Investment Notes

December 31, 2019

GLOBEINVEST
CAPITAL MANAGEMENT INC.

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Overview

The rally in global equity markets gained momentum in the last quarter of the year, led by the U.S. with all three of its major indices - S&P500 Index, Dow Jones Industrial Average Composite and NASDAQ Composite- reaching new highs. The TSX Index, while lagging its U.S. counterparts, also posted a new high in December.

The strong recovery in equity markets was magnified by the marked sell-off at the end of 2018. Nonetheless, even when measuring the S&P 500 Index return from its September 20, 2018 closing high to the end of 2019, the Index was up a respectable 10%.

The largest headwind this past year was trade and tariffs while the largest tailwind was the Powell pivot in the U.S. from raising to lowering interest rates. Other central banks around the world followed suit as it became apparent rising trade tensions were dampening global manufacturing activity and consequently, slowing economic growth.

The drivers behind the recovery in equity markets to new highs in 2019 was the dovish pivot by central banks combined with the apparent de-escalation in trade tensions late in the year, resulting in the expansion of valuation multiples. The sustainability of these drivers into 2020 will be reviewed along with other significant events, including rising geopolitical unrest in the Middle East, which may impact markets this year.

Commentary

Since we are closing out a decade, ten year compound annual growth rates for the major stock and bond indices as well as key commodities have been provided in the statistical summary table at the end of the note. What stands out is the relative outperformance of U.S. markets compared to the rest of the world. We attribute this outperformance to two main factors: (1) superior returns from technology and internet-related stocks, led by the infamous FAANG and (2) low interest rates combined with lower corporate taxes aided by the 2018 tax reform package contributing to corporate earnings growth. Investors have been attracted by the prospect of secular growth opportunities within technology-based industries, which are well-represented in the S&P 500 Index. Ironically, should global economic growth surprise on the upside this year, cyclical growth sectors may outperform, benefitting more resource/commodity weighted stock indices such as the TSX Index.

The U.S. and China announced on December 13th that a Phase One trade deal had been reached, with official signing planned for January 15th. What we know so far is that the U.S. has agreed (1) not to proceed with the 15% tariff scheduled to take effect on December 15th on about $160 billion of Chinese imports and (2) a reduction on the tariff rate on about $120 billion of Chinese imports introduced on September 1st from 15% to 7.5%. The 25% tariff rate on approximately $250 billion Chinese imports will remain in place. In return, China will cancel the retaliatory tariffs scheduled to take effect on December 15th and make substantial additional purchases of U.S. goods and services in the coming years, including according to U.S. Trade Representative, Lighthizer, farm purchases to grow to at least $40 billion annually over a period of two years. To put that in context, China purchased just $10 billion in the first 10 months of 2019 and an average of $22 billion annually between 2013-2017. Negotiations for the Phase Two Deal is expected to begin immediately once Phase One is signed, but any progress will likely hinge on the successful implementation of Phase One. We expect trade tensions will continue to prevail this year and sway investor sentiment.

After three interest rate cuts by the U.S. Fed in 2019, there is less scope for further monetary easing with the Fed funds rate now at 1.50%-1.75%. Jerome Powell coined these rate cuts as a “mid-cycle adjustment”, in response to a softening global economic outlook and muted inflation pressures. With inflation running below

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the Fed's 2% target, monetary policy is expected to remain accommodative over the foreseeable future. In the U.S., contracting manufacturing activity and subdued business investment are counterbalanced by strong labour market conditions and consumer spending. With trade pressures abating, an improvement in global manufacturing activity should hopefully follow.

Although corporate earnings growth for the S&P500 companies was essentially flat in 2019, the Index was up 31.5% over the same period, resulting in an expansion of the forward price to earnings multiple from 15.0x to 18.2x presently, which is elevated versus history. Corporate profits growth will have to resume this year to support higher stock prices. And the pace of profit growth will largely be dependent on the magnitude and timing of the U.S./China trade deal. With the majority of the announced tariffs already reflected in forward earnings estimates, any additional rollbacks or progress would not only improve corporate sentiment but result in positive profit revisions. We note that the corresponding valuation metric for the TSX Index is from 12.8x to 15.0x presently which is in line with the historical average.

In our last note, we cited two flashing yellow signals for economic growth: the albeit briefly inverted U.S. Treasury Bond Yield Curve and the slowdown in manufacturing activity. The spread between the 10 and two year bond yields moved back in positive territory in September and has remained so, with the current spread at 26 basis points. The slowdown in manufacturing activity has not abated, with the U.S. ISM Manufacturing Index contracting in December, signaling that industrial activity shrank in each of the last five months of the year. Boeing's decision to suspend the production of the 737 MAX in mid-January will also reverberate negatively across the manufacturing sector. The magnitude will depend on the duration of the shutdown.

The services sectors, which accounts for 70% of U.S. GDP, is holding in and continues to expand. Sustainable job creation, low interest rates and rising home prices/equity are collectively working to underpin consumer confidence. The latest December reading remains elevated and supportive of consumer spending.

With Boris Johnson's resounding re-election win, the mandate is set for the U.K. to leave the European Union (EU) at the end of this month. What follows is an 11 month transition period to negotiate its new relationship with the EU. With Brexit and its implications in the news for over three years, the final resolution will largely be a big sigh of relief.

Geopolitics came to the fore in the new year with the targeted killing of Iranian Major General Qasem Solemani by the U.S. army. Solemani was the renowned leader of Islamic Revolutionary Guard Corps (IRGC) since 1998, a branch of the Iranian Armed Forces. The IRGC is designated as a terrorist organization by the governments of Bahrain, Saudi Arabia and the United States. Canada is one of several countries examining the possibility to designate the group as well. Retaliatory action from Iran is expected, but in what form, the level of intensity and the timing is unknown. We will monitor developments and assess the fallout impact on the global economy.

President Trump has been impeached by the Democratic Party-controlled House of Representatives. The next step in the process is a trial held in the Senate sometime in January. As a reminder, two-thirds vote is necessary for impeachment in the Senate which is currently controlled by the Republican Party. Thus, a conviction and removal of Trump as president is considered highly unlikely.

Finally, there is the upcoming U.S. presidential election on November 3. At this point, it is premature to speculate who will be the leader of the Democratic Party and the outcome of the election. Suffice to say it will add another layer of invigorating debate and analysis on markets as each event unfolds.

Summary

We remain focused on the underlying economic fundamentals to drive our investment strategy. The indicators and metrics we follow suggest that economic growth continues into 2020 albeit at a slow pace. Trade conflict between the U.S. and China will be ongoing with continued progress supportive for global trade and growth. A resumption of growth in industrial activity would be an encouraging sign to extending the current economic cycle and supplementing the growth from the services sectors.

Your portfolio consists of financially sound, well-managed companies. In this low interest rate environment with no material uptick in rates expected, government bonds are viewed as a risk mitigating investment for clients who follow a more defensive strategy.

We adhere to our investment discipline to be long-term focused and patient to deploy capital at attractive price points.

Housekeeping

Soon you will be receiving your 2019 tax information slips from NBIN. Beginning this year NBIN will be including the adjusted cost base (ACB) on the T5008 Statement of Securities Transactions. This report details security positions that were sold, redeemed or matured in non-registered accounts during the tax year. Please review this information to confirm the ACB is correct to report any capital gains or losses for tax purposes.

Once again we will be mailing out our Investment Policy Statements in early February for you to review. It is very important to let us know if there are any changes that would affect your financial objectives, risk tolerance or time horizon. We would appreciate your attention to this matter as it is imperative that we have up to date information to ensure that we are managing your accounts in a prudent manner.

As we enter into a new decade, we wish all of our clients health and prosperity in the years to come!

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

Upcoming 2020 BNN Dates

Christine: January 14 @ 12:00pm
Christopher: January 16 @ 7:00am
Christine: January 29 @ 7:00am
Christine: February 11@ 6:00pm
Christopher: February 26 @ 6:00pm
Christine: March 10 @ 12:00pm
Christine: April 15 @ 6:00pm
Christine: May 13 @ 12:00pm
Christine: June 11 @ 6:00pm
Christine: July 8 @ 6:00pm
Christine: August 11 @ 12:00pm
Christine: September 14 @ 6:00pm
Christine: October 14 @ 2:00pm
Christine: November 9 @ 6:00pm
Christine: December 14 @ 12:00pm

December 31, 2019 Statistical Summary

STOCK MARKETS	**QTD**	**1 Year**	**10 Year ***
S&P TSX Composite Total Return (CAD)	3.2%	22.9%	6.9%
S&P 500 Total Return (CAD)	7.0%	25.2%	16.0%
S&P 500 Total Return (USD)	9.1%	31.5%	13.6%
DJIA Total Return (USD)	6.7%	25.3%	13.4%
NASDAQ Composite Price Return (USD)	12.2%	35.2%	14.7%
MSCI World Index Price Return (USD)	8.2%	25.2%	7.3%
CANADIAN UNIVERSE BOND INDEX	-0.5%	6.9%	4.3%
COMMODITIES			
GOLD	2.4%	18.8%	3.3%
SILVER	5.0%	15.5%	0.6%
COPPER	8.0%	3.4%	-1.7%
NATURAL GAS	-6.1%	-25.5%	-9.7%
WTI	12.9%	34.5%	-2.6%
BRENT	9.3%	22.2%	-1.4%

TREASURY BONDS	**12/31/19**	**12/31/18**
2 Year (CAD)	1.68%	1.87%
(US)	1.58%	2.59%
5 Year (CAD)	1.66%	1.89%
(US)	1.69%	2.59%
10 Year (CAD)	1.64%	1.96%
(US)	1.92%	2.73%
30 Year (CAD)	1.71%	2.16%
(US)	2.39%	3.05%
Inflation		
CPI (CAD)	2.2%	1.7%
(US)	2.1%	2.2%

*Compound annual growth rate

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