Market Commentary Q2 2018

GP WEALTH MANAGEMENT

Although the fundamentals of the world economy remain strong, there are ominous signs of risk that investors should heed going forward.

In particular, U.S. President Donald Trump's rapid escalation of trade tensions with China in past weeks could prove damaging to business confidence. If the U.S. maintains its current trade posture, the consequences could be substantial for those countries, industries, and companies that are most dependent on global trade and supply chains.

In Europe, meanwhile, the Brexit negotiations between the U.K. and the European Union (E.U.) are hardly progressing well, and the decision by Italian voters in June to elect a coalition government with populist, far-right leanings has spooked the markets. More recently, polling in Sweden, typically viewed as a progressive haven, suggests the far-right Sweden Democrats are on the rise.

▸ Global economy

The world economy continued to expand in Q2 2018, sustained by a blistering U.S. performance, which helped make up for a softening eurozone. However, this positive news is counterweighted by the latest data from the CPB World Trade Monitor, which indicates the world economy is veering towards lower trade volumes in Q2 for the first time in two years. Could this be a sign that the recent wave of trade protectionism is starting to have an impact?

Indeed, the world's major economies seem to be moving towards an all-out trade war. The U.S., which had initially placed tariffs on a variety of imports including solar panels, washing machines, steel and aluminium, raised the stakes in June by announcing its intention of imposing tariffs on an additional $200 billion of imports from China, as well as threatening to slap tariffs on imports of autos and parts. The retaliation was swift with the European Union, Canada, Mexico and China all imposing tariffs of their own on a range of U.S. goods.

Now, the Trump administration has said it's preparing yet another round of tariffs on Chinese goods worth an additional $200 billion.

This dramatic rise in trade protectionism is worrying because a slow-down in world trade has historically been associated with slower growth in world GDP.

▸ Canadian equities bounce back

As was widely expected, on July 11th the Bank of Canada raised its key overnight interest rate by 0.25% from 1.25% to 1.50%. Because the key rate can affect the prime rates offered by Canadian banks, this move by the central bank could lead to an uptick in variable-rate mortgages and other variable-rate loans.

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On the equities front, the S&P/TSX posted its strongest quarter since Q4 2013, with a return of 5.9%. The gains were widespread, with double-digit increases in the energy, health care and information technology sectors.

The top headwinds that could provide challenges for the Canadian investing environment include the uncertainty surrounding the NAFTA negotiations, high household debt (new data shows the average Canadian now owes $1.70 for every dollar of disposable income) and the impact of pipeline politics on the oil patch. Since energy plays a crucial role in the Canadian economy, political impediments to investment in the industry can have far-reaching effects.

U.S. Outlook

Although U.S. equities are displaying elevated valuations compared to their historical levels and relative to other markets, they remain competitive based on strong earnings momentum and due to the strength in the domestic economy. Among the drivers supporting the economy are the recent tax cuts and the hikes in public spending.

Meanwhile, U.S. economic growth appears on track to record an outstanding performance in Q2. In May, unemployment dropped to a new low, growth in retail sales accelerated and consumer confidence remained near a historic high. As well, housing starts rose during the month, supported by rising wages and lower taxes, which further boosted household incomes.

By historical measures, the current U.S. bull market is extended, but its passage through the business cycle remains gradual. A hint of the inevitable late-cycle phase is evident, perhaps, in the decline of corporate profits from peak levels.

Trade war as policy, not bargaining strategy

Thus far, the global economy seems little diminished by the escalating U.S.-driven trade war. However, there is a limit to the amount of uncertainty investors can tolerate. A trade war launched by the U.S. as a bargaining strategy against China creates risk that is, to some degree, calculable. Investors can do the math and decide to accept the risk or not.

But, more and more, the Trump White House appears to be treating higher tariffs, not as a bargaining strategy, but as an aggressive policy tool. From their populist, anti-globalist perspective, Trump's trade advisors seem to think higher tariffs all around can help "make America great again."

How can an investor calculate the risk when a trade war is driven by an unclear policy agenda? And with Trump in the mix, things are invariably more unpredictable, not less.

Quite clearly, global trade tensions could escalate much higher before they cool off. Investors need to keep their heads and endeavour to stay on the right side of the risk equation.

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GP Wealth Management

Getting Advice

Are you looking for additional perspective on the financial markets and how they might affect your portfolio? We encourage you to talk to us. Speak to your Financial Advisor or contact investor services at **1 800 608 7707**.

*As of March 30, 2018

MARKET MONITOR

MARKET INDICATORS	MARKET CLOSE*	2017 RETURN	2018 Q2	2018 YTD RETURN
S&P/TSX Composite	16,277.73	+6.03%	+5.9%	+0.4%
Dow Jones	24,271.41	+25.08%	+1.26%	-1.81%
MSCI World	2,089.301	+22.40	+1.93%	+0.76%

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