Market Matters

JULY 2014 HIGHLIGHTS

- Just one day after powering to a record close, the S&P/TSX composite index took a tumble on July 31 in its biggest one-day decline since early February.
- The same day, the S&P 500 index erased its gains for the month as concerns grew over the strength of economies overseas and ongoing tension with Russia.
- Disappointing earnings reports in Europe, continuing geopolitical risks and persistent disinflationary pressures pushed major European equity markets lower, including the Stoxx Europe 600 index, which had its lowest close since late April.
- Strong inflows into China in July helped push emerging markets higher as investor sentiment improved with the release of better-than-expected economic data.
- Canada's universe bond index rose 0.6%, lifting the year-to-date return to 5.5%. Sub-sector returns ranged from a low of 0.1% for short-term Canada bonds to a high of 1.7% for long-term municipal bonds.

WHAT A DIFFERENCE A DAY MADE

Headline news on Wednesday, July 30 focused on the Ebola outbreak in West Africa, conflict in the Middle East and eastern Ukraine, and investigation into the loss of Malaysia Airlines Flight 17. In the hours overshadowed by strife, stock markets continued to tick. The S&P 500 rose and the S&P/TSX composite index, one of the strongest performers among global stock indexes this year, powered its way to a record close on July 30. Stock markets were bolstered by solid earnings reports, positive US economic data and an indication from the US Federal Reserve (Fed) that it does not expect to raise the target for the overnight rate before the second half of 2015.

On Thursday, July 31 geopolitical struggles continued, but stock markets changed markedly. The S&P/TSX tumbled in its biggest one-day decline since early February. An apparent tipping point was reached with geopolitical concerns and stock-specific news such as Valeant Pharmaceuticals which cut its full-year profit and revenue forecasts, sending the pharma-giant's stock down significantly.

Table 1
Summary of major market developments

Market returns*	July	YTD
S&P/TSX Composite	1.2%	12.5%
S&P 500	-1.5%	4.5%
- in Canadian dollars	***0.6%***	***7.1%***
MSCI EAFE	-0.2%	1.1%
- in Canadian dollars	***0.1%***	***3.4%***
MSCI Emerging Markets	2.5%	5.8%
FTSE TMX Canada Universe Bond Index**	0.6%	5.5%
FTSE TMX Canada Corporate BBB Bond Index***	0.6%	6.7%

*Local currency (unless specified); price only
**Total return, Canadian bonds, previously known as DEX Universe Bond Index
***Total return, Canadian bonds, previously known as DEX Corporate BBB Bond Index

Table 2
Other price levels/change

	Level	July	YTD
CAD per USD exchange rate	$0.917	-2.2%	-2.6%
Oil (West Texas)*	$98.17	-6.8%	-0.3%
Gold*	$1282	-2.7%	6.4%
Reuters/Jefferies CRB Index*	$294.43	-4.5%	5.1%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	July	YTD
S&P/TSX Composite	1.2%	12.5%
Energy	-2.4%	16.4%
Materials	0.9%	16.5%
Industrials	3.6%	15.0%
Consumer discretionary	1.5%	9.4%
Consumer staples	6.2%	16.3%
Health care	-3.2%	1.8%
Financials	3.9%	10.8%
Information technology	2.3%	14.7%
Telecommunication services	0.0%	2.7%
Utilities	-1.6%	6.0%

*Price only
Source: Bloomberg, MSCI Barra, NB Financial, FTSE TMX Global Debt Capital Markets Inc.

In its own one-day slump, the S&P 500 index erased its gains for the month of July as concerns grew over the strength of economies overseas and ongoing tension with Russia.

Disappointing earnings reports in Europe helped push the Stoxx Europe 600, the region's benchmark stock index, to its lowest close since late April. Continuing geopolitical risks, as Russia announced measures to try to counter US and European sanctions over Ukraine, did not bode well for European stock markets. Another soft inflation reading for the euro zone contributed to the decline.

Strong inflows into China in July helped push emerging markets higher as China reported that second-quarter economic growth was slightly faster than market expectations.

What a difference a day made. In the span of 24 hours, stock markets in developed economies transformed from the lion that roared to the mouse that squeaked and scurried away as fast as it could. But the pendulum always swings back to the other side. It's just a matter of time.

ECONOMIES CLOCK GROWTH

Statistics Canada reported that real gross domestic product rose 0.4% in May, a fifth consecutive monthly increase, with year-over-year growth of 2.3%. The US Commerce Department reported the US economy grew at an annual rate of 4% for the three months ended June 30, up from a decline of 2.1% in the first quarter.

US employers added 209,000 jobs in July, below the 288,000 jobs that were created in June and below the gain of 230,000 jobs predicted by economists, although employers added more than 200,000 jobs for the sixth straight month. The US government said the unemployment rate ticked up to 6.2% from 6.1%, giving further support to the belief that the Fed is not in a hurry to raise benchmark interest rates from near zero, where they have been since late 2008.

On the fixed income watch, Canada's universe bond index returned a small gain in July, rising 5.5% year-to-date. Long-term bonds have outperformed expectations this year, having caught a bid from pension plans that are less sensitive to movements in interest rates and are looking to match their longer-term liabilities (even the Government of Canada is issuing 50-year bonds now…and finding a market for them). The outperformance of long-term bonds is also attributed to demand for yield and portfolio repositioning amid record equity prices.

TIME FOR A MARKET CORRECTION

With yield spreads close to historic lows, it is difficult to foresee conditions that would have credit markets continue their pace of gains into the remainder of the year. In the US, the economy has improved, business and consumer spending has increased, and inflation expectations are rising. All things considered, yields are expected to start to increase through the second half of the year.

In light of the duration of the advance, uneven economic progression, select areas of over-valuation and various geopolitical risks, concerns of an equity correction persist. Some caution is warranted in the near term as fewer stocks push the market to new highs, credit spreads start to move higher and long-term sovereign bond yields in Europe and North America remain stubbornly low.

Equities are still expected to outperform bonds over the next several years as the global economy appears to be gaining some traction, notwithstanding some stalling momentum in the euro zone, and second quarter corporate earnings have been encouraging. It is likely a good time to reevaluate portfolios for outsized exposures.

A market correction at this time would be considered healthy and as professional money managers, GLC remains ready to take advantage of any short-term weakness.

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