Credential

Market Insights | MONTHLY

Month in Review

For the month ended December 31st, 2018

Overall Highlights

- **TSX falls.** In a trying year for equity markets, there were few places to hide and the S&P/TSX Composite was no exception. The worst performing sector was little surprise with the collapse of crude prices late in the year as Energy fell 21.5%, followed by Consumer Discretionary (-17.7%), and Health Care (-16.6%). Of the eleven sectors of the Index, only Information Tech, Real Estate, and Consumer Staples gained with 12.5%, 4.4%, and 0.6%, respectively. The Composite closed December at 14,323, a 5.8% monthly loss, and for 2018 was down 11.6%, placing it 68th out of 93 major global equity markets in terms of performance.
- **Dollar lower.** After hitting a 19-month low, the Loonie ended 2018 with its worst performance since 2015 as multiple factors contributed to its weakness. Global trade rifts, a flight to the safety of the U.S. dollar, and the unknown impact of a sharp decline in oil, one of Canada's major exports, added to the woes of our currency. In December, the Loonie ended at US73.30 cents for one Canadian dollar, a monthly decline of 2.5%. For 2018, it dropped 8.0%.
- **Gold twinkles.** The yellow metal rose for a third consecutive month as investors continued to have a risk-off attitude, even as markets rallied late in the month. With the end of 2018, the safe-haven assets remained in favour as uncertainly remained with global trade talks, a new U.S. political landscape, and Brexit issues. A February contact for gold closed the month at US$1,282.60, an increase of 4.6%; however, for the year, gold was down by 1.7%.
- **Oil slips and falls.** Crude oil had another down month to end the year as worries of over-supply persist. A slowing global economy added to the weakness in oil despite support from OPEC members and crude-producing nations to cut daily production and support higher prices. A February contract for a barrel of WTI crude ended trading at US$45.81, a 10.1% drop for the month and 23.8% for 2018.
- **BoC holds rates.** In their final meeting of 2018, the Bank of Canada held its benchmark interest rate at 1.75% after increasing it 25 bps in October.
- **GDP higher.** After cautions of a weaker Q4, the economy bounced back from September's doldrums to post a 0.3% rise in October, besting forecasts of a 0.2% gain.
- **Inflation drops**. The price of a notional basket of goods in Canada fell in November marking the third decline in inflation over the last four months.
- **Unemployment declines.** Employers were busy hiring in November to a 42-year low since when comparable data was first gathered.
- **Retail sales gain.** Thanks in part to higher sales in motor vehicles and at the pumps, retail sales rose by 0.3% in October, just shy of analyst forecasts, but an improvement over the previous month.
- **Fed raises rates.** The Federal Reserve raised its benchmark interest rates for the fourth time this year.
- **U.S. Q3 GDP grows.** The Commerce Department released its second estimate of Q3 GDP growth.
- **ECB to stop its stimulus program.** Despite of concerns around a cooling economy, the ECB announced that it will halt its asset purchase program at the end of this year.
- **Euro-zone inflation eases.** Inflation within the 19-member bloc slowed in November. Eurostat reported that the harmonised index of consumer prices (HICP) rose 1.9% year-over-year, less than economists' expected increase of 2%.
- **Japan CPI falls.** Consumer prices in Japan weakened in November. The consumer price index (CPI) increased by 0.8% on a year-over-year basis in November, slowing down from October's pace of 1.4%.
- **China's economic data disappoints.** A slew of economic data came out of China, some of which caused worries in the stock market.

Index/Commodity/Currency		
Close	**MonthChange**	**YTDChange**
S&P/TSX Composite		
14,322.86	-875.0	-1,886.3
	-5.8%	-11.6%
BMO Nesbitt Burns Small Cap		
766.28	-30.2	-170.1
	-3.8%	-18.2%
Dow Jones Industrial Average		
23,327.46	-2,211.0	-1,391.8
	-8.7%	-5.6%
S&P 500		
2,506.85	-253.3	-166.8
	-9.2%	-6.2%
NASDAQ Composite		
6,635.28	-695.3	-268.1
	-9.5%	-3.9%
MSCI-EAFE Index		
1,719.88	-89.7	-330.9
	-5.0%	-16.1%
WTI Crude Oil (per barrel, in $US)		
45.81	-5.1	-14.3
	-10.05%	-23.8%
Gold (per ounce, in US$)		
1,282.60	56.6	-22.4
	4.6%	-1.7%
Canadian Dollar (¢ per US$)		
73.30	-1.9	-6.4
	-2.5%	-8.0%

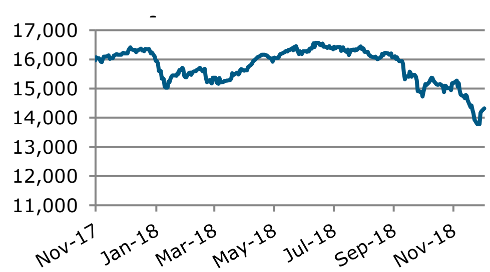
Sources: Bloomberg, PC Bond

Canadian Markets

S&P/TSX Composite Index Sector Snapshot

Sector	Month Return	YTD Return	Weight (%)
Energy	-7.22	-21.48	17.80
Communication Services	-3.71	-5.27	5.90
Industrials	-9.52	-3.91	10.70
Consumer Staples	-1.27	0.58	3.80
Utilities	-3.48	-13.38	4.00
Financials	-7.46	-12.61	34.20
Consumer Discretionary	-8.70	-17.74	4.40
Health Care	-16.66	-16.56	1.60
Materials	5.36	-10.57	10.20
Information Technology	-5.19	12.54	4.10
Real Estate	-4.79	4.42	2.80

S&P/TSX Composite - 1Y Return

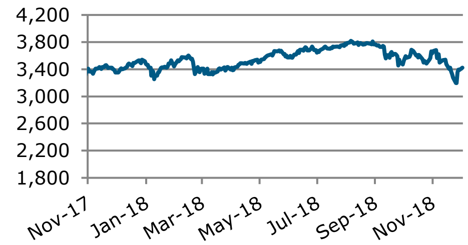


- **GDP higher.** After cautions of a weaker Q4, the economy bounced back from September's doldrums to post a 0.3% rise in October, besting forecasts of a 0.2% gain. This was the fastest pace in five months on rising factory activity and higher wholesale sales. Not considered are the effects of the drop in crude prices on the economy that will likely impact revenue flowing into government coffers and on GDP data in the short term, as well as sales data relating to the recent legalization of marijuana. The economy is expected to grow by 1.5% in Q4 and slowing to 1% in Q1 2019.
- **BoC holds rates.** In their final meeting of 2018, the Bank of Canada held its benchmark interest rate at 1.75% after increasing it 25 bps in October. This was expected by economists as the BoC assesses the effects of the three hikes made during the year on consumption and the housing sectors. It also provides a buffer to ensure the economy's capacity does not cool off too much amidst the lingering trade tensions and recent oil price shocks to government revenues. In his announcement, Governor Stephen Poloz's tone for future rate hikes turned more dovish compared to his previous statements as the future of energy and its recovery remain unknown.
- **Inflation drops**. The price of a notional basket of goods in Canada fell in November marking the third decline in inflation over the last four months. Falling prices at the pumps was the main factor as crude prices and energy costs declined. For the month, inflation fell 0.4%, while annualized inflation dropped to 1.7% from 2.4%, missing expectations. It was the first time since the beginning of the year the inflation rate was below the Bank of Canada's target. Omitting volatile components, core inflation dropped a notch to 1.5% annualized and likely to keep the BoC dovish in the near future.
- **Unemployment declines.** Employers were busy hiring in November to a 42-year low since when comparable data was first gathered. For the month, the economy added 94,100 positions, far more than the 11,000 economists were expecting. This helped push the unemployment rate to 5.6% from 5.8% in October. Most of the hirings were seen in the professional services, healthcare, and construction sectors. Compared to 12 months ago, employment has risen 1.2% with an increase of 218,800 jobs, all of a full-time nature.
- **Manufacturing PMI climbs.** Activity in the manufacturing sector reached a three-month high in November, signaling improvement in business conditions and expansion. For the month, the IHS Markit Purchasing Manager Index reading was 54.9, up from October's 53.9, a 22-month low. Most of the help came from a boost in new order sales, higher employment, and a slower rate of increase in input costs. There was an increase in optimism as well for the next 12 months partly due to formation of the USMCA Agreement, the replacement to NAFTA.
- **Manufacturing sales lower.** The manufacturing sector saw a decline in overall sales in October on lower demand for wood products and primary metals. Although assisted by an increase in food and machinery industries, manufacturing sales fell 0.1% from September's 0.2% advance. The reading was below economist expectations of a 0.4% gain. Of the 21 industries followed, one-third were lower, representing over 40% of the manufacturing sector as a whole. On a volume basis, sales increased 0.2%.
- **Wholesale sales rise.** As reported by Statistics Canada, factory sales rose 1% in October to $63.8B, more than enough to make up for the 0.7% loss in September. Forecasts called for an increase of 0.4%. Machinery, equipment, and household goods industries contributed to gains as four of the seven subsectors tracked advanced, while of the laggards, the largest being autos and their parts. In constant dollar terms, wholesale sales rose 0.9%.
- **Retail sales gain.** Thanks in part to higher sales in motor vehicles and at the pumps, retail sales rose by 0.3% in October, just shy of analyst forecasts, but an improvement over the previous month. This was the fourth straight month of flat or positive growth. For motor vehicles, it was the third consecutive monthly gain (+1.3%) and the first for gasoline (+1.9%) after two months of declines as five of the 11 subsectors monitored by StatCan rose. On a volume basis, retail sales were unchanged in October.
- Canada Housing News:
    - **Housing starts rise.** An increase in ground-breakings of detached homes in Vancouver helped rise housing starts in November above market forecasts. For the month, detached homes rose 7.8% led by Vancouver's 26% rise to 50,458 units, while multi-unit complexes rose by 3.9% to 151,596 units. The annual pace on a seasonally-adjusted basis was 215,941 units, up from October and exceeding the 196,000 unit estimate.
    - **Permits fall.** A sharp decline in industrial building permits sent the total value of building applications down in October. Municipalities issued $8.1B in permits during the month, down 0.2% from September as the non-residential sector fell 7%, with industrial demand falling 29.9%, a third straight monthly decline. Permits for condos and apartments rose 3.8%, while single family homes rose 4.6%, but both were not enough to off the declines.
    - **New home prices flat.** The price of a new home in Canada was little changed in October for a fourth straight month. Of the 27 regional markets tracked by Statistics Canada's index, 16 were either declining or flat for the month due to tighter national mortgage regulations and provincial engagement to curb prices in Toronto and Vancouver, for example. On an annualized basis, prices have risen slightly by 0.1%, the smallest YoY gain since January 2010.

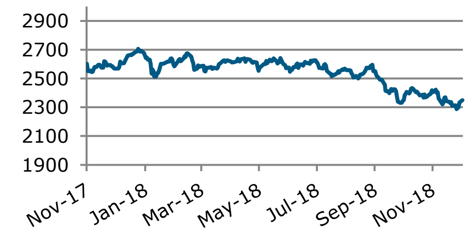
U.S. Markets

- **Worst year in a decade.** 2018 turned out to be a year to forget as far as investors are concerned. All three major indices recorded negative returns for the year. Stocks were deeply in the red in December. Headline news such as the China-U.S. trade war, Fed rate hike, and a slowing global economy all drove stocks down. The broad-based S&P 500 index lost 9.2% for the month, closing just above the 2,500-level at 2,507. The Dow Jones Industrial Average was down 8.7%, ending at 23,327. The tech-heavy Nasdaq was hit the hardest, down 9.5%, closing out the year at 6,635. On the year, the S&P 500 index and the Dow Jones Industrial Average fell for the first time in three years, losing 6.2% and 5.6% respectively. Nasdaq recorded negative returns for the first time in six years, losing 3.9%.
- **Fed raises rates.** The Federal Reserve raised its benchmark interest rates for the fourth time this year. Widely expected by market participants, the Fed raised its funds target range by a quarter point from 2.25% to 2.50%. In its forecast, it revised its projection of three more rate hikes in 2019 down to two rate hikes this year. Fed Chairman Jerome Powell said that the central bank would continue to shrink its balance sheet at the current pace of $50 billion each month, which caused an immediate sell-off of equities.
- **U.S. Q3 GDP grows.** The Commerce Department released its second estimate of Q3 GDP growth. The U.S. economy was reported to grow at an annualized pace of 3.5%, unchanged from the first estimate. Economists also expected the growth pace to stay unrevised.
- **U.S. CPI stays flat.** Consumer prices remained stable in November, according to the Labor Department. The consumer price index (CPI) was unchanged in November after rising 0.3% in October. CPI was up 2.2% year-over-year. Core CPI, which excludes food and energy prices, increased by 0.2% for the month and was up 2.2% on the year.
- **U.S. PPI rises.** Producer prices in U.S. rose in November. The Labor Department reported that its producer price index (PPI) increased by 0.1% in November after jumping 0.6% in October; economists were expecting no change to the index. On a year-over-year basis, PPI was up 2.5%, down from October's pace of 2.9%.

S&P 500 - 1Y Return (CAD)



MSCI EAFE – 1Y Return (CAD)



- **U.S. economy creates fewer number of jobs than expected.** The Labor department reported that nonfarm payrolls increased by 155,000 in November, missing economists' expectation of 198,000. Average hourly wages rose 0.2% from the previous month, also missing forecast of a 0.3% increase. Unemployment remained unchanged at 3.7%, matching forecasts.
- **U.S. 'flash' composite PMI drops**. Business activity cooled down in December, according to a preliminary gauge. The IHS Markit's 'flash' composite purchasing managers' index (PMI) dropped to 53.6 in December, down from 54.4 reported for November. Manufacturing PMI fell to 53.9 from 55.4, while Services PMI dropped from 54.4 to 53.4.
- **ISM indices rise.** Services sector in U.S. expanded at a slightly faster pace in November, according to the Institute for Supply Management (ISM). The ISM non-manufacturing index rose to 60.7 in November, up from October's reading of 60.3; economists were expecting a reading of 59.0. Manufacturing activity picked up in November, according to the Institute of Supply Management (ISM). The ISM manufacturing index rose from October's reading of 57.7 to 59.3 in November; economists were expecting a reading of 57.6.
- **U.S. consumer spending rises.** The Commerce Department reported that consumer spending was up 0.4% in November, slightly higher than forecasts of a 0.3% increase. On the same report, the core personal consumption expenditures (PCE) price index was reported to rise 1.9% year-over-year, on par with economists' estimate. The core PCE price index was the Fed's preferred gauge of inflation.
- **U.S. consumer sentiment rises.** Consumer sentiment rose slightly in the month of December, according to a survey by the University of Michigan. The university's consumer sentiment index increased from November's reading of 97.5 to 98.3, beating economists' expected reading of 97.0.
- U.S. Housing News:
  - **U.S. housing starts rise.** Homebuilding rebounded in November after two straight months of decline. The Commerce Department reported that housing starts increased by 3.2% to a seasonally adjusted annual pace of 1.26 million units; economists were expecting an annual pace of 1.22 million units. Building permits rose 5% to an annual pace of 1.33 million units, also exceeding expectations of 1.26 million units.
  - **U.S. existing home sales increase.** The National Association of Realtors reported that existing home sales rose 1.9% to a seasonally adjusted annual rate of 5.32 million units. Economists were expecting a decline of 0.6% to an annual pace of 5.20 million units. Sales have now increased for two straight months. On a year-over-year basis, however, sales tumbled by 7%.
  - **U.S. pending home sales dip.** The National Association of Realtors reported that pending home sales fell 0.7% in November after falling 2.6% in October. Economists were expecting an increase of 1.5%. On a year-over-year basis, pending home sales were down 7.7%.
  - **U.S. home prices rise.** Home prices rose in October, but the pace of the increase slowed down. The S&P Corelogic Case-Shiller 20-city home price index rose 0.4% in October, matching economists' forecast. On a year-over-year basis, home prices rose 5%, down from the 5.2% annual pace reported in September. Las Vegas, San Francisco, and Phoenix were leading the group in terms of annual percentage gains.

European Markets

- **ECB to stop its stimulus program.** Despite of concerns around a cooling economy, the ECB announced that it will halt its asset purchase program at the end of this year. The ECB's stimulus program started back in March 2015 with purchases totalling €2.5T today. ECB said the economic recovery within the trading bloc was strong enough that it could stop the stimulus program. The central bank also announced that it will reinvest proceeds from the matured bonds back into the market.
- **Euro-zone Q3 GDP growth slows.** Eurostat reported that Q3 GDP within the 19-member economic bloc grew 0.2%, down from Q2's pace of 0.4%, in line with economists' expectation. On a year-over-year basis, GDP rose 1.6% in Q3, missing economists' estimate of 1.7%.
- **Euro-zone inflation eases.** Inflation within the 19-member bloc slowed in November. Eurostat reported that the harmonised index of consumer prices (HICP) rose 1.9% year-over-year, less than economists' expected increase of 2%. It was the slowest pace in three months. The core measure dropped from October's pace of 1.1% to 1%, also missing forecasts.
- **Euro-zone industrial production bounces back.** Industrial production rebounded in October after declining in September. Eurostat reported that industrial production rose 0.2% in October compared to a 0.6% decline reported in September. October's increase was in line with economists' expectation. On the year, industrial production was up 1.2%.
- **Euro-zone PMI falls.** Business activity within the 19-member region slowed down in November, according to the composite PMI. The IHS Markit's composite purchasing managers' index (PMI) dropped from October's reading of 53.1 to 52.7 in November; economists were expecting a reading of 52.4 for November. The services sector PMI fell from 53.7 to 53.4, slightly better than forecast of 53.1. Manufacturing activity continued to ease in November. The IHS Markit manufacturing purchasing managers' index (PMI) dropped to 51.8 in November, down from October's reading of 52.0.

Asian Markets

- **Japan CPI falls.** Consumer prices in Japan weakened in November. The consumer price index (CPI) increased by 0.8% on a year-over-year basis in November, slowing down from October's pace of 1.4%. The core measure, which excludes fresh food and energy prices, increased by 0.3% on the year, down from the 0.4% pace reported in the previous month and remained far away from Bank of Japan's inflation target of 2%.
- **Japan composite PMI falls.** Business activity in Japan continued to grow solidly in November. The Markit/Nikkei composite purchasing managers' index (PMI) came in at 52.4, hovering around the six-month high of 52.5 reported in October. The manufacturing PMI eased to 52.2 from 52.9 while the services sector PMI dropped slightly to 52.3.
- **China official PMI falls.** China's manufacturing activity contracted during the final month of the year according to the official PMI released by the National Bureau of Statistics. The official manufacturing purchasing managers' index (PMI), which has a bias toward state-owned large enterprises, came in at 49.4 in December, lower than economists' expectation of 49.9. It was the first time the manufacturing gauge fell below the 50-mark in more than two years.
- **China's economic data disappoints.** A slew of economic data came out of China, some of which caused worries in the stock market. Industrial output grew 5.4% year-over-year in November, the slowest pace in almost three years, missing economists' expected increase of 5.9%. Retail sales rose 8.1% on the year, lower than economists' estimated pace of 8.8%, the weakest pace since 2003.

Key Take-Aways

A New Leaf. In March 2015, the European Central Bank (ECB) helmed by its president Mario Draghi, introduced an asset purchasing program aimed at fighting deflation in the Eurozone and to instill confidence in the Euro currency that was on the cusp of collapsing. Fast forward to December 2018, all eyes and ears were on Draghi again as he announced an end to the EU-version of QE where the ECB purchased €2.9T of bonds adding liquidity to a now firmer financial system. Leveraging off data showing a looming growth concern of world economies, some criticized whether the timing to stop QE was right or not. In his defense, Draghi iterated that the economy is strong enough to weather a slowdown, existing government bonds would continue to be repurchased and rates would remain at ultra-low levels, until at least Summer 2019. This is similar to the U.S. Federal Reserve who stopped QE3 in October 2014 and began raising rates in December 2015. At their final meeting in December 2018, they are expected to hike rates again but under a more dovish tone. For the ECB, it is a new era where accommodative monetary policy will soon come to an end.

Wages wanted. Employers were able to fill help-wanted openings more than census expected as Statistics Canada reported over 94,000 people found work in November, pushing the national jobless rate to a four-decade low. Almost all jobs were of the preferred full-time nature that provides stability to the labour market as the number of people looking for work, the participation rate, edged higher to 65.4% of the eligible work force. However, despite the favourable headline numbers, the wage growth, or lack thereof, is what garnered a lot of interest. The rate of increase of wages, or wage inflation, was 1.46% in November on a year-over-year basis, which is slower than October's 2.19%; yet even more concerning is that it's below the rate of inflation of roughly 2%. This puts the Bank of Canada in a bind of keeping price growth in check through adjustments in interest rates while trying to not affect wages negatively. If this downward wage trend continues, the central bank will likely still to a more dovish stance to future hikes, especially with the recent decline in oil prices and unrelenting trade tiffs globally.

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