Market Commentary Q3 2017

As discussed in our Q2 commentary, the resumption of coordinated global growth, which occurred in early 2017, is creating a steady backdrop for asset markets. After years of being out of step, U.S. and global cycles are now largely synchronized, with both economies moving in a positive direction. At present, most developed economies are in the mid-to-late stages of the business cycle.

Underpinning this steady economic growth is an improvement in export-oriented sectors and manufacturing activity. Nearly 90% of countries are reporting higher new exports orders, and global trade growth has risen to its highest level since 2011.

Canadian outlook

Canadian equities have been largely rangebound in 2017. A solid improvement in oil fundamentals is perhaps the key factor that could support a new round of valuation increases.

The Canadian economy was blistering hot in the first half of the year — highlighted by Q2's eye-popping 4.5% expansion. In Q3, the economy appeared to pause and catch its breath. Nonetheless, Canadian GDP growth for 2017 is set to come in at about 3.0%, the best performance in six years.

Canadian consumers deserve much of the credit for the recent economic growth. Healthy job-market gains across much of the country and modest wage increases have improved consumer confidence, leading to a rise in household spending.

Headwinds to watch for include continued low oil prices and high-and-rising household debt levels. The slowdown in Ontario housing activity, resulting from implementation of the provincial government's Fair Housing Plan, and the rise in value of the Canadian dollar, coming on the heels of two Bank of Canada interest rate hikes, are additional factors that could weigh on domestic economic growth.

U.S. markets

At the close of the third quarter, the S&P 500 Index was up 12.53% year to date. Sector performance in Q3 was varied, but mostly positive.

Despite Washington's lack of progress on key policy goals like an infrastructure spending bill and tax reform, it's safe to say — until proven otherwise — that the "Trump effect" continues to help lift U.S. equites. A more obvious positive influence on stock prices is the ongoing expansion of the global economy. Many U.S. multinationals are seeing an increase in revenues from their overseas business units, resulting in earnings that are beating investor expectations.

U.S. markets (cont.)

Eventually, all bull markets run out of steam. U.S. equities have been climbing steadily going on nine years. As measured by the S&P 500 in September 2017, prices are now trading at 30 times cyclically adjusted earnings. That's the highest ever, except for 1929 and the late 1990s.

Indeed, the value of U.S. equities could keep grinding higher, but the upside potential would appear to be narrowing, and the drawdown potential could be significant.

Global monetary policy

Following the 2008 financial crisis, central banks worldwide implemented expansionary monetary policies to increase the money supply and, thereby, stimulate economic growth. With the crisis largely tamed, central banks are now reversing course.

The U.S. Federal Reserve announced recently it will start reducing its $4.5 trillion balance sheet in October, and the FED is also on a gradual path of raising interest rates. Similarly, the European Central Bank has indicated, though not yet confirmed, that its asset purchase program will begin tapering off in 2018. And the Bank of England has hinted at an interest rate hike in November. Only the Bank of Japan remains committed to ultra-expansionary monetary policy.

The implication of this new trend by central banks is that global liquidity is poised to tighten and the period of declining long-term interest rates is over.

Some economists and market analysts argue that monetary policy favouring greater liquidity leads to artificially inflated asset prices. If they're correct, the move by central banks to normalize interest rates can be viewed as a risk factor for stocks.

The process of normalizing interest rates will be slow, but it's clearly underway — and could have an influence on the markets for many months to come.

Getting Advice

Are you looking for additional perspective on the financial markets and how it might affect your portfolio? We encourage you to talk to us.

Speak to your Financial Advisor or contact investor services at 1 800 608 7707.