A bag of mixed signals

As the leaves slowly begin to change colors and the kids are back to school, we turn the page on summer and close the books on this year's third quarter. In the U.S., the S&P 500 closed the quarter up 1.2%, while in Canada, the S&P/TSX posted a 1.7% return. Although many of us may have taken a summer holiday during the past three months, the markets had no time off from their continued turbulent journey. While July began with hopes of renewed trade talks, recession fears crept into the minds of investors as the weeks continued and geopolitical tensions began to mount throughout the quarter. The U.S. Federal Reserve cut interest rates for the first time since the financial crisis near the end of July, and cut them for a second time in September. While we fear sounding like a broken record – we believe the economy is still growing, but slowing, and not without some intensified volatility and a bag of mixed signals.

First, the good news. There is a lot to like about the current state of the U.S. economy, which, as we know, is the straw that mixes Canada's drink. The U.S. job market has remained robust with unemployment at near all-time lows. The housing market has been riding on the coat tails of lower interest rates, allowing for an uptick in affordability and stimulating new home sales and housing starts. Further, inflation has remained muted. Where things get a bit more mixed is the U.S. consumer.

This brings us to the not-so-good news. While the U.S. consumer has been resilient throughout the past few months and is doing relatively well, this main engine, which helps drive the U.S. economy, may be starting to show weakness. Consumer spending has started to slow and U.S. consumer confidence has come down as of late, due in large part to the seemingly never-ending talks of tariffs and possible recession. The trade war is a constant topic of contention across the globe with its progress and setbacks riding up and down like a seesaw. Talks have renewed and stalled on multiple occasions, tariffs have been threatened and imposed, and most recently, the White House advised they are considering limiting U.S. investor's portfolio flows into China and delisting Chinese companies from U.S. stock exchanges. As the U.S. and China are set to begin negotiations, again, on October 10th, the uncertainty surrounding the trade war remains unmistakably high and this sentiment is spilling over to the consumer. While talks may be better than no talks, we aren't holding our breath. Adding fuel to the already volatile markets is even more political drama – an impeachment inquiry surrounding President Trump and a messy potential Brexit divorce with new U.K. Prime Minister Boris Johnson at the helm.

As a result of the relentless geopolitical drama around the globe, we carry the same main theme into this year's final quarter – slowing global growth. While we maintain our stance that we do not yet see a recession on the horizon, we believe the risks are continuing to escalate. While it may feel uncomfortable at times, we echo that it's imperative to stick to your long-term plan and reach out to your Portfolio Manager with any inquiries.

Commodities / Currency Performance

	Q3-19	QoQ	YTD	YoY	2018
WTI Oil (USD/bbl)	54.07	-7.5%	19.1%	-26.2%	-24.8%
Gold spot (USD/oz)	1,472.38	4.5%	14.8%	23.5%	-1.6%
Copper (USD/lb)	2.58	-4.7%	-2.0%	-8.1%	-20.3%
USD / CAD	0.7553	-1.1%	3.0%	-2.5%	-7.8%

Fixed Income

During the third quarter, the U.S. Federal Reserve (the Fed) cut interest rates at both their July and September meetings by a total of 0.5%, while the Bank of Canada (BoC) left interest rates unchanged. At the September meeting, the Fed confirmed its belief that the U.S. economy remains strong but suggested it was prepared to move further if the economy showed signs of weakening. Therefore, further interest rate cuts this year will hinge on the ongoing global turmoil, with the market currently expecting up to two more cuts in 2019. Although the BoC has historically moved in-line with the Fed, the market does not expect any rate cuts in Canada this year.

CWB WEALTH MANAGEMENT

Over the past three months, bond investors have been on a wild ride as the volatility of bond yields hit multi-year highs. To provide context, the bond market has not been this volatile since 2016 when Donald Trump was elected President and the United Kingdom voted to leave the European Union (EU). Uncertainty remains rampant as investors worry about the state of the global economy, lingering geopolitical risks and even the impeachment process. As long as these issues remain outstanding, we believe yields will continue on this volatile path.

The U.S. yield curve also made headlines during Q3. While we have discussed the inverted yield curve numerous times since the 10-year Treasury yield fell below the 3-month Treasury yield earlier this year, the 10-year Treasury yield also fell below the 2-year yield. While only lasting for one day, this inversion of the 10-year and the 2-year had not happened for over a decade and sparked further fears of a recession. While the yield curve inversion is well-known as a recession indicator, it often takes around 9 to 18 months before a recession actually comes to life – if it does. We feel it is also important to note the distorting effect that years of quantitative easing are having on the shape of the yield curve. We reiterate that while we do not see a recession on the horizon, we will continue to monitor the state of the yield curve as it is a key consideration in our asset allocation decision-making process.

Also making headlines, the 30-year U.S. Treasury yield dipped below the 2% threshold for the first time in history. While we have discussed the volatility of yields in Q3, we also feel that yields have moved excessively to the downside, and so continue to hold a somewhat shorter duration. Additionally, 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	Q3-19	QoQ	YTD	YoY
3 mo. T-Bill	1.66%	-0	+0	+7
2 yr. Bond	1.58%	+11	-28	-63
10 yr. Bond	1.36%	-11	-61	-107

U.S.A.	Q3-19	QoQ	YTD	YoY
3 mo. T-Bill	1.81%	-28	-55	-39
2 yr. Bond	1.62%	-13	-87	-120
10 yr. Bond	1.66%	-34	-102	-140

Equities

After the S&P 500 posted its best first half of the year in over two decades, this year's third quarter followed suit pushing the U.S. market up another 1.2% and carrying the year-to-date return to over 18.7%. In Canada, the S&P/TSX was up 1.7% in Q3, bringing the year-to-date return to an impressive 16.3%.

Stock Indices Performance					
Country/Region	Index	Q3-19	QoQ	YoY	2018
U.S.	S&P 500	2,976.74	1.2%	2.2%	-6.2%
	S&P 500 (in $C)	3,941.50	2.3%	4.5%	2.0%
Canada	S&P TSX Composite	16,658.63	1.7%	3.6%	-11.6%
Eurozone	Euro Stoxx 50	3,569.45	2.8%	5.0%	-14.3%
Japan	Nikkei 225	21,755.84	2.3%	-9.8%	-12.1%
China	Shanghai Composite	2,905.19	-2.5%	3.0%	-24.6%

*returns based on price performance ex dividends

Canada: As more defensive sectors excelled throughout the turbulent third quarter, the Utilities and Real Estate sectors were up 9.0% and 7.4% respectively, leading the Canadian market to a positive quarterly return. On the other hand, for the second consecutive quarter, the Healthcare sector took a dramatic dive, down 30.1% in Q3 due largely to a selloff in cannabis stocks as an outcome of missed results and investors seemingly becoming more risk-averse. We maintain our stance that Canadian cannabis companies are not investible at the current market valuations and will continue our intentional avoidance of this sub-sector.

While global growth may be beginning to slow, the Canadian economy continues to show its resilience as of late. Canadian consumer confidence has remained high amid the escalating trade pressures. Further, the Canadian housing market has begun to stabilize and unemployment remains at historical lows.

Sweeping to news across the globe, the price of oil got an unexpected boost in mid-September due to a drone attack on Saudi Arabia's oil facilities, knocking out almost half of Saudi Arabia's oil capacity (equaling 5% of the world's oil supply). While oil prices sky-rocketed, leading to the largest single-day surge in oil's history, this gain was short-lived as the majority of the oil production was restored within days. After news of restored production levels were released, oil prices and energy equities gave back almost the entirety of their gains. The market's immediate and aggressive reaction to this disruption and possible decrease in supply highlights the fragile reality we face in today's oil markets. As we believe uncertainty still looms, we used this opportunity to trim some of our energy positions, further positioning our Canadian portfolio in a more defensive stance as geopolitical risks continue to linger.

U.S.: Similar to Canada, the defensive sectors, which tend to perform better during more tumultuous economic times, led the way during the third quarter. The Utilities sector was up 8.4% in Q3 while Real Estate, up 6.9%, and Consumer Staples, returning 5.4%, did not follow far behind. Posting the weakest three-month performance was the Energy sector, down 7.3%. Despite mixed performances in Q3, all the major S&P 500 sectors have positive returns as of this year's three-quarter mark.

To no one's surprise, the trade war remains a key issue in the global landscape and, while talks may be resuming shortly, we do not expect it to be resolved anytime soon. As we discussed, this uncertainty has started to show its effects on not only the U.S. consumer, but also on business confidence which dipped to its lowest level in a decade.

Adding another narrative to the U.S. market newsreel is the impeachment issue. While this inquiry into U.S. President Donald Trump may cause enough noise to result in some short-term movement, the stock market has so far shrugged off the drama. While the impeachment inquiry introduces a new layer of uncertainty in the U.S., the market is more concerned with long-term fundamentals including trade and the Fed's monetary policy, for now.

International: International markets posted mixed returns during this year's third quarter. Of the major global equity markets, the Hang Seng (Hong Kong) was the weakest performer, falling 8.6% as political protests continue to rage on. Outperforming most global markets during the third quarter was the Bovespa (Brazil), boasting a gain of over 3.7%.

The U.K. has been through their own fair share of ups and downs centering around the Brexit saga. In July, Boris Johnson was elected the new U.K. Prime Minister – a well-known hard-Brexit supporter vowing to get the divorce deal done. While the October 31st deadline continues to loom, Prime Minister Johnson is preparing to make his final Brexit offer to the EU. Time will tell if an agreement can be reached, the U.K. crashes out in a no-deal scenario on Halloween, or an extension is requested, allowing the slow, painful demise of Brexit to continue on.

Despite the global economic commotion surrounding the U.S./China trade war, the impeachment inquiry, Brexit's unending spectacle, and bond market volatility, the U.S. and Canadian markets both posted their third consecutive quarterly gains. Both at home in Canada, and South of the border, GDP continues its gradual climb – both economies growing, but slowing. While we continue to believe that a recession is not imminent, we do see the risks rising. Our tactical asset mix shift slightly out of equities remains in place and has positioned the portfolio in a more defensive stance. As risks in the international market increase, we maintain our focus on high quality companies with strong balance sheets with low leverage and stable earnings and cash flows.

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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