performance

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While equity markets were positive in the second quarter of 2019, volatility returned to the markets. The S&P 500 Index had increased by 4.3%, TSX by 2.6%, MSCI World by 4.0% and MSCI Emerging Markets by 0.6%. Unlike the linear increase witnessed in the first quarter however, the path to gains was choppy as most equity markets experienced meaningful losses in May before generally gaining it all back (and more) in June to end the quarter strongly.

The key drivers of market moves largely came from the macro side, with U.S./China trade concerns coming to the forefront in May as markets digested the impact of another round of tariffs. Global trade tensions combined with weakening global growth have had a significant impact on interest rates this year. The IMF lowered its growth forecast again in the second quarter from 3.5% to 3.3%. This was the third time in the previous six months that the forecast was reduced and would represent the weakest growth rate in the past 10 years. From a fundamental standpoint, there was a continued general weakening of economic data, with the main exception being the strong employment situation in the U.S. Given the importance of the U.S. consumer to U.S. GDP however, U.S. employment is an important bright spot. While expectations are for global economic growth to recover somewhat in the second half of 2019, there remains concern about downside risks, ranging from increased trade issues to a no-deal Brexit.

Interest rates declined further around the globe in the second quarter. In the U.S., the 10-year government bond yield fell from 2.41% at the end of Q1 to 2.01% at the end of Q2, and has now fallen below 2% for the first time since late 2016. Similarly in Canada, the 10-year rate fell from 1.62% at the end of Q1 to 1.47% at the end of Q2. In comparison to Europe, however, these yields are positively mouthwatering as the yield on a 10-year German government bond has fallen from 0.24% at the start of the year to -0.33% at the end of June. In fact, the recent decline in interest rates has led to the amount of negative yielding debt globally to increase from $6 trillion (USD) in late 2018 to roughly $11 trillion (USD) in June 2019. From a performance standpoint, the strong move down in yields this year has led to good performance in bond markets, with Canadian investment-grade bonds returning 6.5% in the first half, and U.S. investment-grade bonds returning 6.1%.

The first half of 2019 has seen a very strong rally in both stocks and bonds. Bonds have rallied on the back of weaker global growth and the likelihood of multiple interest rate cuts in the U.S. It is interesting to note that a mere nine months ago, the expectation was to see multiple rate increases in the U.S. Similar to the first quarter, the important driver of equity market performance has been the resetting of monetary policy globally from tightening to accommodative. As markets have priced in an increasing likelihood of multiple rate cuts in the U.S., this has outweighed, for the first time, the negative factors in the macro environment. Similar to what was witnessed during the first quarter, sentiment in the markets has not improved. Despite very strong equity market performance in the first half, the general trend in fund flows has been out of equities and into bonds.

With the environment presenting a mix of downside risks from trade concerns, geopolitical risks and uncertainties, as well as a more supportive technical environment as this has been an unloved market rally, Cidel views a neutral positioning on equities as appropriate.

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