Investment Newsletter (Third Quarter 2019)

Equity Markets
During the quarter, U.S.-China trade tensions and increased geopolitical uncertainty, including Brexit, protests in Hong Kong, conflicts in the Middle East and an impeachment inquiry into U.S. President Trump, were overarching themes that drove global equity markets. A “risk-off” sentiment took hold, and market volatility rose to its highest level since the end of 2018.

Congress in the U.S. launched a formal impeachment inquiry into President Trump’s involvement in Ukraine. A potentially lengthy impeachment process resulted in increased market volatility and greater uncertainty surrounding the upcoming U.S. presidential election. Economic growth within the euro region remained weak. Second-quarter gross domestic product (“GDP”) growth in Germany (quarter-over-quarter) slowed to -0.1%. August inflation growth in the eurozone came in at 0.9%, which was lower than forecast and far lower than the European Central Bank’s (“ECB’s”) inflation target. The ECB cut its deposit rate by another 10 basis points (“bps”) to -0.5%, and will restart its quantitative easing program in November. Oil prices slipped amid slowing global economic growth and trade concerns, which drove Canadian dollar weakness against the U.S. dollar.

Canadian Equities
For the three-month period ended September 30, 2019, the S&P/TSX Composite Index gained 2.5% on a total-return basis. The strongest-performing sectors included Utilities, Real Estate and Materials, which generated returns of 10.1%, 8.5% and 5.8%, respectively. The weakest-performing sectors included Health Care, Industrials and Materials, which generated returns of -30.0%, -1.5% and 0.4%, respectively.

During the third quarter, the two main themes that dominated the Canadian equity landscape were international: the ongoing trade dispute between the U.S. and China, as well as the shift in monetary policy by the U.S. Federal Reserve Board (“Fed”). And while the Canadian equity market extended its rally over the quarter, investor sentiment grew decidedly more risk averse, as the top-performing equites during the period came from more defensive-oriented sectors.

U.S. Equities
The S&P 500 Index posted a gain of 1.7% (in U.S.-dollar terms) and 2.9% (in Canadian-dollar terms) over the third quarter of 2019. The strongest-performing sectors included Utilities, Real Estate and Consumer Staples, which posted returns of 9.3%, 7.7% and 6.1%, respectively. The weakest-performing sectors included Energy, Health Care and Materials, which generated returns of -6.3%, -2.3% and -0.1%, respectively.

U.S. economic growth remained solid, but several indicators showed signs of fatigue. Manufacturing data declined versus what had been previously forecasted as the Institute for Supply Management Manufacturing Purchasing Managers’ Index reading dipped below 50, indicating contraction. August non-farm payrolls slowed to 130,000, versus a forecast of 160,000, and unemployment slightly increased to 3.7%. Inflation remained below the Fed’s 2% target, driving increased expectations for more monetary easing. The Fed cut the federal funds rate two times during the quarter, to a range of between 1.75% and 2.00%.

International Equities
Over the three-month period ended September 30, 2019, the MSCI EAFE Index generated a total return of -1.0% (in U.S.-dollar terms) and 0.18% (in Canadian-dollar terms). Japanese equity

markets drove international returns, with the yen little changed during the period. Japan's Upper House elections in July were won comfortably by Prime Minister Abe's party, confirming continuity of his government's policy for the foreseeable future. Japan's market weakness in August was more than reversed in September.

In Europe, equity markets posted gains during the quarter, with a declining euro muting most of the domestic returns. With economic data remaining somewhat lacklustre, the ECB took steps to boost that region's economy, which included restarting quantitative easing and committing to buying assets until the ECB's inflation target is reached. In the U.K., equities posted modest gains as investors took advantage of relatively attractive valuations, weakness of the sterling and inexpensive debt financing. These gains, however, were muted in response to the sterling's decline.

Fixed Income

The FTSE Canada Long Term Bond Index returned 2.5% over the third quarter of 2019. Corporate bonds, as measured by the FTSE Canada Long Term Corporate Bond Index, returned 2.4% over the quarter, as corporate spreads widened 5 bps. Within corporate bonds, AAA/AA-rated bonds outperformed other credit qualities, while Industrials and Communications were the strongest-performing sectors.

Economic growth remained healthy in Canada, with positive GDP growth posted over four consecutive months, from March to June. Core inflation continued to hover around the Bank of Canada's ("BoC") 2% target. Labour market growth was healthy, with unemployment remaining at 5.7% and substantial job gains in August. This allowed the BoC to hold its overnight interest rate at 1.75%.

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