Investment Notes

September 30, 2019

GLOBEINVEST
CAPITAL MANAGEMENT INC.

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Overview

The resiliency of global equity markets this past quarter has been quite remarkable given the marked deceleration in global manufacturing activity, ongoing trade tensions, political turmoil in many geographies and prevalence of negative interest rates in most developed markets. Post quarter-end, stock markets are retrenching in response to discouraging economic data.

Both the TSX/S&P Index and S&P500 Index posted new highs in the quarter. The Canadian index benefitted from firmer than expected economic data, a knee jerk positive price reaction from energy producers surrounding geopolitical instability in the Middle East and higher gold prices. American equities were buoyed by another interest cut by the U.S. Federal Reserve and optimism on U.S-China trade negotiations.

We are cognizant that the current economic cycle is the longest as well as the slowest one on record, driven in part by unprecedented monetary stimulus by central banks around the world. While some of the economic indicators we track have weakened since last quarter, they do not yet point to a broad-based economic downturn.

Commentary

The divergence between the health of the manufacturing and services sectors is widening. Manufacturing activity in the U.S. had been holding up relatively well but in recent months has succumbed to the global trend of contracting activity. Undoubtedly rising trade tensions and weaker global trade flow have been and continue to be primary drivers of a decelerating global industrial economy. The grounding of Boeing's 737 Max since March and more recently the strike by the United Auto Workers (UAW) against General Motors are also weighing on manufacturing activity. The services sector in the U.S. which contributes close to 70% of GDP, continues to grow, albeit the rate of growth appears to have softened recently.

Not surprisingly, corporations are hesitant to commit to capital expenditures given the increasing uncertainty surrounding global trade and is being reflected in soft data measures. The extent of the follow through into hard data will be closely monitored. As well, corporate executives will provide insight as they discuss their third quarter results in the upcoming weeks.

The current shape of the U.S. Treasury Bond Yield Curve is providing angst in financial markets. An inversion of the yield curve occurs when short dated bonds yield more than longer dated 10 Year bonds. The most closely watched section of the curve is the difference between the 10 and two year bond yields. This part of the curve inverted briefly in August, resulting in a negative spread but moved back into positive territory in September. The spread is presently about +10 basis points.

The yield curve has inverted prior to each U.S. recession over the past 50 years, however, the lead time between the inversion and the onset of the recession has been inconsistent, ranging from 14 to 34 months. Historically, stock market returns have posted on average double-digit gains in the year following the inversion, ranging from -0.4% to 25.9%.

Our interpretation of the flattening yield curve is that: (1) the pace of economic growth is slowing (2) inflationary pressures remain benign and (3) there is strong demand for a safe haven asset represented by the 10 Year U.S. Treasury Bond, driven by elevated uncertainty in the geopolitical landscape and negative interest rates for 10 Year sovereign bonds in many developed markets (see below).

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Country	10 Year Bond Yield (Oct. 4/19)
United States	1.51%
Canada	1.23%
Germany	- 0.59%
United Kingdom	0.44%
France	- 0.29%
Switzerland	- 0.86%
Japan	- 0.22%

The other key indicators we track to assess the health of the economy such as the labour market, credit trends and high yield credit spreads remain relatively solid.

According to Barron's, over the past three months there have been 33 interest rate cuts by global central banks, in contrast to 19 hikes in the third quarter of 2018. Thus, the pivot to an accommodative global monetary policy by central banks should provide some downside protection for stock markets.

Trade negotiations between the U.S. and China are scheduled to resume later this week. The prolonged trade war remains the largest risk for markets, on both the upside and downside. At this juncture, we believe a cessation of additional and/or higher tariffs and commitment to ongoing discussions would be considered a temporary "truce" and greeted positively by investors.

Lastly, a commentary regarding impeachment proceedings against U.S. president Trump. Only two presidents were impeached by the House of Representatives: Andrew Johnson in 1868 and Bill Clinton in 1998. In both cases, the Senate did not convict the then-sitting presidents, allowing them to remain in office. Richard Nixon was never in the impeached but resigned over the threat of impeachment on August 9, 1974. In Trump's case, should impeachment proceedings pass in the House (which requires a simple majority vote and where Democrats hold the majority), the vote must then go the Senate. A two-thirds vote in the Senate, where Republicans outnumber Democrats would be required to convict Trump and remove him from office. There is no foregone conclusion as to how this will unfold, but suffice to say, political uncertainties surrounding impeachment as well as the U.S. presidential election next year will continue to weigh on markets.

Summary

So for now, there are a few flashing yellow signals that warrant a relatively defensive portfolio positioning. As a consequence, exposure in highly cyclical sectors continue to remain low in our client portfolios.

Another defensive overlay is our disciplined approach to stock selection in the portfolio construction process. The income stocks in your portfolios provide a stable stream of dividend income, regardless of overall market price volatility, and have the capability to steadily increase their dividends over time. The growth stocks you own consist of high quality profitable companies that effectively allocate their capital to strengthen their competitive positioning over the longer term. The companies you own in your portfolio are financially sound and well-equipped to endure an economic cycle.

We will continue to monitor developments and be attuned to any signs or events that may result in a shift to our thinking.

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

Upcoming 2019 BNN Dates

Christine: Wednesday, October 9 @ 6:00pm
Christine: Tuesday, November 12 @ 12:00pm
Christopher: Thursday, November 21 @ 7:00am
Christine: Tuesday, November 26 @ 7:00am
Christine: Tuesday, December 10 @ 12:00pm

September 30, 2019 Statistical Summary

STOCK MARKETS	**QTD**	**YTD**	**1 Year**
S&P TSX Composite Total Return (CAD)	2.5%	19.1%	7.1%
S&P 500 Total Return (CAD)	2.9%	17.0%	7.0%
S&P 500 Total Return (USD)	1.7%	20.6%	4.3%
DJIA Total Return (USD)	1.8%	17.5%	4.2%
NASDAQ Composite Price Return (USD)	-0.1%	20.6%	-0.6%
MSCI World Index Price Return (USD)	0.1%	15.7%	-0.2%
CANADIAN UNIVERSE BOND INDEX	1.2%	7.8%	9.7%
COMMODITIES			
GOLD	5.3%	16.1%	25.7%
SILVER	11.4%	10.0%	16.2%
COPPER	-4.8%	-4.3%	-9.1%
NATURAL GAS	1.0%	-20.7%	-22.5%
WTI	-7.5%	19.1%	-26.2%
BRENT	-8.7%	11.9%	-27.1%

TREASURY BONDS	**09/30/19**	**12/31/18**	**09/30/18**
2 Year (CAD)	1.58%	1.87%	2.19%
(US)	1.63%	2.59%	2.81%
5 Year (CAD)	1.40%	1.89%	2.32%
(US)	1.55%	2.59%	2.94%
10 Year (CAD)	1.37%	1.96%	2.41%
(US)	1.68%	2.73%	3.05%
30 Year CAD)	1.53%	2.16%	2.41%
(US)	2.12%	3.05%	3.19%
Inflation			
CPI (CAD)	1.9%	1.7%	2.8%
(US)	1.7%	2.2%	2.7%

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