



April Market Update: Rising Bond Yields Present New Challenges for Investors

Global equity markets diverged sharply in April, with Wall Street lagging its peers in Europe and Asia as investors grappled with the reality of rising interest rates in the world's largest economy. On the earnings front, Corporate America is poised for its best quarter of growth in nearly eight years thanks to a synchronized global recovery and generous tax cuts on the domestic front.

U.S. Stocks Underperform as Bond Yields Surge

After a solid start to the month, U.S. stocks gave back most of their gains in April as bond yields surged to more than four-year highs. The S&P 500 Index and Dow Jones Industrial Average each returned a mere 0.3% for the month despite being up more than 2% through mid-April.

Risk appetite began to sour as the yield on 10-year U.S. Treasury notes reached and eventually exceeded the 3% mark for the first time since early 2014. Yields rise as bond prices fall. Conventional wisdom states that yields in excess of 3% pose a serious risk to the financial market.

The latest figures from the Commodity Futures Trading Commission (CFTC) show that net short positions on 10-year Treasury futures jumped by more than 90,000 in the final week of April to reach 462,133. That represents an increase of 28% in less than a year. Meanwhile, net short positions in five-year Treasury's rose by roughly 18,000 contracts to 591,849, a new record.ⁱ

Corporate Earnings Deliver

Rising interest rates notwithstanding, Corporate America is pacing toward its best quarter of earnings growth since 2010.

Data compiled by FactSet, a financial research firm, shows 79% of S&P 500 companies reporting better than expected earnings during Q1 2018. Meanwhile, 74% have also reported positive earnings surprises. Combined, S&P 500 companies are on track for blended earnings growth of 23.2%, which far exceeds forecasts of 17.1%.ⁱⁱ

Reporting season is set to continue in early May, with several major companies scheduled to deliver their earnings call. As of April 27, roughly 53% of S&P 500 companies had reported quarterly results.

Global Stocks Accelerate

With the exception of mainland China, the month of April was overwhelmingly positive for global equity markets. Indexes in Tokyo, Sydney, London and Madrid posted strong results during as upbeat corporate earnings and the easing of geopolitical tensions on the Korean peninsula boosted investor confidence.

Canadian stocks also outperformed Wall Street, as the loonie declined against the U.S. dollar and capital flowed back into energy companies. The S&P/TSX Composite Index rose 1.6% during the month to close at 2,648.05. It peaked near one-month highs on April 18.

The TSX's energy component is benefiting from the renewed upsurge in oil prices, which peaked last month at more than three-year highs. Oil prices are being propped up by global efforts to drain the supply glut, with Saudi Arabia and Russia leading the charge.

Peace on the Korean Peninsula?

On April 27, the leaders of North and South Korea met in the border truce village of Panmunjon, where they pledged “permanent” and everlasting peace. Kim Jong Un has also vowed to close down North Korea's nuclear test site later this month and invite experts into the country to ensure “transparency” around its closure.ⁱⁱⁱ

Peace talks were led by the Trump administration in collaboration with Chinese officials and their Korean counterparts. Experts say both the United States and China must be party to any peace deal given that South Korea was not part of the 1953 armistice.^{iv}

The Month Ahead

Corporate earnings, geopolitics and interest rates will continue to dominate the headlines this month. For investors, the challenge will be balancing earnings optimism with rising bond yields and uncertainty over the outcome of trade negotiations between the United States and its allies.

In Canada, the conclusion of NAFTA negotiations is critical for manufacturers and service providers that rely on tariff-free access to the world's largest economy. While a deal remains elusive, all sides are committed to reaching an agreement before Mexico's federal election this summer.

Sincerely,

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Sources

- i. Jamie McGeever (April 30, 2018). "Commentary: Hedge funds take higher U.S. bond yields bet to record levels." Reuters.
- ii. FactSet (April 27, 2018). Earnings Insight.
- iii. Ben Westcott, Yoonjung Seo and Sophie Jeong (April 29, 2018). "North Korea will close nuclear test site in May, South says." CNN.
- iv. USA Today (April 29, 2018). "Readers debate: Who's really to thank for Korean peace talks?"

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ⁱⁱ FactSet (April 27, 2018). Earnings Insight.

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^{iv} USA Today (April 29, 2018). “Readers debate: Who’s really to thank for Korean peace talks?”