Market Review
First quarter 2017

The stock markets were up in the first quarter as interest rates were fairly stable.

Oil prices fell below $50 a barrel toward the end of the quarter; as a result, the Canadian stock market rose less than the other markets during the period.

The economic indicators have recently strengthened in all the major regions of the world. The U.S. economy is operating at full employment, with an unemployment rate below 5%, and consumer confidence continues to be high. As for Canada, it is approaching full employment, even though most people are not aware of it. Canada has rarely had an unemployment rate of 6.7% in the past 40 years; moreover, it comes at a time when Alberta has barely emerged from a recession.

In Europe, the unemployment rate has started to fall, and the leading economic indicators, such as purchasing managers' intentions, have reached levels not seen in years. China's economy is also strengthening.

We will therefore see a synchronized global economic expansion in 2017, for the first time since 2007-2008.

Performances in Canadian currency

	Q1 2017	1 year	3 years (annualized)	5 years (annualized)
Bonds	1.2%	1.4%	4.0%	3.5%
Canadian equities	2.4%	18.6%	5.8%	7.8%
U.S. equities	4.9%	20.1%	17.4%	20.0%
Europe and Pacific equities	6.1%	14.5%	6.9%	12.1%
Emerging markets equities	10.2%	20.2%	7.7%	6.7%
REITs	3.7%	10.0%	6.6%	6.1%
Canadian/U.S. dollar	0.9%	-2.4%	-6.0%	-5.6%

Source: Bloomberg, March 31, 2017

Oil price

The oil prices began to firm up in the fall of 2016 after OPEC announced production cuts, but it dipped below $50 in March, when oil inventories suddenly increased in the United States. It appears that U.S. producers have developed their techniques to the point that some deposits are now profitable at prices ranging from $50 to $60, and perhaps even below $50. That being said, global inventories continued to fall and the price went back up to $53 early in April.

Oil consumption has not increased in developed countries in recent years but it is still rising in the developing countries, which is sustaining global demand. For example, more cars are now sold in China than in the United States. Global inventories should therefore continue to fall in the months to come, which will support the oil price. Even so, we must not expect prices to exceed $60 to $70, given the costs of producing shale oil in the United States.

Canadian dollar

The oil price is the most important economic variable for the Canadian economy and therefore for the Canadian dollar. It appears that we have reached an equilibrium, with oil prices ranging from $50 to $60 and the loonie at US$0.75. The economy is expanding nicely in most regions, Canada's exports are firming up and the unemployment rate is falling. An excessive increase in the oil price would bring back the imbalances we experienced in 2011-2012, when the Canadian dollar was too high, causing a slowdown in the East and an unsustainable boom in the West.

Inflation

Since 2010, Canada's inflation rate has ranged from a low of 1% in 2013 to a high of 2.5% in 2015. It has been easing over the past year and is currently 1.6%. There appears to be no inflationary pressure in Canada, even though the economy is approaching full employment. This context will prompt the Bank of Canada to begin raising interest rates by year-end.

House prices in Toronto

Not so long ago, speculation took hold in Vancouver's real estate sector. Now it is Toronto's turn: the city's average house price jumped 30% in one year. It looks very much like a speculative bubble.

The situation is dangerous for the Canadian economy for two reasons; First, we must not underestimate the importance of the Greater Toronto Area market, because it represents half of Canada's economy. Second, a slump decrease the residential real estate market usually causes an economic crisis not a simple recession. We need only think of the United States or

Spain in 2008-2009. In fact, Spain has still not recovered from the crisis.

The federal government has already taken steps to slow house sales, such as by restricting mortgage credit, but it must be said that the measures are inadequate.

House prices in general

Over the long term, house prices rise along with the rate of inflation. In Canada, inflationary expectations are about 2% a year, but because house prices have risen a great deal in recent years and the supply of new housing has also increased a great deal (housing starts recently set a record), it is quite possible that prices will rise very little in this sector in the next 10 years.

Most people think mortgage rates as low as 2% or 3% represent an opportunity for home buyers, but that is not the case; interest rates are low precisely because the expected rate of inflation is also low. Moreover, new buyers run the risk that rising interest rates will be accompanied by falling house prices.

U.S. equities

Since the start of the bull market in 2009, the U.S. stock market has outperformed the world's other major stock markets by far. Moreover, the greenback has been very strong in relation to other currencies since 2014. The following table shows the returns on the major stock markets in Canadian currency since March 2009:

United States	300%
Canada	140%
Europe	150%
Japan	170%
Emerging markets	150%

The U.S. economy was the first to recover from the Great Recession, so it is normal that it recorded the best performance, but it has also become the most expensive market. As the stock market cycle becomes more advanced, we have to expect the other stock markets to catch up with the United States.

European equities

European equities were up 20% over the past nine months, because the leading economic indicators reached levels not seen for years. In addition, European equities are far less expensive than U.S. equities: they are trading at a price-earnings ratio of 15 versus 18 for U.S. equities.

That being said, we must pay close attention to the risk that comes with the French election in May. If Marine Le Pen becomes President, we must expect nothing less than a euro crisis, because she wants France to revert to the franc. Other countries, such as Italy, will also want to abandon the euro, and that will cause a great deal of uncertainty in the markets, because there is no precedent for the dismantling of a major currency such as the euro.

DASHBOARD

	31 mars 2016
Canada	
Canadian dollar versus U.S. dollar	+
Corporate bonds	+
Long-term government bonds	=
S&P/TSX 60	+
REITs	+
United States	
U.S. dollar versus euro	=
Long-term Treasury bonds	=
S&P 500	+
NASDAQ	+
Europe	
Euro versus U.S. dollar	=
MSCI Europe	-
Asia	
Yen versus U.S. dollar	=
MSCI Japan	=
Emerging markets	
MSCI Emerging Markets	+

= : neutral   + : overweighted   – : underweighted