June 2017 – Canadian rates take-off eh!

The final month of the second quarter saw a moderation in equity returns with defensive outperforming cyclicals. The S&P 500 which, was the top performing market in our investable universe, delivered an uninspiring gain of 0.6%. Holding the index back was a -3.0% return in tech, which took a breather after May's impressive 4.5% return. The top performing sector over the month was the financial sector which delivered a gain of 5.5%. We take this performance as an encouraging sign given banks act as a "canary in the coal mine", performing as an early warning system of sorts. The S&P/TSX Composite again lagged US equities, falling -0.9%, not surprising after a -7.0% sell-off in oil on continued supply concerns. Still, energy equities fared better than the commodity, falling by -5.0%. Overlooked by the market was stronger than expected oil demand (according to the IEA) which increased by 50% over Q1. Canadian financials were up 1.9% on the month, possibly indicating decreased concern surrounding the Canadian housing market. European equities were down over the month and International equities as group sold off by -0.8%. The Canadian dollar rallied 3.8% finishing the month at 0.77 US cents.

Bob and Doug Mackenzie's catch phrase take-off EH (to the great white north) fittingly captured Canadian bond market performance over the month as yields took-off, rising 0.35% to end the month at 1.77%. If you were invested in 10-year government bonds, this would have equated to a -3.2% loss. And losses were not limited to 10-year bonds either, as the broader universe fell by -1.2%. Driving yields higher was the Bank of Canada (BoC) signalling it would hike rates at their July meeting (which they did) representing the first rate hike in nearly seven years, bringing the overnight rate to 0.75%. The increase was well communicated to markets by Bank of Canada officials over the last month after largely downplaying persistent strength in the Canadian economy year to date. Despite weak and falling inflation the Bank of Canada seems confident we have weathered the worst of any downturn related to lower energy prices and have communicated the two rate cuts of 2015 have done their job. Markets are now bracing themselves for a second 0.25% rate hike in the fall. The BoC sees 2017 growth of 2.8% with growth slowing to 2% in 2018. On the inflation front they are forecasting average core inflation of 1.6% for 2017 with core reaching their 2% target sometime in 2018. While the BoC has moved from a neutral policy stance to that of higher rates, any move higher in rates is expected to be gradual and dependent on the strength of the Canadian economy.

While most markets we invest in were down over the month, our conservative investment style helped protect client capital relative to peers. The Active Balanced Portfolio was down -0.8%, vs the broader universe which was down by -1.7%. The performance differential was more pronounced in the Active Balanced Growth Portfolio shedding -0.7%, faring better than peer performance of -2.0%. Our most conservative portfolio, Active Balanced Income Portfolio suffered the biggest loss at -1.0% but still outperformed peers. In terms of positioning within the Active Balanced portfolios we took a neutral position versus our benchmark. Our neutral view takes into account the fact that decent corporate fundamental performance is somewhat offset by high valuations, low yields and a generally high level of uncertainty with respect to global risks.

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