GLC ASSET MANAGEMENT GROUP

Market Matters

OCTOBER 2017 HIGHLIGHTS

- It was another month of strong positive returns for global equity markets.
- Strong corporate earnings continue to meet and beat market expectations, supporting stock values – a theme that carried through North America, Europe, Japan and the emerging markets.
- The Canadian dollar and Canadian yields were weighed down by a more cautious tone from the Bank of Canada (and widening US-Canada interest rate differentials), stubbornly low inflation levels, and concerns over the progress (or lack thereof) of NAFTA negotiations.
- Oil prices rose on an improved outlook for strong global economic growth (increasing demand) and falling inventories (limiting supply).

EARNINGS' RULE

While the world debated issues of trade, climate change and tax reform, there was little debate on what investors cared most about in October - earnings!

Strong (and stronger still with each passing quarter) corporate earnings supported equity markets. The S&P 500 posted 11 new closing highs during the month. That's a new closing high for one out of every two trading days in the month! With over half of the companies in the S&P 500 having reported their Q3 earnings, close to three-quarters of them beat analysts' expectations. Importantly, most companies also beat analysts' sales expectations. Since increasing the bottom-line via cuts and buybacks can't go on forever, sales growth is seen as a major factor in supporting the future earnings potential of companies. The big US tech companies continued to drive market results south of the border. Consider that stocks like Apple, Alphabet, Microsoft and Amazon are up in the range of 30%-45%+ year-to-date.

CANADIAN HAT-TRICK

The Canadian equity market posted a strong monthly return and finished with all-time closing highs for each of the last three days of the month (a hat-trick!). While oil prices rose on strong global growth outlooks (consider that the International Monetary Fund raised China's expected 2017 and 2018 economic growth rates), the energy sector remains burdened with negative sentiment, weak natural gas prices and pipeline issues

Table 1
Summary of major market developments

Market returns*	October	YTD
S&P/TSX Composite	2.5%	4.8%
S&P 500	2.2%	15.0%
- in Canadian dollars	*5.6%*	*10.3%*
MSCI EAFE	2.9%	11.8%
- in Canadian dollars	*4.8%*	*14.0%*
MSCI Emerging Markets	3.8%	25.9%
FTSE TMX Canada Universe Bond Index**	1.6%	2.1%
FTSE TMX Canada all corporate bond index **	1.5%	3.1%

*Local currency (unless specified); price only
**Total return, Canadian bonds

Table 2
Currency and Commodities
(in USD, % change)

	Level	October	YTD
CDN$	$0.776	-3.2%	4.3%
Oil (West Texas)*	$54.38	5.2%	1.2%
Gold*	$1,270	-1.0%	10.2%
Reuters/Jefferies CRB Index*	$187.56	2.4%	-2.6%

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	October	YTD
S&P/TSX Composite	2.5%	4.8%
Energy	-0.4%	-10.3%
Materials	1.6%	3.2%
Industrials	3.4%	17.3%
Consumer discretionary	3.2%	19.4%
Consumer staples	2.2%	2.7%
Health care	-0.3%	-9.6%
Financials	4.0%	8.7%
Information technology	2.8%	15.6%
Telecommunication services	3.0%	9.7%
Utilities	3.1%	7.9%
Real Estate	3.2%	4.2%

*Price only
Source: Bloomberg, MSCI Barra, NB Financial, FTSE TMX Global Debt Capital Markets Inc.

preventing produces from getting their product to market. It remains the worst performing sector for the year. Instead, Canadian financial companies (and banks specifically) have continued to perform well since the second Bank of Canada rate hike in early September. Higher interest rates improve net interest margins for banks, not to mention that the sector's stock price pendulum may have swung too far to the downside throughout the middle of the year (March to September), and is now benefiting from some recovery.

LAND OF THE RISING SUN

Themes of strong corporate earnings and economic growth also spread through Europe, the emerging markets and Japan.

We think Japan (the largest country weight in the MSCI EAFE index) deserves special notice this month. It was a remarkable October for Japan and the Nikkei rewarded investors with an 8% gain for the month. Solid corporate earnings and a stable yen have helped, but much of the credit is going to Japan's Prime Minister, Shinzo Abe. Abenomics (the term commonly used to refer to Prime Minister Abe's economic policies) have largely been viewed as successful, helping stock markets rise and improving conditions for Japan's unemployed and poor. In October's election, Abe's Liberal Democratic Party and its coalition gained more than a two-thirds' majority of seats in Japan's parliament. The continuity of the government and polices in general appears to have further boosted the market confidence.

BANK OF CANADA: HAWK….'ISH

Comments made by Bank of Canada Governor Poloz during the month were 'less hawkish' than expected and tempered expectations for the timing and pace of future rate hikes. The slight change in tone, coupled with stubbornly low inflation levels and concerns over the state of NAFTA negotiations, caused yields to take a step back. As a result, bond market results rose in uncharacteristic unison with stock markets for the month of October. The longer dated provincial bonds did best as interest rates weakened, and the maritime provinces led the pack. Provincial bond spreads narrowed as investors maintained their desire for high quality credit product.

QUESTIONING HAPPILY EVER NAFTA?

The NAFTA renegotiations aren't going well. With round five set to take place in Mexico City from Nov 17-21 (and two final rounds taking place in early 2018), there is a long way to go toward a deal. Furthermore, round four saw a number of contentious issues raised by the US. The trade agreement and ongoing negotiations are important to Canada. Uncertainty over the progress of the negotiations will likely cause heightened capital market volatility over the coming months.

The US wants these discussions to serve as a template for trade deals with other countries. For example, consider the discussions President Trump plans to have during his early November Asia trip. As such, the US is taking a much more adversarial position, despite evidence that NAFTA has been beneficial to all three countries. Trade plays a very significant role in the Canadian economy (around 30% of our GDP), so more barriers to neighbourly trade would weigh on our economy.

At this stage, we continue to believe that a deal can be made, but we need to consider a broad range of possibilities. What we know for sure is that there will be both winners and losers among industries and companies as a result of whatever trade deal does, or does not, result, but longer-term we don't see a break-down of the agreement as the end of economic prosperity for Canada. Not unlike other market, economic and industry factors, as these NAFTA negotiations progress, our portfolio managers will continue to monitor their holdings (and potential holdings) to make measured decisions related to the specific risks and opportunities on a company by company basis.

As the negotiations unfold and headlines appear, we caution against knee-jerk reactions within your risk-aligned, long-term investment plans. Investors with balanced and diversified portfolios, benefitting from active portfolio management, tend to already be well equipped to weather market disruptions over the longer term.

Copyright 2017 GLC. You may not reproduce, distribute, or otherwise use any of this article without the prior written consent of GLC Asset Management Group Ltd. (GLC).

This commentary represents GLC's views at the date of publication, which are subject to change without notice. Furthermore, there can be no assurance that any trends described in this material will continue or that forecasts will occur; economic and market conditions change frequently. This commentary is intended as a general source of information and is not intended to be a solicitation to buy or sell specific investments, nor tax or legal advice. Before making any investment decision, prospective investors should carefully review the relevant offering documents and seek input from their advisor.