Words speak louder than actions

Kicked off by the annual Canada Day celebrations across our nation, the markets continued their climb during July, posting another positive month of returns. In Canada, the S&P/TSX was up a quiet 0.15% while the U.S. market rose 1.31% in the month. Reaching a new all-time high (again), during the month of July the S&P 500 surpassed the 3,000 mark for the first time in history. While the U.S. market continued its rise, investors had to wait until the final day of the July for the main event—the U.S. Federal Reserve (the Fed) monetary policy announcement. For the first time since the financial crisis in 2008, the Fed cut interest rates by 0.25%.

Before we dive into the reaction of the market, we want to consider the reasoning behind the Fed's action to cut rates. As we recall above, the last time the Fed lowered interest rates we were in the midst of a serious market downturn—a period so bad it became coined the 'Great Recession'. As we watch the U.S. market reach all-time highs and the unemployment rate reach all-time lows, why are seeing an interest rate cut now? The quick answer: prevention.

This time around, the Fed is trying to stay one-step ahead using the rate reduction as an insurance measure to attempt to keep the economy on track in the face of global economic uncertainty. In Fed speak, one reason for the move came "in light of the implications of global developments for the economic outlook." In other words, the Fed is pointing to a concern most investors are getting all too familiar with, the trade war. While July saw renewed talks between the U.S. and China, we believe the trade war is far from a resolution and expect its impact on economies worldwide to be increasingly felt as the disputes drag on. Although the Fed is encouraged by low inflation along with a continued healthy economic outlook, slowing global growth as a result of these continued trade tensions remains a vital issue, giving the Fed enough concern to lower interest rates by 25 basis points, for now.

With every action there is an equal and opposite reaction. As discussed in the second quarter market commentary, the market had assigned a 100% probability of a rate cut at the July 31st meeting. What the market expected was the Fed's action, but what came as a surprise was the Fed's words. When the Fed's Chairman, Jerome Powell, took to the podium, he described the cut as a "mid-cycle adjustment" and "not the beginning of a long series of rate cuts." The market sold off on his words as Powell attempted to define the rate path ahead. While he later clarified, the Fed likely is not 'one-and-done' in terms of further cuts, the market's volatility made its opinion clear; the want for confirmation of further rate cuts to come. While the old saying goes, actions speak louder than words, we are not so sure investors agree.

Meanwhile, North of the border, we have seen surprising strength from the Canadian economy. In July, the Bank of Canada increased its forecast for second quarter GDP growth significantly from 1.3% to 2.3%. Additionally, the 2019 estimate for annual GDP growth was lifted from 1.2% to 1.3%. While these increases may be tempered due to trade tensions, the positive increases prove a strength to the Canadian economy through times of international turmoil. Further bolstering the Canadian

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economy is a record-low unemployment rate and additional stabilization of the housing market. Due to these several factors, as of the end of July, the market does not foresee the Bank of Canada cutting interest rates in the footsteps of the Fed. While there is a lot to be positive about for the Canadian economy, not all news is good news. Manufacturing weakness has increased as of late while the debt-servicing burden for Canadians is at a historical high.

Internationally, the U.K. has a new Prime Minister, Boris Johnson—a well-known hard-Brexit supporter. With Johnson in power as we near the extended Brexit deadline of October 31st, the odds of a 'no-deal Brexit' continue to climb as it looks like we may be in for a spooky Halloween. Also taking place across the pond during the month of July, the European Central Bank (ECB) signalled more easing measures and said it expects its key interest rates to "remain at their present levels or lower at least through the first half of 2020" thanks to continued global uncertainty tied to trade tensions. As the trade war continues to weigh on the global economy we believe growth will continue to slow and the overall risks of recession remain elevated.

As we have reiterated over the past few months, we continue to be more cautious in the portfolio and have taken certain opportunities to become more defensive. Our overall asset mix remains slightly underweight equities due to the unrelenting global risks. While our tactical asset allocation decisions are continually monitored, our fundamental investment process never wavers, focusing on companies that have a proven history of navigating the market cycle. We have said it before and we will say it again and again, rooted within our investment process, our philosophy as investment managers remains consistent – be disciplined and stay the course.

This monthly commentary is produced by our in-house research team. If you are interested in learning more about our investment solutions please contact us at info@cwbwealth.com or 1.855.292.9655. You can also visit our website: cwbwealth.com.

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