Investment Notes

June 30, 2017

GLOBEINVEST
CAPITAL MANAGEMENT INC.

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Overview

In the year-end Notes, one comment was that if anything, the economic and markets cross-currents were as severe as ever seen. As of writing, (July 6th) nothing has changed – if anything they are more so particularly in the geo-political area. In the March 31st Notes, we asked whether the US economy and stock markets could maintain their positive momentum even if President Trump's legislative program came to nothing? After a statistical review of the first half, we will discuss those issues.

First half Statistics

In currency markets, the $CDN rose 3.65% against the $US but declined about 4.59% against the Euro. The $US also lost ground against the Euro, declining about 8.45%. The $US as measured by the DX/Y (the US dollar index) declined 6.58% (thus helping US exports) which puts it in a current over-sold position. Three leading measures of inflation showed sharp declines: the Rogers International Commodity Index 7.3%, the Goldman Sachs index 6.5% and the Thomson Reuters index 9.2%. The growth rate of Canada's and the US CPI also slowed. However, gold rose 7.76% for the half. WTI fell 19.8% as of June 23rd but rebounded to end the quarter at – 14.3%. In equity markets, total returns in their local currencies were for the TSX Composite + 0.7%, the S&P 500 +9.3% and the Nasdaq Composite + 14.1% thanks in part to the FAANG stocks' performance. Government bond yields year over year are shown below.

Maturity	% as of JUL 8/16	% as of DEC 31/16	% as of JUN 30/17
2 Yrs. CAN	0.47	0.76	1.10
US	0.61	1.19	1.38
5 Yrs. CAN	0.52	1.12	1.38
US	0.95	1.93	1.89
10 Yrs. CAN	0.96	1.72	1.75
US	1.36	2.44	2.30
30 Yrs. CAN	1.55	2.31	2.13
US	2.10	3.07	2.83

While yields in all categories are higher than a year ago, during the first half there was considerable volatility depending on the outlook for economic growth and inflation. Future changes will depend in part on the perceptions about both the Canadian and US economies and in the US, the perception of the impact of the Fed starting to shrink its balance sheet.

Commentary

As we look at the US economy, sharp differences of opinion are starting to appear between our two main economic consultants: Ed Yardeni of Yardeni Research Associates and David Rosenberg of Gluskin Sheff. At the end of the day we make our own decisions, but highly value their input and that of others. Ed and ourselves have stayed on much the same course. We have stated ad nauseum that given the severity of the last recession, the subsequent recovery would take longer and be weaker than previous recoveries, partly due to deleveraging in some areas. We stick to that thesis. For now, with the exception of autos, the major sectors of the US economy remain healthy and are expanding. However, we admit that there have been modest pull-backs in some. David Rosenberg thinks they are the start of something more severe. He likens the current anticipated future Fed tightening to what happened in 1937-38 when the Fed tightening nipped the recovery in the bud and kindled a new recession, which was ultimately ended by the start of WW 2. We respectfully disagree with DR's comment but that said, one ignores his comments at one's peril. Therefore, we will closely monitor the path of the US economy. Also, to return to a key question, we understand that for the moment any impetus from the initially hoped for Trump legislative agenda is not likely to impact 2017. As long as the economy does not take DR's route, it will continue to grow albeit slowly.

Also, although it is hard to see for now, some aspects of the Trump agenda may become legislation later this year or next.

Finally, we note that while there may be a pause in the US economy, it increasingly looks as if Europe's and Asia's growth is picking up which may compensate for any US weakness or supplement any continuing improvement.

Looking ahead to what may impact Canadian and US stock markets, we suggest the following. In Canada, if oil can hold the $45.00 - $55.00 level, we think the industry will make an increasing contribution to Canada's recovery. The outlook for oil largely depends on how well OPEC maintains its discipline, which shows signs of fraying as other members ex Libya and Nigeria, have shown signs of cheating. Also, it very much depends on any change in Saudi oil policy engineered by Mohamed bin Salman (Saudi's new Crown Prince). He has in the past espoused the idea of opening the taps regardless of price to maximize cash to be used for a Saudi diversification away from oil. The more others cheat, it will strain the Saudi commitment to production cuts.

In US equity markets, the forward price-earnings ratio ("PER") for the S&P 500 is relatively high (currently about 17.5 compared to the post 2000 high of about 18.4). Unless earnings tank, we do not see much likelihood of a major PER contraction. If however, interest rates start to rise too quickly, then PERs and equity markets may suffer. In our view, a major current threat to US equity markets would be an acceleration of the inflow of funds into US equity ETFs, which must be invested as received regardless of stock prices. It could lead to extreme higher valuations. Should there be a change of heart about equity ETFs efficacy, it could cause a sudden outflow and catalyst for a market pullback as any ETF that is redeemed must sell without regard to valuation and timing.

On a geo-political basis, perceived risks abound. At the moment, North Korea presents the most serious. However, and we do not pretend to be experts in international politics, we observe that North Korea's nuclear and rocket/missile development is likely to continue. As a guess, North Korea's leaders are not totally nuts and must realize that the first missile, nuclear or not, directed to South Korea, Japan or the US would immediately lead to their total and instant annihilation. However, accidents do happen and if there is one, it may result in an over-reaction on Trump's part with unknown disastrous consequences.

Summary

We are about to enter the US earnings' season. So far the results have been most encouraging. If they continue they should provide the basis for ongoing growth in the economy and better stock markets.

Peter Brieger, HBA, CFA
Christine Poole, MBA, CFA
Wendy Sanita, CFP®, CIM®

BNN Dates:

July 12 @ 1:00 pm – Christine

July 20 @ 6:00 am - Christine

August 16 @ 5:30 pm – Christine

September 12 @ 5:30 pm – Christine

October 11 @ 1:00 pm – Christine

November 14 @ 5:30 pm – Christine

December 12 @ 1:00 pm – Christine

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