Market Update: S&P 500 Shines in First Half Despite Political Drama; Canadian Stocks Fail to Advance

June was a volatile month for the global financial markets, as plunging oil prices and rotation on the sector front triggered heavy losses in the benchmark indexes. Despite slipping from their recent peaks, Wall Street capped off one of its best first-half performances since the global financial crisis. However, the same couldn't be said for Canadian stocks, which failed to grow in the first six months of the year.

Tech Sector Volatility Weighs on Wall Street

Technology stocks slammed into reverse last month, as a rotation on the sector front triggered heavy losses for the year's top-performing group. The S&P 500's technology index plunged nearly 4% during the month, trimming its year-to-date return to a little more than 15%.

Analysts say the speed with which the rotation took place was evidence of algorithmic trading, a form of stock-picking that has induced heavy volatility in the market.[i]

Technology's outsized performance this year is reflected in the Nasdaq Composite Index, which far outpaced the S&P 500 and Dow Jones Industrial Average through the first six months of the year. The Nasdaq gained more than 15% in the first half of 2017.

Financials and healthcare were the strongest performers in June. Real estate – the S&P 500's newest addition – also outpaced the broader market.

The tech-sector slide drove the CBOE VIX Volatility index to nearly six-week highs in the second-to-last session of the month. The so-called "fear index" pared most of those gains to close just above 11.00. The VIX trades on a scale of 1-100, where readings below 20 are correlated with periods of stability on Wall Street.

Oil Prices Plunge on Supply Overhang

Crude prices endured a fresh five-week collapse through mid-June, as oversupply worries dragged on market sentiment. Both U.S. and global crude futures plunged to new yearly lows on news that OPEC members Libya and Nigeria were ramping up production. In the case of Libya, output rose to four-year highs after its key Sharara oil field came back online.[ii]

The sharp increase adds to the growing challenge that the Organization of the Petroleum Exporting Countries (OPEC) faces in draining the supply glut. Back in May, the cartel joined forces with Russia in extending last year's production-cut agreement until March 2018.

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A booming U.S. shale industry is also adding to oversupply concerns. Active U.S. rig counts – a proxy for the domestic shale industry – rose for a 23rd straight week through June 23. That was the longest streak of consecutive gains on record. Although the rig count finally declined in the final week of June, drillers have expanded their footprint in 52 of the past 57 weeks.

As Goldman Sachs rightly predicted, the oil-price collapse through mid-June encouraged bargain-hunters to return to the market. As a result, oil prices staged an impressive eight-day rally through U.S. Independence Day.

Canadian Stocks Mediocre Through the First Half

June was another dismal month for Canadian stocks, which have failed to benefit from the so-called Trump reflation trade. The benchmark S&P/TSX Composite Index fell 1.1% last month, capping off a disappointing first half.

Canadian equities have underperformed their U.S. and European peers at a time of rapid economic expansion domestically. The Canadian economy accelerated 3.7% annually in the first quarter, easily tops in the Group of 7. The country has added jobs in each of the last six months, raising optimism about the sustainability of the recovery effort.

Stronger than expected growth has put investors on high alert for a possible interest rate increase later this month. Growing rate-hike bets have pushed the Canadian dollar to four-month highs, with the BOC Governor Stephen Poloz acknowledging that ultra-low interest rates have “done their job.”[iii]

Canada’s growth outlook has raised optimism that its equity markets can turn things around in the second half. However, given the TSX’s high concentration of financials, energy and materials, any rebound will largely on the performance of these sectors.

Global Growth Divergence Continues

An upward revision to U.S. first-quarter growth did very little to alleviate concerns that the world’s largest economy is slowing. Across the Atlantic, Eurozone GDP growth was revised higher in the first three months of the year.

A stronger euro area recovery is one of the main reasons why fund managers are increasingly bullish on European stocks. Optimism in the recovery is partly reflected in the strength of the euro, which recently surged to 14-month highs amid hawkish commentary from the European Central Bank.

A string of negative data releases failed to deter the Federal Reserve from raising interest rates in June. The Fed also maintained its outlook for three rate increases this year despite taking a softer stance on core PCE inflation.

Hawkish Fed commentary failed to lift the U.S. dollar, which plunged nearly 6% through the first six months of 2017. This included a fresh nine-month low at the end of June that was largely attributed to a weaker domestic outlook.

The Look Ahead

If history is any indication, stocks are poised to end the year on a high note. Data compiled by Kensho for CNBC show that the main U.S. equity gauges trade higher in the second half of the year between 65% and 75% of the time.[iv] However, much of those gains are attributed to a healthy technology sector – something investors won't be able to count on in the coming months.

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At the same time, a legislative battle in Washington over healthcare reform will almost assuredly be felt on the financial markets. President Trump's goal of repealing and replacing Obamacare is under intense scrutiny by Democrats as well as members of his own party.

Investors will continue to monitor the economic data over the next four weeks for clues about the health and trajectory of the global economy. July is also earnings season, which will keep market participants on high alert.

Sincerely,

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Sources

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[ii] Salma El Wardany (July 2, 2017). "Libya Oil Output at 4-Year High Loosens OPEC Grip on Supply." Bloomberg.
[iii] Andy Blatchford (June 28, 2017). "Low interest rates have 'done their job,' Bank of Canada governor says." The Star.
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