Credential

Market Insights | MONTHLY

Month in Review

For the month ended October 31st, 2018

U.S. Mid-Term Elections – November 6th, 2018

With the U.S. midterm elections coming up this week, we'd like to share some thoughts from Addenda Capital, subadvisor for OnPoint Managed Portfolios offered on the IIROC platform.

Addenda predicts the most likely outcome to be a divided Congress, with the Democrats taking the House of Representatives (House) —where the Republican Party (GOP) currently has a 23 seat majority—and the GOP retaining the Senate, where it currently has a one seat majority and could possibly gain a few more. This appears to be market consensus.

In terms of market reaction, Addenda believes the most favourable outcome for stocks is for the GOP to retain both. Next would be a divided Congress and finally Democrats taking control of both the House and the Senate, thereby leading to potential gridlock. A divided Congress is a bad outcome as it puts constraints on Trump's power and use of executive orders. A small amount of gridlock is not a bad thing as the market has already seen the most pro-growth aspects of his agenda—tax reform and deregulation for example—and these will not be repealed.

As an aside, the 12 months following the midterms are historically the strongest for the stock market of any part of presidential cycle. Since 1946, there have been no down periods over the 12 months following midterms.

Addenda is a long-term investor that invests in high quality companies. Therefore, short-term events like midterms shouldn't have a material impact on their investment thesis. There certainly could be some short-term volatility, but what the market likes most is certainty and predictability. Regardless of the outcome of the election, there will be better clarity of what the future holds once the results are final and this is no longer an overhang and contributor to uncertainty.

Overall Highlights

- **TSX stumbles.** Triple digit daily gains and losses for the month were the norm as the S&P/TSX Composite had its worst month pullback since September 2011. The declines were broad-based, led by Energy, Financials, and Industrials as the effects of tariff and rising interest rates have begun to take effect on the economy. The market volatility was not only isolated to Canada as other global markets experienced multi-year lows. The Composite closed October at 15,027, a 6.5% monthly loss, while for the year it slipped into the red, down 7.3%.
- **Dollar lower.** A flight to the safety of the U.S. dollar and safe-haven assets sent the Loonie lower for the month. In addition, economic data at home showed some softness in the health of the economy. Reduced risk tolerances by investors lowered demand for our dollar as U.S. protectionism on Canadian steel remained despite a new deal on North American free trade. In October, the Loonie ended at US76.09 cents for one Canadian dollar, a monthly decline of 1.5%.
- **Gold shines.** The yellow metal found footing as the go-to asset during the recent volatility, posting its first strong gain in seven months in October. Gold posted higher gains throughout the month as bull markets retreated and attractive buying opportunities quickly saw a reversal of inflows back into equities. A December contact for gold closed the month at US$1,216.70, an increase of 1.8%.
- **Oil slips and falls.** Noticeable increases in global supplies confirmed by increased production by OPEC members and the U.S. sent crude prices plummeting in October. U.S. inventories also showed a rise as the recent equity market turbulence raised worries of slowing economies around the globe. As well, a persistently strong U.S. dollar deterred demand for the commodity given its expensiveness. A December contract for a barrel of WTI crude ended trading at US$64.98, an 11.6% drop for the month.

Index/Commodity/Currency		
Close	**MonthChange**	**YTDChange**
S&P/TSX Composite		
15,027.28	-1,045.9	-1,181.8
	-6.5%	-7.3%
BMO Nesbitt Burns Small Cap		
826.91	-77.1	-109.5
	-8.5%	-11.7%
Dow Jones Industrial Average		
25,115.76	-1,342.5	396.5
	-5.1%	1.6%
S&P 500		
2,711.74	-202.2	38.1
	-6.9%	1.4%
NASDAQ Composite		
7,305.90	-740.5	402.5
	-9.2%	5.8%
MSCI-EAFE Index		
1,815.17	-158.4	-235.6
	-8.0%	-11.5%
WTI Crude Oil (per barrel, in $US)		
64.98	-8.6	4.9
	-11.63%	8.1%
Gold (per ounce, in US$)		
1,216.70	21.5	-88.3
	1.8%	-6.8%
Canadian Dollar (¢ per US$)		
76.09	-1.2	-3.6
	-1.5%	-4.5%

Sources: Bloomberg

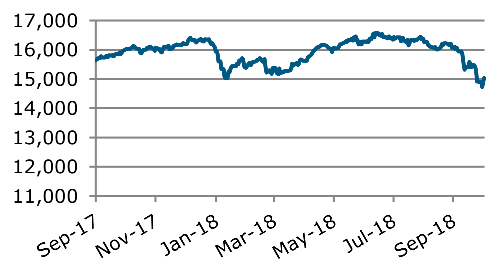
Canadian Markets

- **GDP edges higher.** For a seventh straight month, amongst the rate hikes, tariff battles, and NAFTA negotiations, the economy reported an increase of 0.1% in August, as reported by Statistics Canada. Expectations were for a flat reading but growth in oil and gas and the finance sectors helped overcome declines in 12 of the 20 sectors followed. Industry-wise, Manufacturing was unchanged while Services where higher by 0.1% during the month. The GDP data will likely keep the Bank of Canada on track for another hike in early 2019.
- **Unemployment rate drops.** Statistic Canada reported that unemployment rate dropped 0.1 percent to 5.9% in September, matching the forecast. The economy added 63,300 job positions after a decline of 51,600 reported in August, beating economists' expectations of 25,000 jobs added by a wide margin. Most job gains came from British Columbia and Ontario.
- **NAFTA deal reached.** After months of back-and-forth negotiations and political dramas, the U.S., Canada, and Mexico reached consensus on a new trilateral trade deal. The new trade pact will be renamed the United States-Mexico-Canada Agreement (USMCA). Details around the new trade agreement are still forthcoming, but it is expected to clear some of the uncertainties that have been lingering around for months. Stock markets had little reaction to the news.
- **Rates rise.** As expected, the Bank of Canada rose rates for a third time this year to 1.75% as it remains committed to unwinding its accommodative monetary policy. In their announcement, the central bank will "continue to take into account how the economy is adjusting to higher interest rates" as household debt to income of Canadians hold at record high levels. This is the fifth rate increase by the Bank since the summer of 2017—additional rate increases are anticipated to continue over the next year.
- **Inflation softens.** The country's consumer price index (CPI) fell in September for a second consecutive month as gas prices and travel costs fell. For the month, inflation declined 0.4% following a 0.1% drop in August, which was worse than estimates of a flat reading. On an annualized basis, inflation declined to 2.2% from 2.8% despite advances in all eight major components, and well below market expectations of 2.7%. Core inflation for the same 12-month period slipped to 1.5% from 1.7%.
- **PPI up.** The price of products sold by producers rose in September as energy and chemicals rose, in a report by StatCan. Costs of non-ferrous metals and meat, fish and dairy products helped temper any increases as the Producer Price Index rose 0.1%, bettering economist expectations of no change for the month. On an annualized basis, producer prices have increase 6.2%, up from last month's 5.7% reading.
- **Wholesale sales drop.** Factory sales declined in August by 0.1% to $63.6B in total receipts, as reported by Statistics Canada. Four of the seven sectors followed declined as economist expectations called for no change in the measure. Building supplies and materials decreased the most, falling 2.3%, followed by automobiles and parts which fell 1.4%. In constant dollar terms, sales by volume also fell 0.1% for the month.
- **Manufacturing sales fall.** Factory sales added up to $58.6B in August, a 0.4% decline from the previous month and bettering expectations of a 0.6% decline, as reported by StatCan. Seven of the 21 sectors tracked declined, representing 50.9% of the manufacturing sector. Motor vehicles declined the most, by 8.3%, primarily because of lower production totals due to assembly plant shutdowns. Demand for primary metals and wood products also dropped, with total volumes also declining by 0.3% in August.
- **Retail sales decline.** Consumers were in a less of a spending mood in August as Statistics Canada reported a decline of 0.1%i n retails sales. Final receipts for the month were $50.8B as lower sales were seen at the gas pumps and at clothing and accessories stores. Of the 11 sectors included in the data, seven declined with the big advancer being with motor vehicles and parts, which increased 0.8%. On a year-over-year (YoY) basis, retail sales edged higher to 3.6% from 3.5% in July.
- **Canada Housing News:**
  - **Existing homes sales down.** For the first time since April, sales of existing homes fell as reported by the Canadian Real Estate Association (CREA). For the month, sales fell 0.4% as the Vancouver Island and Edmonton regions led all decliners, which was more than half of the markets tracked by CREA. The rise in interest rates and effects of new mortgage rules introduced at the beginning of the year contributed to the decrease. On a YoY basis, homes sales have fallen 8.9%.
  - **Canadian housing starts slow.** Housing starts slowed in September, as reported by CMHC. September's housing starts came in at an annualized rate of 188,683 units, down from August's pace of 198,843. Economists were expecting an annual pace of 210,000 units.

S&P/TSX Composite Index
Sector Snapshot

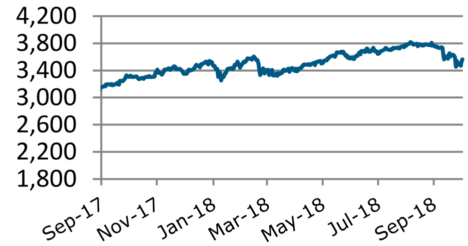
Sector	Month Return	YTD Return	Weight (%)
Energy	-9.18	-12.80	18.60
Communication Services	-2.11	-8.03	5.50
Industrials	-5.86	4.80	10.70
Consumer Staples	-0.80	-5.31	3.60
Utilities	-2.81	-13.58	3.90
Financials	-6.88	-7.21	34.10
Consumer Discretionary	-6.43	-12.25	4.30
Health Care	-17.67	6.32	1.70
Materials	-4.63	-15.08	10.30
Information Technology	-8.13	15.39	4.00
Real Estate	-3.31	2.01	3.20

S&P/TSX Composite - 1Y Return

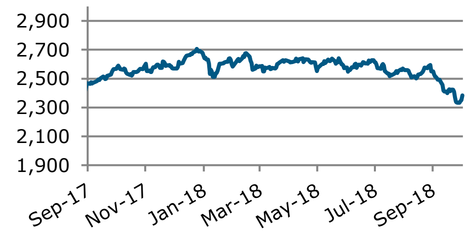


U.S. Markets

S&P 500 - 1Y Return (CAD)



MSCI EAFE – 1Y Return (CAD)



- **U.S. market plummets.** The U.S. had its worst monthly drop this year. All three major indices lost more than 5% for the month. A more hawkish Fed, continuous trade tension between U.S. and China, and disappointing earnings from some of the market heavyweights all contributed to the broad decline. The broad-based S&P 500 moved down 6.9%, ending the month at 2,711. The Dow Jones Industrial Average, the 'best' performer of the month, closed the month down 5.1% to 25,116. Nasdaq was hit the hardest in October, falling 9.2% to close the month at 7,305.
- **Fed staying course.** Despite Donald Trump's recent criticism over its decision on interest rates, the Fed signaled that gradually increasing interest rates is the best course of action for the health of the U.S. economy. "With regard to the outlook for monetary policy beyond this meeting, participants generally anticipated that further gradual increases in the target range for the federal funds rate would most likely be consistent with a sustained economic expansion, strong labor market conditions, and inflation near 2% over the medium term," the minutes of the September meeting read.
- **U.S. Q3 GDP growth better than expected.** The U.S. economy grew faster than expected in Q3, according to the Commerce Department. Q3 GDP was reported to grow at an annualized pace of 3.5%, slightly above consensus estimates of a 3.4% increase. Consumer spending rose a better than expected 4% during the quarter, offsetting the 7.9% decline in business spending.
- **U.S. CPI rises.** Consumer prices rose less than expected in September. The Labor Department reported that the consumer price index (CPI) edged up 0.1% in September, missing the expected increase of 0.2%. On a year-over-year basis, CPI was up 2.3%. Core CPI, which excludes food and energy prices, rose 0.1% on the month and 2.2% on the year.
- **U.S. PPI rises.** Producer prices rebounded in September. The Labor Department reported that the producer price index (PPI) rose 0.2% in September, in line with economists' forecast. It was the first increase in three months. On a year-over-year basis, PPI rose 2.6%.
- **U.S. non-farm payrolls rise less than expected.** The Labor Department reported that the U.S. economy pumped out 134,000 jobs, way short of the estimated figure of 185,000. However, the unemployment rate dropped to 3.7%, its lowest level since 1969 and a tick lower than economists' expectation of 3.8%. Hourly wages rose 2.8% year-over-year, in line with forecasts.
- **U.S. trade gap widens.** The U.S. trade deficit widened for the third straight month in August despite Trump's "American First" policies. The Commerce Department reported that the August trade deficit increased 6.4% to $53.2 billion; economists were expecting a slightly larger deficit of $53.5 billion. Exports fell 0.8% to $209.4 billion while imports rose 0.6% to $262.7 billion. The politically sensitive trade deficit with China gained 4.7% to a record high of $38.6 billion.
- **U.S. factory goods orders gain.** The Commerce Department reported that factory goods orders jumped 2.3% in August, the largest increase since September 2017. It was a nice rebound from a 0.5% decline reported in July. Economists were expecting a 2.1% increase. On a year-over-year basis, orders were up 8.6% in August.
- **U.S. 'flash' composite PMI advances.** The IHS Markit 'flash' composite purchasing managers' index (PMI) rose from September's reading of 53.4 to 54.8 in October; economists were expecting a reading of 54.1. Manufacturing PMI rose slightly from 55.6 to 55.9, beating forecasts. Services PMI improved from 52.9 to 54.7, also better than expectations.
- **U.S. wholesale inventories rise.** The Commerce Department reported that wholesale inventories rose 1% in August, higher than economists' expected increase of 0.8%. On a year-over-year basis, inventories rose 5.3%.
- **U.S. consumer sentiment slips.** U.S**.** Consumers' confidence faded in October according to a survey by the University of Michigan. The University's consumer sentiment index dropped from September's reading of 100.1 to 98.6 in October; economists were expecting a reading of 99.0.
- **U.S. retail sales rise.** The Commerce Department reported that retail sales moved up 0.1% in September, missing economists' expected increase of 0.6% by a wide margin. The core measure, which excludes automobiles, gasoline, building materials and food services, climbed 0.5%, higher than forecasts of a 0.3% rise. On an annualized basis, retail sales were up 4.7%.
- **US Housing News**
  - **U.S. home prices rise**. According to the S&P Corelogic Case-Shiller home price index (HPI), prices continued to rise in August, but at a slower pace. The 20-city index rose 5.5% on a year-over-year basis, down from the previous month's pace of 5.9%. Economists were expecting home prices in the 20 cities to rise 6%. Las Vegas, San Francisco and Seattle saw the biggest annual gains among the 20-city index.
  - **U.S. new home sales fall.** New home sales dropped to a two-year low in September. The Commerce Department reported that new home sales declined 5.5% to a seasonally adjusted annual pace of 553,000 units; it was the fourth straight month of decline and was the lowest level since December 2016. Economists were expecting an annual pace of 625,000 units.
  - **U.S. pending home sales increase**. The National Association of Realtors reported that pending home sales rose 0.5% in September, better than economists' expectation of no change. On a year-over-year basis, sales declined by 1%.
  - **U.S. housing starts drop.** Homebuilding fell more than expected in September. The Commerce Department reported that housing starts declined 5.3% in September to a seasonally adjusted annual pace of 1.20M units; economists were expecting an annual pace of 1.22M units. Building permits also fell, down 0.6% to an annual pace of 1.24M.
  - **U.S. existing home sales drop.** Existing home sales fell to its lowest level since 2015. The National Association of Realtors reported that sales fell 3.4% in September to a seasonally adjusted annual rate of 5.15M units; economists were expecting an annual pace of 5.3M units. It was the sixth straight month of decline.

European Markets

- **ECB stays its course.** Even though a global trade war could potentially derail growth in the Euro-zone, policymakers determined that the threat was not sufficient enough to backtrack on policy normalization; Minutes of the ECB's September meeting revealed that the central bank kept its monetary policy unchanged. The ECB was set to wrap up its massive bond purchase program by the end of this year and raise interest rates next Fall.
- **Euro-zone GDP growth slows**. The preliminary estimate of the Euro-zone's Q3 GDP growth indicated a slowdown in the 19-member economy. Eurostat reported that the Euro-zone economy grew 0.2% in Q3 from the previous quarter, missing economists' estimate of a 0.4% expansion. This quarterly performance was the worst since Q2 of 2014. On a year over-year basis, GDP grew 1.7% in Q3, down from the previous quarter's 2.2% increase.
- **Euro-zone unemployment remains low**. The unemployment rate within the Euro-zone remained at a decade low in September. Eurostat reported that the unemployment rate stayed flat at 8.1% in September, matching economists' forecast. It was at its lowest level since November 2008. Czech Republic and Germany had the lowest rates while Greece and Spain had the highest.
- **Euro-zone inflation at 6-year high**. Euro-zone's inflation rose to a 6-year high thanks to spiking energy prices. Eurostat reported that the preliminary estimate of the harmonised index of consumer prices (HICP) rose 2.2% in October, up from September pace of 2.1%; economists were expecting an annual rise of 2.3%. A 10% rise in energy prices was the main driver of the October increase.
- **Euro-zone 'flash' composite PMI drops.** Business activity within the euro-zone slowed down in October according to the 'flash' composite PMI. October's IHS Markit 'flash' composite purchasing managers index (PMI) fell from September's reading of 54.1 to 52.7, a 25-month low. Manufacturing PMI dropped from 53.3 to 52.1 while the services PMI declined to 53.3 from 54.7.

Asian Markets

- **Japan's unemployment rate falls.** The Ministry of Internal Affairs reported that Japan's unemployment rate dropped from August's 2.4% to 2.3% in September; economists were expecting the unemployment rate to stay flat at 2.4%.
- **Japan manufacturing PMI grows**. Japan's manufacturing activity grew at its fastest pace since June. October's Nikkei manufacturing purchasing managers' index (PMI) increased from September's reading of 52.5 to 52.9. It was the highest reading since June.
- **Japan composite PMI drops.** The Markit/Nikkei Japan composite purchasing managers' index (PMI) dropped from the August reading of 52.0 to 50.7 in September. Services PMI fell to a two-year low of 50.2, down from August's reading of 51.5. Manufacturing PMI remained unchanged at 52.5.
- **China's Q3 GDP growth slows.** China reported slower than expected growth in Q3. Official data showed that the world's second largest economy grew at a year-over-year pace of 6.5% in Q3, missing economists' expectation of a 6.6% growth. It was also down from the 6.7% in Q2.
- **China's CPI and PPI rise.** Consumer prices rose faster in September while producer prices cooled down. The National Bureau of Statistics reported that the consumer price index (CPI) rose 2.5% on a year-over-year basis, in line with economists' estimate. On the other hand, the producer price index (PPI) slowed from August's annual pace of 4.1% to 3.6%; economists were expecting an annual increase of 3.5%.
- **China's official manufacturing PMI slides**. China's manufacturing sector posted its weakest growth in more than two years amid an ongoing trade dispute with the U.S. The official manufacturing purchasing managers' index (PMI) for October fell from September's reading of 50.8 to 50.2 in October; economists were expecting a smaller drop to 50.6. In a separate report, the Caixin/IHS Markit manufacturing PMI, which has a bias toward small and medium size enterprises, rose slightly to 50.1 from 50.0, beating expectations of a 49.9 reading.

Key Take-Aways

It was time. The recent volatility in the markets did not deter the Bank of Canada (BoC) as it ratcheted a second interest rate hike in a little over three months, sticking to its strategy of gradual easing of the monetary policy it started in 2008. After having aggressively increased rates three-fold in 15 months, the central bank has taken a wait-and-see approach to see how rates are affecting the economy as it nears capacity and on sounder footing. The more upbeat tone of the BoC's statement hinted to markets and investors to anticipate more hikes to come; however, the latest hike puts further rate action on the back-burner for now, allowing the BoC to turn its attention towards dealing with the persistently high household debt of Canadians. Similar to other central banks around the world—the U.S. Federal Reserve, the Bank of England, and perhaps soon the European Central Bank (ECB)—the time was right to ease off the stimulus pedal and begin introducing higher rates to control growth and inflation.

Good bye NAFTA, hello USMCA. On Sunday September 30, U.S. and Canada finally sealed the trade deal between U.S., Canada, and Mexico. The trilateral trade pact will be dubbed the U.S.-Mexico-Canada Agreement (USMCA). While some of the key details are yet to be revealed, here are some of the key changes:

- The agreement includes a provision to review the deal every six years; the mandatory review process can take up to ten years, giving the deal an effective life of up to sixteen years.
- The NAFTA dispute settlement system remains in place.
- Canada will give U.S. limited access to the daily market. U.S. will be able to export the equivalent of 3.6% of Canada's dairy market, compared to the existing level of 1%.
- 75% of a car must be produced by the three members for it to be duty-free, up from the previous 62.5%. Canada will be able to ship 2.6M cars and $32.4B worth of parts to the U.S. without tariffs.
- Canada will give U.S. more access to its agricultural goods market.

As the new agreement cleared some of the uncertainties lingering around for months, it is expected to benefit our economy and equity markets. Also, with this major hurdle removed, the Bank of Canada will have more room to raise interest rates for the remainder of the year, which is likely to give our dollar a boost.