Selective Progress Amid Trade Tensions

By Ian M. Riach

Trade news dominated headlines during the second quarter, with the focus reaching far beyond NAFTA talks. Following through with earlier threats aimed at major US trading partners, President Donald Trump implemented steel and aluminum tariffs. Canada, Mexico, the eurozone and China responded with retaliatory tariffs on an array of US products, igniting fears of a broad trade war. Despite uncertainty prompted by US trade policies, developed world equity markets managed to post gains, with Canada leading the way.

Looking at the S&P/TSX Composite Index, equity market returns were broadly based, with Utilities the only declining sector. Strong performance in the Energy and Health Care sectors, both up over 14% for the period, fuelled overall gains.[1] Higher crude prices benefited oil producers, but the two major pipeline companies also participated in the rally. Valeant Pharmaceuticals' stock price, which rose approximately 50% in the quarter, was the main driver of Health Care sector returns.[2] Gains in other sectors were more widespread.

The US equity market was much more volatile and returns were more narrowly focused, with Consumer Staples, Industrials, Financial Services and Telecommunications all posting declines. Like Canada, the Energy sector was a key driver of US equity gains. The Consumer Discretionary sector followed, led by gains from Amazon and Netflix, two of the so-called "FAANG stocks." Other members of this group, Facebook, Apple and Google, bolstered returns in the Information Technology sector. This positive performance was offset somewhat by weakness in the Financial Services sector, particularly those firms with large wealth management operations who are facing new proposed disclosure regulations that could pressure profit margins.

In the Europe/Australasia/Far East (EAFE) area, Energy was the top-performing sector once again with large multinational integrated companies achieving the greatest gains. Pharmaceutical and biotechnology companies also contributed to outsized gains while six other sectors provided positive, but more muted returns, and three sectors declined. Based on combined results, the EAFE area was the poorest performing developed world equity market.

Emerging markets didn't fare well as global trade issues hit these export-driven areas hard. In addition, the strengthening US dollar meant hard currency debt obligations increased in value, giving investors concerns regarding repayment.

Turning to the bond market, Canadian yields were volatile. At the start of the quarter, yields began rising as growth prospects were favourable and higher inflation expectations began to materialize. However, as trade rhetoric heightened, the trend reversed and 10-year Government of Canada bond yields fell from almost 2.5% in mid-May to around 2.0% at June's end.[3] The decline in yields and corresponding increase in bond prices led to the bond market's overall gains. The yield curve in Canada remains quite flat, reflecting muted expectations for economic growth.

Market Performance (%)	Q2 2018	1-Year
S&P/TSX Composite Index	6.8%	10.4%
S&P 500 Index (CDN$)	5.4%	15.7%
MSCI EAFE Index (CDN$)	1.0%	8.6%
FTSE TMX Canada Universe Bond Index	0.5%	0.8%
CDN$ Versus US$	-1.8%	-1.3%

The above Index reviews are calculated from external sources and, where applicable, reflect total returns. All figures are in Canadian dollars and are as of June 30, 2018.

1. As of June 29, 2018; Source Bloomberg Finance L.P.
2. As of June 29, 2018; Source Bloomberg Finance L.P.
3. As of June 29, 2018; Source Bloomberg Finance L.P.