April 2016

Market Matters

Q1 2016 HIGHLIGHTS

- It was a volatile start to the year as many global markets fell into bear market territory toward the end of February before rebounding back up into the end of March.
- A strong rebound in commodity prices helped the resource-heavy Canadian S&P/TSX Composite performance charge ahead of its peers.
- Oil rebounded strongly in March, crossing the $41 USD level to close at $38 US (up from February's $34 US).
- A concerted effort by central banks, including the Bank of Japan, European Central Bank, and U.S. Federal Reserve pushed interest rates (even) lower.
- A risk off sentiment dominated much of the quarter and investors flocked to the safety of global government bond markets. The flight to safety trade reversed modestly in March as equity markets recovered.

AN EARLY LEAD

The Canadian market had a relatively strong start to the year, led higher by the resource sectors (see table 3), which have benefitted from a recovery in commodity prices. Compared to other developed market performance this quarter, the S&P/TSX Composite outperformed virtually all its peers, most notably the S&P 500 – a welcome result on the heels of five years of under-performance versus our American neighbours.

A ROLLER-COASTER START

So far in 2016 heightened volatility has been seen not only in equity markets, but also currency, fixed income and commodity markets as well. The quarter started with a significant equity sell-off that continued into February, at which point markets managed a strong rally to the end of the quarter. The issues driving the volatility were many, diverse, and included:

- Emerging market economic and currency fears (specifically in China and Brazil);
- The continued commodity sell-off which lasted well into February;
- The March 22nd Brussels terrorist attack heightening geopolitical fears; and
- Uncertainty regarding monetary policy (e.g. U.S. Federal Reserve's tightening schedule, unknown ramifications of European quantitative easing and Negative Interest Rate Policies (NIRP) in various countries).

For fixed income markets, the beginning of the year continued where 2015 left off, as a risk off sentiment dominated and investors flocked to the safety of global government bond markets. Global government bond markets rallied

Table 1
Summary of major market developments

Market returns*	March	YTD
S&P/TSX Composite	4.9%	3.7%
S&P 500	6.6%	0.8%
- in Canadian dollars	*2.2%*	*-5.4%*
MSCI EAFE	2.5%	-7.2%
- in Canadian dollars	*1.7%*	*-9.7%*
MSCI Emerging Markets	8.1%	2.4%
FTSE TMX Canada Universe Bond Index**	0.8%	1.4%
FTSE TMX Canada all corporate bond index **	1.6%	1.5%

*Local currency (unless specified); price only
**Total return, Canadian bonds

Table 2
Other price levels/change

	Level	March	YTD
CAD per USD exchange rate	$0.769	4.1%	6.4%
Oil (West Texas)*	$38.34	13.6%	3.5%
Gold*	$1,232	0.0%	16.0%
Reuters/Jefferies CRB Index*	$170.52	4.5%	-3.2%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	March	YTD
S&P/TSX Composite	4.9%	3.7%
Energy	9.0%	7.9%
Materials	3.3%	19.3%
Industrials	5.4%	3.5%
Consumer discretionary	6.1%	2.4%
Consumer staples	1.0%	6.7%
Health care	-53.1%	-67.4%
Financials	7.3%	2.8%
Information technology	2.9%	0.1%
Telecommunication services	3.1%	10.3%
Utilities	8.0%	8.3%

*Price only
Source: Bloomberg, MSCI Barra, NB Financial, FTSE TMX Global Debt Capital Markets Inc.

significantly, including Canada with its benchmark 10 year bond reaching an intraday low of 0.91% (an all-time low) in early February. The market reversed course after calmer heads prevailed when economy data proved to be not as weak as expected, and central banks re-affirmed their inclinations toward a cautious and measured approach. The U.S. Federal Reserve and the Bank of Canada remained on the sideline during the quarter, leaving their overnight rates at 50 bps and remaining in what appears to be a 'wait and see' mode. The Bank of Canada wants to see the effects of the fiscal stimulus before easing rates further, while the U.S. Federal Reserve wants to monitor global developments before it continues on its tightening cycle.

COMMODITY RELIEF

In Canada, the Materials sector, gaining almost 20%, was the strongest sectoral performer in the quarter, boosted by strong commodity pricing (e.g. gold +16.0%, copper +3.7%). The more defensive sectors also advanced well in the quarter, with Telecommunications up 10.3%, Utilities up 8.3%, and Consumer Staples up 6.7%. These sectors benefitted from the decline in interest rates, as well as growing concerns (early in the quarter), over U.S. economic health. The Energy sector rounded out the strong performing sectors in Canada in the first quarter. Oil prices rose strongly in March due to encouraging signs of production/rig activity declines, potential production freeze agreements, a weaker US dollar, and a relief rally for the beaten down commodity.

The S&P/TSX Composite performance would have been even greater if it wasn't for the Healthcare sector, down a whopping 67%. The small Canadian sector continues to be dominated by its largest constituent – Valeant Pharmaceuticals (down almost 76% in the first quarter of 2016). Valeant's stock continued its slide with growing uncertainty over its outlook amidst regulator concerns and leadership turmoil.

Following some early struggles, U.S equities rebounded in March to end the quarter just above the red line, into positive return territory. Sector returns varied greatly. Resources performed well, as did higher yielding, defensive sectors like Telecommunications and Utilities, which became more attractive in response to the growing belief that interest rates will be held lower for longer than previously anticipated. Dividend-focused investment strategies benefitted from this.

U.S. political news from the campaign trail will surely ramp up over the coming quarters, but for now U.S. political primary results have simply advanced both front runners Mr. Trump (Republican) and Mrs. Clinton (Democrat) as the state-by-state process continues. The capital market response to the November election run-up has thus far been muted.

GLOBAL IMPACT

With a number of global-impact issues hitting very close to home, Europe was not immune to the volatile capital markets in the first quarter of 2016. Earlier in March, in support of what remains an extremely fragile European economic recovery, the European Central Bank (ECB) cut interest rates and announced additional stimulus through accelerating the rate of bond purchases (from 60 to 80 billion euros/month), and expanding their purchases to include corporate bonds.

Additional volatility will likely continue from the uncertainty surrounding the June 23rd European Union membership referendum in Britain (dubbed the 'Brexit' vote). Year to date, the British pound sterling is down 7% versus euros.

Finally, the Brussels attack in March killed dozens of people and reignited global concerns over security and the role of governments in protecting their citizens. The effect on markets however was limited, and leads to an unsettling sense that capital markets are becoming more accustomed to these types of events than any of us would like to believe.

"IT'S NOT WHAT HAPPENS TO YOU, BUT HOW YOU REACT TO IT THAT MATTERS." EPICTETUS

Navigating the market's ups and downs has its challenges, but again and again we find that disciplined investment processes, with experienced and skilled portfolio management teams hold us in good stead.

For more on how GLC's portfolio managers have been responding to market volatility, see a recent interview with four of GLC's senior portfolio managers on GLC Asset Management Group's LinkedIn page.