MARKET UPDATE FROM THE GLOBAL CIO OFFICE

SEPTEMBER 2019

Sentiment remained fragile in August as investors grappled with a flurry of trade headlines, a fraught geopolitical backdrop, and yield curve inversion that stoked recession fears. The US-Sino trade debacle intensified and overshadowed a generally supportive message from global central banks. At the beginning of August, President Trump announced a 10% tariff on the final tranche of Chinese imports effective September 1st – though walked that back on August 13th and delayed the tariff on some of those goods until December. Then on August 23rd, China retaliated and raised tariffs on US imports effective in September and December, while Trump responded with a plan to ratchet up duties on all Chinese imports even further. In the end, the 15% tariff on $110 billion of Chinese goods went into effect on September 1st, as did China's retaliatory tariffs – with little clarity regarding the way forward for the US-China trade dilemma.

FINANCIAL MARKET DASHBOARD

	AUGUST 30 2019	AUGUST	YTD	1 YEAR
EQUITY MARKETS		% PRICE CHANGE (LC)		
S&P 500	2926	-1.81%	16.74%	0.86%
S&P/TSX	16442	0.22%	14.80%	1.10%
MSCI EAFE	1843	-2.87%	7.13%	-6.09%
MSCI EM	984	-5.08%	1.92%	-6.78%
FIXED INCOME (%)		BASIS POINT CHANGE		
US 10 Year Bond Yield	1.50	-51.8	-118.8	-136.4
US 2 Year Bond Yield	1.50	-36.8	-98.4	-112.3
US Corp BBB Spread	1.48	8.0	-38.0	-4.0
US Corp High Yield Spread	4.22	38.0	-105.0	81.0
CURRENCIES		% PRICE CHANGE		
CAD/USD	0.75	-0.88%	2.47%	-2.01%
EUR/USD	1.10	-0.85%	-4.23%	-5.34%
USD/JPY	106.28	-2.30%	-3.11%	-4.28%
COMMODITIES		% PRICE CHANGE		
WTI Oil (USD/bbl)	55.10	-5.94%	21.34%	-21.06%
Copper (USD/pound)	2.53	-4.99%	-3.72%	-4.38%
Gold (USD/oz)	1523.00	6.79%	18.86%	26.75%

Global equity markets were on the defensive as ongoing trade deliberations between the world's two largest economies clouded the global backdrop and sapped risk appetite. The MSCI All Country World retreated 2.6% in August. Regionally speaking, the S&P 500 posted its first monthly decline since May (-1.8%), while weakness also spread to overseas markets, with both European and Japanese bourses joining the retreat. Not surprisingly, emerging market bourses took the brunt of the weakness and lost 5.1%, marking the worst August since 1997. In contrast, the S&P/TSX managed to buck the downward trend and posted a modest gain, thanks to soaring gold prices that bolstered the materials sector.

Bond yields were pummelled across the globe as unrelenting demand for the safety of bonds lingered-on. The US treasury market posted its biggest rally since the depths of the global financial crisis. The 30 year treasury yield fell to an all-time low and ended the month at 1.96% (56 basis points lower), while the 10-year treasury yield ended the month at 1.50% (down 52 basis points). Meanwhile, the spread between the 10- and 2-year treasury turned negative (the yield curve inverted), which fueled fears of recession. Interestingly, this profound plunge in bond yields was somewhat self-fulfilling in that nervous investors moved even more aggressively into bonds in response and accentuated the downward move.

The US dollar extended its advance in August, underscoring weakness elsewhere across the globe. The euro collapsed to a two-year low amid worrisome political developments in Italy, while deteriorating Eurozone economic results bolstered bets for increased stimulus from the ECB. The pound slipped as the likelihood of a "hard" Brexit rose following PM Johnson's announcement that he's suspending Parliament this fall (reducing the time for opponents to halt a no-deal Brexit). In contrast, the Japanese yen was the sole winner and thrived as investors flocked to the safe-haven currency in what was a tumultuous month.

Gold rallied for a fourth month as trade uncertainties and negative real rates drove bullion prices to a six-year high, while copper skidded lower as investors faced fresh evidence that the trade war is taking its toll on the global economy. Finally, oil collapsed amid concerns that US-China trade relations are weighing on the demand outlook, which completely overshadowed signs that OPEC's supply cuts are proving successful in trimming stockpiles.

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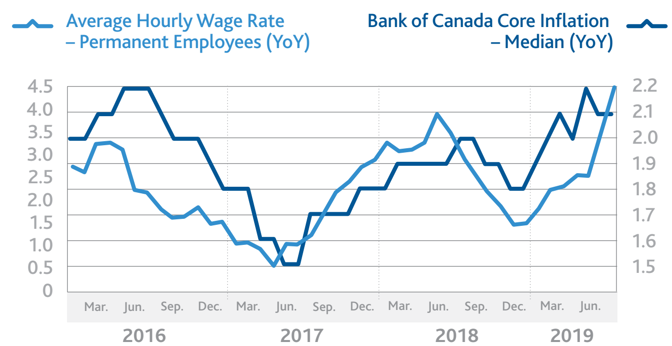
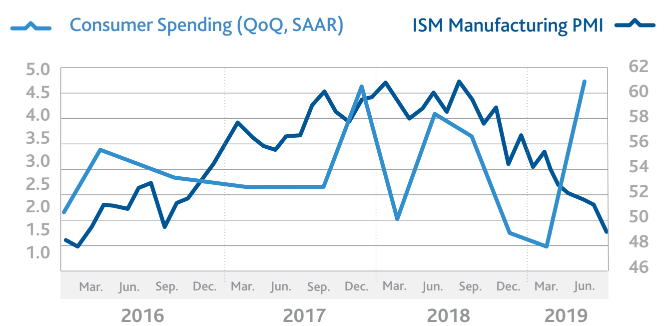


The Canadian economy grew at a faster than expected 3.7% annualized pace during the second quarter - far-exceeding the Bank of Canada's 2.3% forecast. Meanwhile, the preferred core inflation gauge has been running in-line with the 2% target since April, while wages grew at the fastest pace since 2009 - tempering the case for immediate rate cuts from the Bank of Canada.

CANADA

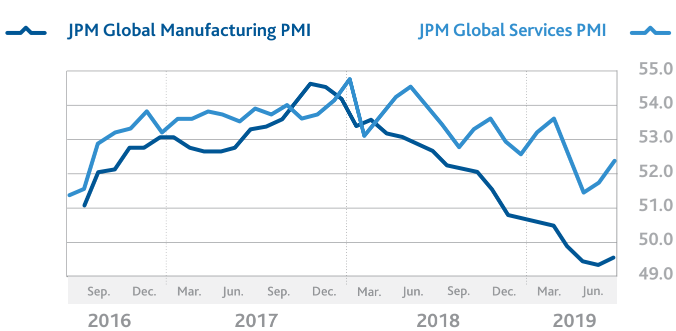
After a difficult start to the year, the Canadian economy recovered meaningfully in the second quarter of 2019. The stronger-than-expected 3.7% (annualized) acceleration in output was primarily a result of a 13.4% surge in exports, which marked the fastest increase in exports since 2014. However, household consumption growth and business investment were broadly weaker and resulted in a decline in domestic demand overall. Encouragingly, inflation results surprised to the upside in July, with the average of the Bank of Canada's three measures of underlying "core" inflation unexpectedly ticking up and is now sitting right at the central bank's target – providing the scope for the Bank of Canada to remain sidelined for now even as other major central banks embark on easier monetary policies.



The US factory sector unexpectedly slipped into contraction terrain in August for the first time since 2016 in response to an intensifying trade backdrop, though regional surveys suggest that factory sentiment may be stabilizing. Meanwhile, household fundamentals remain robust amid tight labour market conditions and should allow the consumer (2/3 of the economy) to remain insulated from factory woes.

USA

The US consumer continues to be fairly immune to trade-related woes, which should prevent weakness in manufacturing from dragging the US into a recession anytime soon. Consumer spending grew at the fastest rate since 2014 during the second quarter, while stronger than expected retail sales and personal spending data for July suggest that the consumer remained a pivotal source of strength early-on in the third quarter. As widely expected, the Federal Reserve followed through with an "insurance" rate cut at the July gathering in response to a number of global "crosscurrents" at hand (notably trade tensions that have clouded the global growth backdrop), which when combined with subdued inflationary pressures has provided the flexibility and optionality to provide further stimulus if warranted.



While deepening woes from the US-China trade debacle have plagued the global factory space, it isn't yet evident that the manufacturing slump will spillover to the services sector. The global services PMI remains firmly in expansion territory (at 52.5), while the global manufacturing PMI ticked higher in August (to 49.5).

INTERNATIONAL

While the global manufacturing sector remains firmly in contraction terrain, the consumer-oriented services sector continues to defy weakness in the factory space and has remained the driving force of global growth. Notably, trade-induced uncertainty in the factory sector has been contained thus far and has yet to spillover to the larger, more prominent services-side of the global economy. Indeed, the consumer has maintained its resilience given solid employment trends that have bolstered confidence and spending and ultimately sheltered the global economy from the storm. Moreover, the good news is that the global manufacturing PMI ticked higher in August, marking the first increase in 16 months – though deteriorating forward-looking sub-indices (new orders/exports) suggest that businesses remain in defensive-mode as the trade war lingers-on unresolved.