

Market Commentary

Maintaining Perspective on the Markets

Equity markets have continued their rapid sell-off this week, with most major markets selling off in the 5-7% range. Even the S&P/TSX has declined over 5%, despite not experiencing the strong run-up that other major developed world markets experienced in 2017 or in the first month of 2018. Prior to this correction U.S. equities had experienced a recent move upward in a parabolic fashion as the S&P 500 was up 7.5% year to date at its January peak.

Why is the market selling off?

While the market sell-off initially could be attributed primarily to fears around rising interest rates and the threat of inflation, the recent massive spike in the Volatility Index (VIX) to over 30 and the large intra-day swings experienced in equity markets indicates that something else is at play here. In addition, other higher risk asset classes have also moved as you would expect with Bitcoin losing almost two-thirds of its value since its peak levels at the end of 2017. Marijuana stocks have also experienced a significant correction, losing 30-40% on average since their highs. With these large intra-day swings, it is clear that sentiment is driving market returns and not fundamentals.

The January U.S. Jobs report indicated an additional 200,000 jobs were created, but also showed wages rising 2.9% over the past 12 months. In spite of a near 4% unemployment rate in the U.S., there has been little sign of inflation based on the reported headline and core inflation numbers. This jobs data, in combination with the Fed's reference to 'further gradual adjustments in the stance of monetary policy', spurred speculation that the federal reserve would be forced to go beyond the three-rate hike guidance that was provided at the end of 2017.

Even before this jobs report, bond markets were anticipating more hawkish data as the sell-off in U.S. treasuries (and Canadian government bonds) began on the first trading day of the year, and bond markets haven't looked back since, with the yields on 10-year U.S. treasuries climbing over 40 basis points year to date and Canadian 10-year government bonds have followed this trend with about a 30 basis point move higher as well.

Portfolio Positioning

Our asset allocation decision-making process uses a fundamentals based approach where macro-economic factors are the primary consideration. We continuously assess the outlook for the economy, fiscal and monetary policy, and market valuation levels. Currently we do not see a major shift in fundamentals as economic data continues to confirm a robust outlook for global growth and inflation in major developed markets remains low. In spite of the sell-off in equities, earnings continue to come in strong for most companies. According to the Wall Street Journal, with over half of S&P 500 companies reporting their fourth quarter results, roughly 80% have exceeded analyst expectations.

Although bond yields are moving higher in anticipation of higher inflation levels, bond yields are still not high enough to warrant a major shift out of equities and into bonds. Furthermore, there is no basis for anticipating any major economy is heading towards recession.

Although there is no change in our positioning, we review these factors on a frequent basis and will shift where there is high conviction that a change has occurred. Violent movements in the equity markets are not a reason to shift portfolio positioning alone as market corrections are normal. In fact, not experiencing a market correction is NOT normal; over the last 25 years, intra-year market price corrections have averaged approximately 14% despite ending at positive levels in 21 of those years.

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