Investment Notes

March 31, 2018

GLOBEINVEST
CAPITAL MANAGEMENT INC.

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Overview

Certainly Q1/18 was one of the most tumultuous in recent memory. While rising about 7.5% in the early part of January, the wheels fell off the wagon, having two significant declines, one in February and one in March. The former's related to an unexpected rise in the US CPI and fears of a continuing upward path, which would put an upward pressure on interest rates. March's sell-off was sparked by fears about new tariffs and a potential trade war and a fear of what the Facebook mess implied for social media/technology stocks.

While we always remain acutely aware of events and their short to medium impact on both the economy and markets, our focus continues to be on long-term fundamentals and an assessment of how these events fit in, if at all.

That said, we remain positive on US and Canadian equity markets through 2019 and possibly into 2020.

Commentary

To provide our clients with a continuum of our investment thinking, let's review what we said in our year-end Notes. We commented that given the acceleration of growth in the global economy, it laid the groundwork for an economic cycle, which while one of the longest in history but with one of the slowest recovery rates, could well go on through 2019. On the other side, we observed that some forecasters opined that the economic numbers couldn't get any better and markets had already discounted them. We also mentioned the dangerous geo-political situation, a Fed tightening and withdrawal of quantitative easing, the inflationary impact of rising wage rates and their impact on interest rates. Finally, we worried about the potential negative impact of sudden unexpected ETF redemptions and relatively elevated valuation levels.

Let's take a look at items on that list and any new ones that have come up during Q1.

Length of Cycle: The economic data, leading indicators, manufacturing & services survey data and sentiment measures suggest economic growth is sustainable, with no signs of a recession on the horizon. The U.S. Treasury yield curve is flattening but still positive. Historically, an inverted yield curve precedes the onset of a recession. As well, stocks have never peaked before the yield curve inverted.

Geo-politics: Suddenly the North Korea issue may be moving to a less bellicose state. The West's reaction to the alleged Russian poisoning of a former spy and his daughter and Russia's counter reaction could cause further Russian provocations particularly in the Ukraine. In Germany, Chancellor Merkel finally was able to form a coalition government, which is a positive for Europe. In France, President Macron is trying to eliminate some of the truly outrageous benefits for new railway employees. For current workers they stay the same. We hope his anti-unionism succeeds. At this point, our major concern is the seemingly inexorable trend by Trump toward a de facto "one man rule". That could be problematic down the road in that accidents, particularly in foreign relations, could occur.

The US Fed: The pace of federal funds rate increases will be driven by the inflation rate, which remains subdued with the core personal consumption expenditures (PCE) index at 1.6% in February, below the Fed target of 2.0%. Wage inflation remains contained for now, but we will monitor trends closely, especially with the U.S. unemployment rate at a 17-year low of 4.1%. Perhaps the wild card is the price of WTI and Brent oil, which were at $64.91 and $70.27 a barrel respectively, last Friday, March 29th. There is now some speculation that the latter will reach $80 this year. While energy is only about 7.3% of the US CPI, in the past oil price swings have had an inordinate impact on the CPI numbers.

ETF Withdrawals: After truly amazing inflows for the past year, ETFs suffered withdrawals in March. No doubt to celebrate the Ides of March which saw the end Of Julius Caesar on March 15th in 44 BC. The inflows into ETFs were major drivers of equities' upward move. Events that trigger ETF outflows may result in abrupt downward pressure on stock prices.

Equity Market Valuations: With the recent pullback, stock valuations are now looking more reasonable, with the price to earnings (P/E) multiple for the broad market indices closer to historical averages. For the TSX, the forward P/E is 15.1x compared to 18.2x at year-end and the long term median of 15.0x. Similarly, for the S&P500, the forward P/E is 16.3x versus 18.6x at the end of 2017 and the long term median of 15.5x.

Looking forward: (1) NAFTA – at year end a generally pessimistic view prevailed regarding the outcome of NAFTA and impact on Canada. However, with the White House showing some flexibility on the auto rules of origin issue, the final outcome could be better than initially feared. (2) Supposedly 50% of adjustable rate mortgages are up for rate adjustments this year in Canada. This along with the newly mandated mortgage stress test could dampen the Canadian housing market. (3) Corporate Profits - Q1/19 earnings season will commence shortly. For the S&P 500 companies, Q1/19 EPS is expected to be up 18% year-over-year and 20% for the whole year. For the TSX, 2018 EPS is forecast to be up 13%. Double- digit earnings growth should provide downside support for stock prices.

Summary

We recognize that the prospect of elevated volatility will create short-term market fluctuations. Our focus remains on the longer- term. At this juncture, we remain constructive on equity markets, underpinned by a strengthening global economy and rising corporate earnings.

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

2018 BNN Dates for Christine Poole

April 16 @ 5.30 pm
May 8 @ 5.30 pm
June 8 @ 5.30 pm
July 10 @ 1.00 pm
August 8 @ 5.30 pm
September 11 @ 1 pm
October 10 @ 5.30 pm
November 13 @ 1.00 pm
December 11 @ 1:00 pm

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March 31, 2018 Statistical Summary

STOCK MARKETS	**QTD**	**1 Year**
S&P TSX Composite Total Return (CAD)	-4.5%	1.7%
S&P 500 Total Return (CAD)	1.7%	10.3%
S&P 500 Total Return (USD)	-0.8%	14.0%
DJIA Total Return (USD)	-2.0%	19.4%
NASDAQ Composite Price Return (USD)	2.3%	19.5%
MSCI World Index Price Return (USD)	-1.8%	11.4%
COMMODITIES	**QTD**	**1 Year**
GOLD	2.4%	6.3%
SILVER	-5.1%	-10.8%
COPPER	-8.5%	14.3%
NATURAL GAS	-18.6%	-21.4%
WTI	8.0%	28.8%
BRENT	3.7%	24.5%

TREASURY BONDS	**03/31/18**	**12/29/17**
2 Year Maturity (CAD)	1.18%	1.69%
(US)	2.27%	1.89%
5 Year Maturity (CAD)	2.00%	1.86%
(US)	2.56%	2.20%
10 Year Maturity (CAD)	2.11%	2.03%
(US)	2.74%	2.40%
30 Year Maturity (CAD)	2.28%	2.24%
(US)	2.97%	2.74%
Inflation		
CPI (CAD)	2.2%	2.1%
(US)	2.2%	2.2%

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