Equity Markets Bounce Back in First Quarter

By Ian M. Riach

Investor sentiment did an abrupt about-face from the latter part of last year, causing a sharp rebound in global equity markets in the first quarter of 2019. Major developed markets rose 12% to 14% in local currency terms, nearing last fall's peaks.[1] Investors appeared to change their view that a US recession was in store for 2019, pushing expectations out to later in 2020. These views seemed to be backed by central bank attitudes, which became more dovish and resulted in a hold on further rate increases. A low and steady interest rate environment is supportive of higher equity prices.

Bond prices also rallied, causing the 10-year Government of Canada bond yield to fall from a high of over 2% to approximately 1.5% at the end of March. The decline brought yields to levels earned on much shorter-dated money market instruments, resulting in a very flat yield curve. In fact, the yield curve inverted slightly during the quarter, with three-month treasury bills providing higher yields than 10-year bonds in both Canada and the United States. In previous market cycles, an inverted yield curve has sometimes foreshadowed the onset of a recession. While there is some debate among market watchers that "this time is different," at the very least, the bond market is signalling that an economic slowdown is evident.

Overseas markets, including Emerging Markets, also performed well, but lagged North America somewhat. Mixed economic numbers and the overhanging Brexit situation prompted investors to favour more stable North American markets. Canada was a net beneficiary of this, and returns, compared to foreign markets, were bolstered by our strong dollar, which gained over 2% against the US dollar. Higher oil prices also helped, as the benchmark West Texas Intermediate (WTI) crude oil price rose from around $45 to $60.[2] As importantly, the differential between the WTI and Western Canadian Select price returned to historical levels.

Equity and bond investors clearly have differing views these days. Based on several themes, equity investors are signalling, "all is well." For instance, though the global economy may be slowing, it is still growing. Interest rates remain low and look to remain low for some time, so higher valuations are justified. Corporate fundamentals remain positive and fears of rising input costs, such as wages, are seemingly being offset by productivity gains. All these arguments make up the "bull case" for some investors.

Meanwhile, the bond market is saying that economic growth is definitely slowing and recession risk is high, especially if there is a surprise to inflation rates, which could cause central banks to overshoot. Given this tug-of-war, we expect volatility to remain high. In this environment, we do not think it is prudent to take an aggressive stance on risk assets and prefer to be positioned a bit defensively.

Market Performance (%)	Q1 2019	1-Year
S&P/TSX Composite Index	13.3%	8.1%
S&P 500 Index (CDN$)	11.5%	13.4%
MSCI EAFE Index (CDN$)	8.0%	0.4%
FTSE TMX Canada Universe Bond Index	3.9%	5.3%
CDN$ Versus US$	2.2%	-3.4%

The above Index reviews are calculated from external sources and, where applicable, reflect total returns.
All figures are in Canadian dollars and are as at March 31, 2019.

1. All performance numbers sourced from Bloomberg Finance L.P.
2. Bloomberg Finance L.P.