Slowing but growing (still)

Summer has officially arrived and this year's second quarter proved to be an eventful one. While the ride had its fair share of ups and downs, this quarter saw new all-time highs set in both the U.S. and in Canadian equity markets. As geopolitical tensions flared up and tempered down during May and June, when all was said and done, the S&P 500 posted a gain of 3.8% during the quarter while the S&P/TSX returned 1.7%. Continuing to dominate headlines during the quarter, to no one's surprise, was the U.S.-China trade war which stoked fears of slower global growth leading to lower bond yields as comments from the U.S. Federal Reserve seemed to indicate lower interest rates on the horizon.

After a collapse in trade negotiations in early May, investors remained focused on U.S. President Trump and Chinese President Xi's next possible meeting date – the G-20 summit in Osaka, Japan scheduled for late June. In a meeting on the sidelines of the G-20 summit, Trump and Xi agreed to resume trade talks and struck a trade truce. This truce includes three major elements: 1) the U.S. will postpone the impending tariffs on another $300 billion of Chinese goods, 2) the U.S. will lift some restrictions on exports to Chinese Telecom giant Huawei, and 3) China will buy more U.S. agricultural products. Another key element of note is that none of these three agreements have a deadline. While this truce is a step in the right direction, our belief is that neither side is prepared to make any further concessions to solidify a deal and the lack of a deadline further reduces any urgency. Although new tariffs likely won't be imposed for now, it is also less likely any tariffs will be removed or lowered. This new status quo, albeit more acceptable, may stay in place for the long haul and long term effects will likely be felt.

As mentioned above, in addition to the seemingly unending geopolitical drama, a main theme continuing into the second quarter is slowing global growth. We believe the tariff tantrum in the U.S., although in an improved position as of the end of Q2, is going to have an effect on economic growth globally. A slowing economy will lead to lower earnings for corporations. Despite the turbulence in the past three months, we feel estimates for corporate earnings remain too high, heightening the risk for a market correction in the upcoming months. With this in mind, we made the decision in early June to make a small shift out of equities. While we maintain our stance that we do not yet see a recession on the horizon, we believe the risks have risen. While we felt this tactical asset mix shift was a good opportunity to take some risk off the table and look to add value to our client portfolios, we reiterate that it's important to stick to your long-term plan and stay the course.

Commodities / Currency Performance					
	Q2-19	QoQ	YTD	YoY	2018
WTI Oil (USD/bbl)	58.47	-2.8%	28.8%	-21.1%	-24.8%
Gold spot (USD/oz)	1,409.55	9.1%	9.9%	12.5%	-1.6%
Copper (USD/lb)	2.71	-7.9%	2.8%	-8.3%	-20.3%
USD / CAD	0.7637	1.9%	4.2%	0.3%	-7.8%

Fixed Income

Both the U.S. Federal Reserve (the Fed) and the Bank of Canada (BoC) left interest rates unchanged during the second quarter with the Fed presenting a more dovish tone. Both central banks have continued to note that their respective economies are doing reasonably well, and are still emphasizing that any interest rate moves will be data dependent. The Fed's Chairman Jerome Powell has continued to take any opportunity possible to assert the central bank's independence from short-term political pressures (cough, Trump) when setting the U.S. monetary policy.

On the other hand, market participants in the U.S. are no longer questioning if the Fed will cut rates this year, but rather how many times? The market's interest rate expectations have done a 180-degree turn since the end of 2018 and are now expecting up to four rate cuts during the remainder of the year. Currently, the market is assigning virtually a 100% chance of a rate cut at the July 31st policy meeting.

In Canada, surprisingly the market is not currently holding the same conviction when it comes to interest rate expectations. While the BoC normally follows in the Fed's footsteps, the market is not convinced this time around. Currently, the market in Canada is showing an almost 70% probability of no rate cut this year.

CWB WEALTH MANAGEMENT

The U.S. yield curve inverted briefly for the second time this year in mid-May and then again near the end of May, where it remains as of this writing. As you may recall from previous commentary, this means the 10-year Treasury yield fell below the 3-month Treasury yield. Yield curve inversions are generally seen as a recession indicator by market forecasters but can often take place many months before a recession comes to fruition. In rare cases, the yield curve inversion has also indicated a false positive with no recession materializing after all. As stated previously, we do not see a recession in the immediate future, but we will continue to keep a constant eye on the state of the yield curve as its status is key in our asset allocation decision making process.

We expect geopolitical movements to cause increased volatility in future interest rates. Further, we feel that yields have moved excessively to the downside, and so continue to hold a somewhat shorter duration. Increased global tensions, and increased risks to global growth could lead to a flight to safety pushing North American yields down (especially U.S. Treasuries). Conversely, economic resilience (as evidenced by the equity market) suggests that North American yields could also move up in response to continued issuance by governments and corporations.

We continue to like non-sovereign bonds as we feel they give us fair compensation for the additional risk.

Rates are itemized in the following charts:

Canada	Q2-19	QoQ	YTD	YoY
3 mo. T-Bill	1.66%	-1	+1	+40
2 yr. Bond	1.47%	-7	-39	-44
10 yr. Bond	1.47%	-15	-50	-70

U.S.A.	Q2-19	QoQ	YTD	YoY
3 mo. T-Bill	2.09%	-29	-27	+17
2 yr. Bond	1.75%	-51	-73	-77
10 yr. Bond	2.01%	-40	-68	-86

Equities

After markets soared during this year's first quarter, U.S. and Canadian markets posted more muted low-single digit returns through the end of the second quarter. While Q2 returns may have been more modest, the S&P 500 was still able to climb to its best first half of the year since 1997, up over 17.3% year-to-date. In Canada, the S&P/TSX is boasting an almost equally impressive 14.4% return year-to-date. These strong returns have turned most markets positive on a one year basis and have more than made up for the downturn in Q4-18.

Stock Indices Performance

Country/Region	Index	Q2-19	QoQ	YoY	2018
U.S.	S&P 500	2,941.76	3.8%	8.2%	-6.2%
	S&P 500 (in $C)	3,851.65	1.7%	7.8%	2.0%
Canada	S&P TSX Composite	16,382.20	1.7%	0.6%	-11.6%
Eurozone	Euro Stoxx 50	3,473.69	3.6%	2.3%	-14.3%
Japan	Nikkei 225	21,275.92	0.3%	-4.6%	-12.1%
China	Shanghai Composite	2,978.88	-3.6%	4.6%	-24.6%

*returns based on price performance ex dividends

Canada: The Canadian market was up over 1.7% in Q2, driven mainly by a strong quarter from the Information Technology sector, up over 14.2%. The Information Technology sector is also the leading sector year-to-date (up 43%) mainly due to strength from Shopify. Shopify is a cloud based e-commerce platform for merchants and while we like the company's business model, we do not like the valuation. The company is worth $47B but is forecasted to generate less than $2B in revenue in 2020 and under $200M in earnings. On the other hand, following its reign as the best performing sector in Q1 due to a sharp increase in cannabis stocks, the Healthcare sector had a skunky Q2 (pun intended), down 9.4%. Despite a mixed performance from the Canadian market sectors during the second quarter, all major sectors of the S&P/TSX remain in positive territory through the midway point of the year.

In Canada, while GDP growth is experiencing a soft patch as of late, this slowing growth has not been reflected in the labor market. The Canadian unemployment rate is at a 45-year low and wage growth has continued to accelerate. While the Canadian economy's growth may be slowing, the Canadian dollar has been benefitting from the interest rate cut expectations south of the border. Following a surge in June, the Canadian dollar is the best performing major currency so far this year courtesy of the central bank's dovish turn along with a resurgence in oil prices and healthy inflation.

U.S.: In the U.S., after a tough sell-off during the month of May, the S&P 500 rebounded strongly in June, and returned 3.8% for the second quarter. All major S&P 500 sectors posted a positive performance during the quarter with the only exception being Energy, down 3.7%. The best performing sectors were Financials and Materials, up over 7.4% and 5.7% respectively. Year-to-date, all major sectors that make up the S&P 500 have posted solid positive returns.

As we discussed, thanks to a trade truce agreed upon at the G-20 summit near the end of the quarter, the U.S. and China avoided a major escalation in the trade war, for now. While the situation may have eased, business confidence in the U.S. has been decreasing as of late. Trade war residual effects have continued to weigh on businesses and in turn has delayed spending and slowed hiring. Despite the less-than-stellar economic data, the market has continued to stay focused on accommodative monetary policy and hopeful trade news, pushing the S&P 500 near all-time highs. While a rising market is certainly encouraging, we believe the market is not paying enough attention to earnings – a key metric for any corporation and a factor that should be driving stock prices. Earnings estimates for the second half of 2019 remain at elevated levels considering the slowing global growth and lingering geopolitical tensions. The market has yet to reflect this downward pressure on earnings.

International: International markets posted mixed returns during the second quarter. Of the major global equity markets, the Shanghai Composite (China) was the weakest performer, falling over 3.6%. Outperforming most global markets during the second quarter was the DAX (Germany), boasting an almost 7.6% gain. While concerns remain surrounding weakening economic growth across the globe, we have seen some relieved tensions regarding trade protectionism, lower expectations for a hard Brexit and a continued dovish tilt by central banks around the world.

We are still of the belief that company fundamentals are strong for the most part, but we must remain aware that we are closer to the end of this economic cycle than the beginning. While we continue to believe that a recession is not imminent, our tactical asset mix shift slightly out of equities has positioned your portfolio in a more defensive stance. As risks to the market increase, we are maintaining our focus on high quality companies with strong balance sheets and stable earnings and cash flows.

This is a portion of a quarterly client report produced by CWB Wealth Management's in-house research team where we discuss our market overview and actions taken in our portfolio. An example of this is us de-risking our portfolios from the US/China trade war by trimming Best Buy and Target. If you'd like more insights into how our investment solutions can benefit you, please contact us at 1.855.292.9655 or info@cwbwealth.com. You can also find more information on our website: cwbwealth.com

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