Canaccord Genuity Wealth Management

Where will your investments take you?

GOERNERT WEALTH MANAGEMENT

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Well welcome to 2019!

I'm sure we can't have 2018 in our rear-view mirror fast enough but what a difference a year makes. This time last year in my Winter 2018 newsletter I was cautioning against complacency and emphasizing that the S&P 500's impressive run in 2017 was unlikely to be repeated and that it was time to carefully rebalance your portfolio with an eye to reducing risk. So, what happens when you have a period of historically low volatility bundled with an abundance of optimism underpinned by hopes of continued synchronised global growth that doesn't materialize? Well, apparently, a vicious correction. In fact, we begin 2019 with almost a mirror image of the sentiment at the beginning of 2018. The market is not only pricing in a recession, but a deep one at that. Yet the US non-farm payroll number just out last Friday showed impressive job gains. That's important because those are contemporaneous numbers that represent a significant data point on what the situation on the ground looks like. That has been coupled with a return of a more positive yield curve. The US 10-year treasury yield is back 15 basis points above the 2-year treasury which leads me to believe that the markets are far too pessimistic. Yes, we don't anticipate the US economy to grow at its torrid space of 2018 and do expect earnings growth to moderate in 2019 but the key is that both will be growing, albeit at a slower rate than 2018. In this context we see the markets pricing in an "end of the world" scenario which we just don't see happening. Our human condition tends us toward recency bias and as investors, we always look at the most recent market calamity (the 2008 financial crisis in this case) as a guide to what to expect the next time much like generals always fight the last war. A scenario that rarely plays itself out. Tony Dwyer, Canaccord Genuity chief strategist argues, quite convincingly in my opinion, that this correction (or crash in his words-he can be prone to hyperbole and that's why we love him) is much more akin to market events in 1987, 1998 and 2011 rather than the 2008 market meltdown. He makes the case that if history is a guide, these events are generally violent but short-lived with a sharp reflex rally followed by a retest of the lows within 4-6 weeks and a subsequent sustainable rally to better reflect economic reality. Remember that the economic cycle, like history, may not repeat but it does rhyme.

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Now, onto policy matters and other concerns that are creating so much angst in the markets. On trade, I argued in my Fall 2018 newsletter that *"given China's relatively measured response to the recent US Tariff announcements, part of me wonders if that after the US midterms in November, there might be a quiet rapprochement on the trade file after the US mid-term elections"* before tariffs and the threat of a sustained trade war negatively affected the US economy. Recent news reports have confirmed that a US delegation is travelling to China and that substantive negotiations may begin on this file.

The US continues to enjoy the late expansion stage of the economic cycle but keep in mind, late in the cycle doesn't mean the cycle is over. Barring a policy mistake by the Fed (or a late-night tweet from the oval office) we expect the US economic growth to slow through the second half of the year but remain comfortably positive. Jerome Powell has walked back his earlier communication on interest rates made before Christmas and stressed that any further moves would be data dependent. This has eased concerns that the yield curve will invert in the short term.

Europe continues to be troubled. The strong German economy's benefits to the region are being outweighed by the impending Brexit event in March. In their parlance, whether it will be a hard Brexit or some other form of Brexit arrangement is still being debated. (Is it just me or do these debates remind you of the lyrics from the Pet Shop Boys 80's hit "West End Girls" you know, "Which to you choose a hard or soft option?").

Now to Canada. I'm worried. Typically, Canada does well in the late economic cycle as we are predominantly a resource based economy. However due to a series of policy mistakes (the unwillingness/inability to build infrastructure due to an uncertain and complex regulatory burden, relatively higher taxes and a neglect bordering on hostility to the key resource drivers of our economy) undertaken over the past number of years, combined with high debt levels and a weakening housing market, there will be a drag on Canada's economy for the foreseeable future. Remember, despite all the promises (it doesn't matter the political stripe of the party that makes them), from an economic point of view, Government cannot create jobs, they can create an environment where jobs can be created by the private sector or in Canada's case recently, can create enough uncertainty where a rational business person would decide would be wiser to invest elsewhere until we decide what we want to be when we grow up. The implications of these policy mistakes are just beginning to be felt and will have a measurable, negative impact on the quality of life of our population. This isn't a political statement and while "Sunny Ways" may have made a great campaign slogan, it isn't a substitute for sound economic policy.

Cheers!

Greg

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