GESTION DE PORTEFEUILLE LANDRY

Market Review
Fourth quarter of 2018

Performance table in CAD (in %)

	3 months	1 year	3 years (Annualized)	5 years (Annualized)
Bonds	1.8	0.8	1.9	3.5
Canadian equities	-10.1	-8.9	6.4	4.1
U.S. equities	-8.9	4.0	8.7	14.0
Euro Pacific equities	-7.9	-6.2	2.4	5.6
Emerging market equities	-2.6	-7.1	8.7	6.8
REITs	-3.2	6.3	11.2	7.7
Canadian/U.S. dollar	-5.3	-7.8	0.5	-4.9

Source: Bloomberg, December 31, 2018

The stock markets were down in the fourth quarter. For the U.S. market, the decline from the August peak to the year-end low was about 20%. Since 1966, there have been about 20 selloffs of 10% to 20% that have not been followed by a recession and we think the current event is one such temporary decline.

The two main reasons for the uncertainty currently prevailing on the markets are (1) the trade dispute between China and the United States and (2) the fact that short-term interest rates in the United States are gradually rising to the point where they are approaching long-term rates and may even exceed them in 2019, causing a recession in 2020.

There have been five episodes when short-term rates equalled long-term rates, and each time a recession ensued. Five episodes are far from constituting strong statistical evidence, and several of the episodes were characterized by credit restriction, which is not the case today.

As for the trade dispute, it could last several more months, with various ups and downs, as is often the case with President Trump; but at the end of the day there will probably be an agreement, as was the case with NAFTA.

U.S. equities

In the past 50 years, there have been about 20 corrections of more than 10% that have not become bear markets associated with recessions. The average decline was 15%, and they lasted from three to five months on average. The current 20% decline, with a duration of four months, is therefore average.

The U.S. economic indicators suggest that the current expansionary phase will continue along with a moderate rate of inflation, which is favourable for equities.

U.S. interest rates

The U.S. Federal Reserve is the first central bank in the developed countries to raise its interest rates since the financial crisis. The objective is not to restrict credit, but simply to ensure there is not too much liquidity on the markets. We have never experienced such an expansionary monetary policy for such a long time, so we do not know what the appropriate interest rate level in the current conditions is. The Federal Reserve is therefore proceeding cautiously by raising its key rate a quarter of a point each time, so that it can observe its policy's impact on the economy and the markets.

Canadian interest rates

Unlike the Federal Reserve, the Bank of Canada has not raised its key rate recently because the weak oil price is having a deflationary effect on the Canadian economy. As long as that is the case, Canadian interest rates will be lower than U.S. rates.

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Oil price

The oil price has gone from $70 a barrel to less than $50 recently as a result of an increase in global oil inventories. The U.S. sanctions against Iran were intended to cause Iranian output to fall, but President Trump has exempted so many countries from the sanctions that Iranian production has dropped far less than expected. As a result, global oil inventories have ballooned, and prices have fallen. That being said, global oil consumption continues to rise, and production adjustments by Saudi Arabia and Kuwait will enable the market to adjust in the months to come. The price should go back up to more than $60 in 2019.

Preferred shares

The uncertainty prevailing on the stock markets has caused corporate bonds and preferred shares to decline; even so, preferreds have declined far less than corporate bonds. Unless a recession is imminent, there is no reason for this to be the case; preferred shares are therefore currently very appealing, especially those trading at a discount to their redemption value.

REITs

The prices of Canadian and U.S. REITS have held up recently, even though the stock market has declined, and credit spreads have deteriorated. At the moment, REITS are less appealing than preferred shares.

Global Momentum Asset Allocation Portfolio

Our global portfolio invests in the asset classes that have performed best over the past 12 months. We monitor a total of 15 asset classes – not only Canadian, U.S. and emerging market equities but also gold, commodities and bonds.

The portfolio returned -2.2% in 2018. Its performance compares favourably with the -7.6% return for the global equity market. The portfolio currently holds only bonds and REITs.

Dashboard

December 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