Market Matters

AUGUST 2016 HIGHLIGHTS

- It was a tepid month for capital markets. Trading volumes were low, as were volatility measures.
- Canadian equity momentum remained positive (just barely), but saw a significant shift, rotating from a resource sector-driven market in the first half of the year, to a non-resource sector-driven market thus far in the second half of the year.
- US equity indices hit the trifecta of record highs. The S&P500, Dow Jones Industrial Average, and the NASDAQ all hit record highs on the same day (August 15) for the first time since 1999.
- Canadian bond markets experienced mixed performance across the bond market credit segments and across maturity dates. A-rated corporate bonds led the seven major credit segments, and long-term bonds outpaced short and mid-term bonds.
- Corporate bond spreads tightened in August, inspired by a robust pace of new issues (the second busiest August on record); movement into corporate bonds from the plentiful cash sitting on the sidelines; and investors' growing comfort with risk driving appetite for bonds with higher relative yield.
- Global central banks continue to move in different directions. The Canadian and American central banks remained on hold, while Britain, Australia and Japan's central banks announced a combination of rate cuts and/or further stimulus. Of note, the Bank of England reduced its rates for the first time since 2009, moving from 0.50% to 0.25% - a 322-year record low.
- The Chinese government announced another step toward market liberalization through the Shenzhen-Hong Kong Stock Connect Plan. This significantly increases the number of stocks available to foreign investors, and notably creating greater access to China's IT sector.

SUMMER SLOW DOWN

Vacation season slowed life on Bay Street and Wall Street to a crawl. Both trading and volatility were down, with not one day in August in which the S&P/TSX Composite or the S&P500 moved (up or down) 1% or more. To drive home the point, consider that trading volume on the S&P500 was down 18% from its 10-year average for the month of August (already considered the slow month of the year). With the exception of emerging markets, which outperformed their developed market peers, Table 1 reveals August capital market results floating around the flat line.

Table 1
Summary of major market developments

Market returns*	August	YTD
S&P/TSX Composite	0.1%	12.2%
S&P 500	-0.1%	6.2%
- in Canadian dollars	***0.3%***	***0.8%***
MSCI EAFE	0.7%	-4.1%
- in Canadian dollars	***0.2%***	***-6.8%***
MSCI Emerging Markets	2.6%	8.9%
FTSE TMX Canada Universe Bond Index**	0.1%	5.0%
FTSE TMX Canada all corporate bond index **	0.5%	5.3%

*Local currency (unless specified); price only
**Total return, Canadian bonds

Table 2
Other price levels/change

	Level	August	YTD
CAD per USD exchange rate	$0.763	-0.5%	5.6%
Oil (West Texas)*	$44.70	7.5%	20.7%
Gold*	$1,308	-2.9%	23.2%
Reuters/Jefferies CRB Index*	$180.21	-0.4%	2.3%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	August	YTD
S&P/TSX Composite	0.1%	12.2%
Energy	2.3%	19.4%
Materials	-9.9%	45.1%
Industrials	2.9%	15.5%
Consumer discretionary	1.6%	5.9%
Consumer staples	4.8%	12.6%
Health care	13.8%	-66.6%
Financials	1.6%	7.6%
Information technology	1.4%	4.0%
Telecommunication services	-2.0%	15.0%
Utilities	-3.2%	14.1%

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

That said, the S&P500, Dow Jones Industrial Average and Nasdaq Composite marked a milestone in August, with all three indices closing at record highs on the 15th of August. By and large, data released in August showed improvement in US economic conditions, including the all-important areas of housing and employment (critical to the well-being of the US consumer). Equity markets were also bolstered by recovering oil prices. After testing out the low $40USD/barrel range in July, oil prices in August flirted with crossing the $50USD/barrel threshold. Ultimately the attempt was missed and oil prices settled back down in the mid-$40's.

CANADIAN SECTOR ROTATION

While Canadian equity momentum has remained positive in the second half of 2016, the drivers of performance have changed. In the first half of 2016, resource sectors dominated the Canadian market results, contributing 85% of the index returns. Whereas the second half of the year pullback in gold and gold-related equities, alongside a slowdown in energy stock gains, have given way for the non-resource sectors to drive the large majority of the S&P/TSX Composite's gains. From the end of June to the end of the end of August 2016, one could have captured 98% of the S&P/TSX Composite's gains without exposure to Canada's resource sectors. The quick turnaround has rewarded disciplined diversifiers, at the expense of performance-chasers.

Global central banks find themselves leaning in various directions and moving at different speeds, all of which is likely to continue to influence equity markets and sector leadership in the coming months. Just as the 'lower for longer' yield environment has helped to support equity market gains, the converse response (i.e. equity market weakness) could occur with the prospect of higher yields. The anticipated US Federal Reserve rate hike decision (with odds in favour of a late fourth quarter move) should encourage shorter-term bond yields to creep up and support US dollar strength - making it difficult for the resource sectors to repeat their strong gains booked in the first half of 2016. Meanwhile, yields of longer-term European and Japanese bonds have recently started moving higher, which in turn may pressure North American yields to follow suit. All that said, if yields are rising as a result of "good" reasons (i.e. an improving economic environment) and not "poor" reasons (i.e. a monetary policy mis-step) equity markets should return their focus toward fundamentals – which have thus far shown improvement.

Patience within a changing environment will be warranted as August's muted temperament is unlikely to spill over into the following months. September's 'back-to-work' mentality, coupled with numerous developing narratives on the geopolitical scene (not the least of which will be the hotly battled last leg of the US presidential election run) are sure to add additional risks and market volatility to the forefront of investors' attention.

PRICING THE METAL OF PRICELESS MEDALS

Anyone who's earned a prized medal, trophy, certificate of achievement (or a participation ribbon that meant a world more than the effort of simply showing up) knows you can't put a price on its sentimental value. So, just for fun, here are some interesting facts about the valuable hardware our Canadian athletes have earned:

- The Rio Olympic medals, at 500 grams, are reportedly the heaviest medals in the history of the Summer Olympics.
- Of the 500 grams, the gold medal contains only 6 grams of gold with 99.9 percent purity. The remaining 494 grams is made of silver with 92.5 percent purity.
- Silver medals contain 500 grams of sterling silver, whereas the bronze medals are 475 grams of copper and 25 grams of zinc.

In non-inflation adjusted terms, the Olympic medals given out in London in 2012 – when the commodity super-cycle was on - were the most costly to produce.

Table 4
Metal price at August 31st

	Gold (USD/oz)	Silver (USD/oz)	Bronze (USD/lb, 90% copper, 10% zinc)
2008	$831.15	$13.61	$3.16
2012	$1,692.01	$31.73	$3.19
2016	$1,308.91	$18.65	$1.99
% change in last four years	-23%	-41%	-38%

Source: GLC, Bloomberg