Market Review

January 10, 2019

Most major stock indices around the world posted double-digit declines in the last quarter of 2018, resulting in overall negative returns for the year. Reasons behind the steep selloff included concerns of the U.S./China trade war, softening global economic data, the abrupt collapse in crude oil prices and a flattening U.S. Treasury Yield Curve, which culminated in a mass exodus from equity mutual funds and exchange traded funds in December. Funds flow from computer driven trading programs also exacerbated the selloff.

Our view remains that stock markets are experiencing corrections or panic attacks and adjusting to a slower pace of economic as well as corporate profit growth in 2019.

Cycle indicators indicate expanding U.S. economic activity, albeit at a moderating rate. The employment situation in the U.S. remains healthy with preliminary reports suggesting holiday retail sales were the strongest in six years. Growth in GDP is expected to slow from 2018, but remain positive.

With growth in the U.S. economy decelerating and the Chinese industrial economy contracting, we think there is an incentive for both sides to reach a mutually beneficial trade agreement. China has also been ramping up stimulus measures to support its economy.

U.S. Fed Chairman Powell has recently adopted a more dovish tone and has said that the Fed's policy is not on a fixed course and that it reacts to changes in the economy. Recall that in 2016, despite projecting four rate increases in December 2015, due to worries of a growth slowdown in China and a collapse in crude oil prices, the Fed went on pause for a year and raised its benchmark rate just once in December 2016. Should economic conditions slow materially, we suspect the Fed will react similarly. In Canada, policy decisions will also be data dependent and given a softening economy, further interest rate increases appear to be on hold.

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For our constructive view to hold, corporate profits have to continue to grow this year, which will provide fundamental support for stocks. Consensus earnings per share (EPS) for the S&P 500 companies is expected to be up 13% year-over-year for Q4/18, 23% for all of 2018 and 7% for 2019. As companies report their results in the coming weeks, we will receive better clarity on the profit outlook.

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