

Q1 2018 - MARKET COMMENTARY

After a strong start to the year in January, all major stock and bond indexes declined in the first quarter of 2018. Similarly, the Canadian dollar was also strong in January but it too reversed direction and declined by the end of the quarter. This currency movement partially buffered portfolio returns from the losses experienced in the U.S. and other global markets.

The Canadian stock market, was the worst performer among the markets we track closely, losing 4.42%*; The US stock market declined 1.0%^. While the Canadian Universal Bond Index declined 0.25%** . The Canadian dollar (CAD) declined relative to the USD, by 2.45%^^. International markets declined 3.62%***.

Through all of this, our most widely-held portfolios experienced slightly positive returns. These results represent outperformance relative to the major capital market benchmarks.

For the first time in a long while we are experiencing coordinated global economic growth. Unemployment rates in the U.S. are at multi-generational lows and the tax law changes the President implemented in late 2017 are very supportive of greater job creation, corporate earnings and therefore higher stock valuations.

In spite of the weakness displayed by the major stock market benchmarks during this first quarter, the primary trend for the U.S. market is still 'upward'. Corporate earnings are gaining in strength, providing support for current stock valuations and technical indicators are also indicative of an upward primary trend.

Here's the view from the **IPC Portfolio Management Team**:

"Positive fundamental economic news continues to support equity markets with no immediate signs of a long-term market contraction. We remain slightly in favour of U.S. and international markets."

The reason behind the recent volatility is the market's reaction to President Trump's initial (and so far, minor in scope) trade sanctions against China.

Most people don't realize that President Obama also complained loudly about the Chinese trade imbalance initially in early 2010 and then again in his 2012 State of the Union address.

"It's not right when another country lets our movies, music and software be pirated. It's not fair when foreign manufacturers have a leg up on ours only because they're heavily subsidized," Obama said. "I will not stand by when our competitors don't play by the rules."

Excerpt from 2012 State of the Union Address – President Obama

Source: <https://www.cnn.com/2012/01/24/politics/international-reaction-sotu/index.html>

The difference with Obama was that he pursued a *diplomatic solution* to the situation which was ultimately unsuccessful. As you can see, President Trump is more resolved and is taking a more aggressive stance since diplomacy previously didn't sway the Chinese.

Here's what U.S. Growth Equity specialist, Tom Marsico had to say about the current dispute:

"China's IP [intellectual property] theft is real (with U.S. estimates adding up to US\$50bn notional). Something needs to be done, but it will probably be a slow, incremental improvement rather than any big change upfront. Trump needs to claim a win, if the U.S. pulls back its US\$50bn of tariffs in exchange for Chinese President Xi agreeing to work down the trade deficit and focus on IP theft reduction—that would be enough. Markets would likely be supportive, Trump would have a great talking point (as would Xi at home) and in the end there would be little economic impact."

I expect this current spat with China to be relatively short-lived and for the U.S. market to gather strength as the year progresses. Given the imbalance of trade favouring China, they have more to lose in a trade war than the U.S. Therefore, I anticipate a relatively short-lived dispute with some improvement in trading conditions for the U.S.

It now appears that President Trump's approach is gaining some traction with the Chinese.

On April 9th, 2018 Reuters News Agency reported the following:

“BOAO/BEIJING, China (Reuters) - Chinese President Xi Jinping promised on Tuesday to open the country’s economy further and lower import tariffs on products like cars, in a speech seen as an attempt to defuse an escalating trade dispute with the United States.”

Domestically

By contrast, the Canadian market and economy are weaker than the US’s, due to poor policy implementation choices by the federal government and 3 major provinces – B.C., Alberta, and Ontario. Economic growth has been due primarily to net immigration and its impact on the housing market. Policy makers at these levels of government have created a high tax, high cost environment for businesses and are therefore impeding economic activity.

In general, most of our client portfolios have minimal exposure to Canadian equities, so this is not a material concern other than in the way in manifests itself in currency movements. The IPC PM team’s currency hedge was 50% through most of the first quarter while the Canadian dollar strengthened and was then reduced to 25% as it weakened.

Here’s what the IPC Portfolio Management Team had to say on the US dollar hedge:

“We are monitoring this closely, as volatility in the currency markets continues. Longer term, the U.S. dollar outlook continues to be attractive.”

IPC’s currency management continues to add value to portfolio results.

Looking Ahead

Stock market volatility has been low by historical standards over the last 5-7 years prior to this quarter. The spectre of rising interest rates and therefore a contracting global money supply, coupled with a contentious U.S. President who spares diplomatic courtesies, is likely to cause volatility to increase in a meaningful way over the coming months and years.

I encourage you to maintain your focus on the long-term horizon and not be influenced by every media pronouncement regarding government policies or geopolitical issues. Wealth management is a process and not event-driven in nature. Our Retirement Portfolio Series introduced in early 2016 has an embedded mechanism to mitigate downside risk which will allow you to endure periodic, significant market-downturns with less upset.

Sincerely,

John Soutsos, CIM, EPC, B.Econ.
Investment Adviosr
IPC Securities Corp.

Performance notes:

* as represented by the total return of its proxy ETF XIC

^ as represented by the total return of its proxy ETF 'SPY'

** as measured by the total return of its proxy ETF 'XBB'

^^ as measured by its ETF proxy 'FXC'

***as measured by their ETF proxy 'XIN'

Source: www.stockcharts.com 3 months ending March 31, 2018