February 6, 2018

Market Drop – Update

Dear clients,

After their initial 5% rise in early 2018, global markets corrected over the past week leaving them down 2% year to date earlier this morning. Canadian stocks have pared a bit worse and are down 5% year to date. Bonds meanwhile are also down around 1.5%. US markets seem to have stabilized today, and in fact are seen rallying at the close (S&P500 up 1.5% and TSX up 0.5%), a positive sign. Nonetheless the real test will be over the next few days and weeks that follow.

The fundamentals have not changes very much with the global economy still on course for a 3.9% GDP increase and corporate earnings further expanding. To a certain extent the worry and even anticipation of a market correction did render this market vulnerable to just about any catalysts. The one that seemed to trigger the drop was an increase in US wage growth, a harbinger for higher inflation then expectations. This caused a readjustment of bond market yields with the 10 year US treasury going up 30 basis points to 2.80% and 10 year Canada Bonds up to 2.35%; All enough to cause above normal selling and trigger a mini-sell off reaction across all markets. One has to keep in mind that such stock market drop remain very small in contrast to the 182% increase in the Global equity markets (in $Cdn) since the 2008 financial crisis.

From a portfolio strategy perspective, one change we will likely implement in portfolios is to lower exposure to Canadian Equities in favour of diversifying more into other asset classes. Such a change is more of an investment policy adjustment rather than a tactical asset allocation strategy.

The reason for such a reduction in Canadian equities is that this market remains far too underrepresented in many sectors while overly concentrated in others. Overall it means these investments are not truly representative of one's living conditions and change in cost of living. Furthermore this market is likely to remain an underperformer. The high exposure within the TSX Index to the energy sector (20.6% vs only 6.2% for the MSCI World) as global oil supplies continue to remain in a glut due to largely to US shale drilling, combined with a domestic price discount (oil and natural gas) due to the lack of export capacity out of Canada, render this sector's outlook particularly weak. The high TSX index exposure to our financial sector, largely banks, at 34.7% versus 18.0% for the MSCI, is another reason to be cautious just as the overleveraged Canadian consumer faces up to rising interest rates. The uncertainty over NAFTA renegotiations is another major challenge for the Canadian market.

To be cautious, this move will be accomplished over two phases, the first being to shift Canadian Equity investments into cash (Daily Interest) and reinvesting only 50% of the proceeds now and the other 50% a bit later.

Of note and through all of this volatility, the GWL Real Estate Fund has steadfastly advanced and is up 0.5% year to date, reminiscent of Lafontaine’s fable, The Heir and The Turtle (Le lièvre et la tortue).

All the very best,

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