September 2017: Canada's Economy Shines Again as Equity Markets Overcome Volatility

For market participants, the month of August was no time to be idle. Record highs on Wall Street were followed by the biggest one-day fall in three months as geopolitical risks and concerns over President Trump's agenda loomed large for investors. Back home, the Canadian economy emerged as the best-performing nation in the Group of Seven by posting yet another quarter of stellar growth.

Canadian Economy Tops G7

The Canadian economy blew away forecasts in the second quarter, as consumer spending and exports surged. Gross domestic product (GDP) expanded at an annualized 4.5% from April to June, easily tops in the G7.

Exports rose 2.3% on the quarter, up from just 0.4% in the first quarter. Energy exports spiked 9.2%, while exports in goods and services climbed 2.3%. Household spending rose at a sturdy 1.9% in the second quarter – the strongest increase since 2007. Combined with the 3.7% expansion in January-March, the second-quarter result gives Canada its best start to a calendar year since 2002.[1]

By comparison, the U.S. economy grew 3% annually in the second quarter, revised data showed last month. That was higher than the preliminary estimate showing a 2.6% expansion.

Canada's solid growth prospects all but assure that the central bank will continue to normalize interest rates. The Bank of Canada (BOC) is widely expected to raise rates at least one more time this year. Back in July, the BOC became only the second major central bank after the Federal Reserve to begin normalizing monetary policy.

Stellar Economy Fails to Inspire TSX

The Toronto Stock Exchange posted rare gains in August, although it certainly wasn't anything to write home about. The benchmark S&P/TSX Composite Index edged up 0.4% during the month to settle at 15,211.87 on August 31. It would subsequently plunge the following week.

Canada is booming, but the TSX is lagging due to its outsized exposure to banks and energy companies. As the stalwarts of the Canadian economy, the Big Six banks have been under the microscope as of late amid concerns of rising consumer debt and an overvalued housing market. At the same time, rising interest rates may pressure bank margins moving forward.

While the worst of the energy downturn appears to be behind us, the long-term picture on oil prices remains tilted to the downside. That means investors in pursuit of yield will have to look beyond the nation's second-largest asset class. Energy stocks account for 20% of the S&P/TSX Composite Index, but have registered double-digit percentage losses this year.[2]

Wall Street Erases Losses After Multiple Selloffs

Wall Street ended August on a high note, with the S&P 500 Index and Dow Jones Industrial Average posting their fifth straight monthly gain. The technology-heavy Nasdaq Composite Index also recorded its ninth positive month in the last ten.[3]

U.S. stocks overcame heavy volatility earlier in the month, as investors reacted to a growing geopolitical rift between the United States and North Korea. On the home front, President Trump faced a political backlash for not adequately condemning white nationalist protests in Charlottesville, Virginia. As a result, several high-profile CEOs distanced themselves from the president's business advisory committees. Trump would later disband those councils in a highly-publicized tweet.

Trump also threatened to shut down the government if his border wall with Mexico doesn't receive appropriations by the September 30 budget deadline. Congress must simultaneously raise the debt ceiling and pass a spending measure by the end of the month to keep government funded.[4]

As stocks sold off during the middle of the month, the CBOE VIX Volatility Index reached its highest level since the November presidential election. But just like every selloff before it, the August dip was immediately bought by major institutions.

U.S. equities pulled ahead in August despite reports of ten consecutive weeks of net outflows – the longest such streak since 2004.[5] This is a strong indication of robust demand for U.S. large-caps. After all, if the major indices can maintain strength in a weak period, they are likely to maintain strength during a stronger period.

The Month Ahead

September is a notoriously difficult month for equities, especially Wall Street. Various studies have confirmed that the major U.S. indices have performed negatively during the month – a trend that dates back 100 years in the case of the Dow.[6]

A congressional battle over the budget and Trump's border wall will influence investor behaviour this month. The Trump administration is also said to be working more aggressively in pursuit of tax reform. Last month, White House economic advisor Gary Cohn said new tax legislation could come before the end of the year. In his view, the House Ways and Means Committee can pen legislation in as little as one month.[7]

Sincerely,

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