Market Review
First Quarter 2018

LANDRY INVESTMENT MANAGEMENT

Performance Table

Source: Bloomberg, March 31, 2018

	Performance in Canadian currency			
	3 months	**1 year**	**3 years (annualized)**	**5 years (annualized)**
Bonds	0.1%	1.4%	1.2%	2.9%
Canadian equities	-4.5%	1.7%	4.1%	6.9%
U.S. equities	2.2%	10.5%	11.4%	18.8%
Euro Pacific equities	1.3%	11.3%	6.1%	11.6%
Emerging markets equities	4.3%	21.0%	9.4%	10.1%
REITs	1.3%	7.4%	5.0%	5.1%
Canadian/U.S. dollar	-2.5%	3.3%	-0.6%	-4.6%

Stock markets were volatile at the beginning in the first quarter of the year, but were down only slightly over the quarter. The MSCI World Index was up in Canadian currency, because the loonie lost 2.5% in the turmoil caused by the NAFTA renegotiations. Bonds were down at the start of the quarter amid concerns about an uptick in inflation, but they later recovered.

Despite the recent fluctuations, we continue to think that the bull market in equities is intact. The economic scenario that we have been putting forward for years remains the same: sustained global economic growth with tamed inflation. Obviously, stocks are far more expensive than they were a few years ago, but their outlook continues to be appealing. We have two scenarios:

1- The U.S. stock market continues to rise with leadership concentrated in technology companies. As it outperforms the other markets, a speculative bubble forms. This scenario ends with a severe correction of 25% or more in 12 to 18 months.
2- The U.S. stock market continues to follow its long-term trend, rising 5% to 8% a year as the other stock markets play catch-up, with increases of 10% to 12% a year. In this scenario, stock markets would keep rising for three more years.

The first scenario is a typical bull market in it's final peaks, whereas the second is similar to the bull markets in the years preceding 1990.

The fraught trade negotiations initiated by the United States are disrupting markets, but we shouldn't necessarily conclude that they will end badly. President Trump's negotiating strategy is completely different from that of his predecessors. He has threatened to impose tariffs on the two countries that have the largest trade surplus with the United States – Mexico and China

– to force them to negotiate. This approach has never been used before, so we don't know whether it will work.

As for Canada, it appears that the negotiations are going well and that NAFTA will essentially be renewed. If so, we can expect the Canadian dollar to rise and the Canadian stock market to recover.

Interest Rates

We expect interest rates to go up by 0.5% in the United States between now and year-end, but that does not necessarily mean long-term rates will increase. It all depends on how inflation behaves in the months to come, and the indicators are not clear. It appears that wage increases are now 2.7%, but it also seems that technological advances are limiting price increases.

In Canada, the increase in short-term rates could be slightly higher if NAFTA is renewed, because the Bank of Canada has been saying for months that the trade talks constitute a major source of uncertainty for the Canadian economy. Once this uncertainty dissipates, short-term rates could be raised, given that the Canadian economy is operating almost at maximum capacity and no longer requires stimulus.

Canadian Dollar

Our forecasting model indicates that, if the NAFTA renegotiations are a success, the Canadian dollar should rise against the U.S. dollar in the months to come. The loonie should appreciate because the price of crude oil has gone up a great deal in recent months, but its strength is still not reflected in the currency. Moreover, the forecasted interest rate hikes by the Bank of Canada will have a favourable impact. The model indicates a potential increase to US$0.89.

REITs

Canadian REITs have performed well in the past year despite higher interest rates. In fact, there is enough of a difference between the current yield of REITs and that of bonds to expect further price stability for these securities, even if interest rates keep rising. Investors were temporarily concerned with the impact of Ecommerce on the value of shopping centres, but there has been no significant impact so far. Obviously, this situation has to be monitored closely.

Preferred Shares

Preferred shares generated an excellent return in 2017 and will probably repeat their performance in 2018, since yields that are still comfortably higher than bond yields. Normally preferred shares trade at a lower yield than bonds because of their tax advantage.

Housing Market

A study comparing the world's main metropolitan housing markets shows that Canada's largest cities, such as Toronto and Vancouver, are among the most expensive in relation to household income, as has been the case for several years. The federal government has taken several steps to restrict mortgage credit somewhat and these measures are starting to have the intended effect: house prices in Canada have fallen slightly in recent months. It is important that this moderating trend continue, because Canadian households are still the most indebted in the world.

Emerging Markets

Emerging market equities have outperformed U.S. equities in the past year. This behaviour is fairly typical because emerging markets usually outperform during the last phase of a bull market. The recent increase represents a catch-up phenomenon, but the valuation ratios are still appealing. According to historical valuation parameters, these markets have the potential to outperform U.S. equities for the next five years.

Global Momentum Asset Allocation Portfolio

Our Global Momentum Asset Allocation Portfolio invests in the asset classes that have performed best over the past 12 months. Eligible asset classes include not only equities and bonds but also REITs, commodities and gold – namely the main asset classes that make up a global portfolio. The momentum approach makes it possible to obtain returns that outperform a global equity portfolio while limiting downside risk to half that of an equity portfolio.

Currently, common shares make up about 60% of the asset allocation portfolio, with an emphasis on the United States and emerging markets. The portfolio holds no Canadian equities. The remainder of the investments are commodities and gold.

Dashboard

March 31, 2018	
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