June Market Update: Trade Tensions on the Rise

June was an active month for Wall Street and global equity markets, as the threat of an all-out trade war between the United States and its global allies weighed heavily on investors. On the monetary policy front, the Federal Reserve voted to raise interest rates for a second time this year while the European Central Bank (ECB) signaled for the end of crisis-era policies.

In commodities, a decision by the Organization of the Petroleum Exporting Countries (OPEC) to raise production levels had a positive impact on oil prices as market participants continued to forecast a supply shortage amid rising demand.

U.S.-China Trade Tensions Grip Markets

Toronto's benchmark TSX and the Nasdaq Composite Index in New York rose to fresh record highs in June, though gains would soon fade as the Trump administration moved forward with its protectionist agenda.

Turmoil on the trade front has been a major factor in the half-year correction on Wall Street. Those fears were reignited on June 24 after The Wall Street Journal published a report indicating that President Donald Trump is planning to ban Chinese nationals from investing in U.S. technology companies. Trump's Treasury Secretary Steve Mnuchin later clarified that Washington is not singling out any country in its campaign to stop intellectual property theft.[i]

Earlier in the month, President Trump announced plans to move forward on tariffs targeting $50 billion worth of Chinese goods. The tariffs came into force in the first week of July.

Monetary Policy in Focus

The Federal Reserve and European Central Bank headlined an active month for monetary policy. On the U.S. front, the Federal Open Market Committee (FOMC) concluded its two-day policy meeting by raising the target on the federal funds rate to 2%. In doing so, officials forecast two more upward adjustments this year, bringing the total number of rate hikes to four. The Fed previously forecast three interest rate increases in all of 2018.

The ECB, meanwhile, announced it would wind down its controversial bond-buying program in December, after which interest rates will remain on hold until at least next summer. From October to December, the central bank's quantitative easing program will run at €15 billion per month, which is half the current rate of €30 billion.

ECB officials "concluded that progress toward a sustained adjustment in inflation has been substantial so far," President Mario Draghi said in following the June 14 decision.[ii]

OPEC Raises Production Levels

The Organization of the Petroleum Exporting Countries (OPEC) outlined a new production policy following its biannual meeting in Vienna on June 22. The Saudi-led cartel voted to raise output by an average of 600,000 barrels per day. According to analysts, the new quotas will allow OPEC and its allies to raise output by up to 1 million barrels per day in the second half of 2018.[iii]

Oil prices rose following the announcement, as investors doubted the cartel's ability to ramp up crude production fast enough to offset an expected shortage of supplies. The value of oil would later surge to new multi-year highs as the Trump administration moved ahead with plans to re-impose sanctions on Iran. According to analysts, the sanctions could limit Iranian crude shipments by up to 1.1 million barrels per day.[iv]

Portfolio Overview

Our investment process utilizes a multi asset approach which may include Canadian equities, U.S. equities, developed international equities, emerging international equities, currencies, commodities, Real Estate Investment trusts (REITs), bonds, preferred shares and cash. We actively measure the supply and demand for each asset class, and allocate our investments to the strongest asset classes.

Within the Multi Asset Portfolios, the strongest asset class has always been US stocks or International stocks. Canada has been a laggard compared to most stock markets globally as the interest sensitive utility and financial sectors have weighed heavily on the Canadian market so far this year. We utilize Exchange Traded Funds (ETFs) to garner sizeable country or sector exposure. ETFs provide the liquidity to the portfolios that individual stocks can't. Due to ongoing global demand, U.S. and International equities have had a significantly higher exposure in the portfolios compared to equity allocations to Canada.

All of our Multi Asset portfolios maintain a modest permanent exposure to both a U.S and Canadian portfolio of individual stocks. The stocks are selected using the same process when selecting asset classes. The process works extremely well when the market experiences strong sector leadership, and will underperform when there is a lack of sector leadership, or a change in sector leadership.

In 2017, the Canadian individual stock portfolio underperformed the S&P/TSX Index for the second time since the portfolio's creation in 2008. However, in 2018 the portfolio has again experienced excellent performance thanks to stocks such as Bombardier and Valeant. In the US, the portfolio has continued to provide significant outperformance thanks to contributions by Netflix, Amazon, and Nvidia. Strong leadership in technology stocks continues to add value to the overall portfolio. The decline of the Canadian dollar relative to the US dollar has provided additional returns for the Global Multi Asset portfolios as they maintain an intentional exposure to the US dollar for currency diversification purposes.

Bonds have been a disappointing asset class in Canada, but especially so in the US this year. Both the Bank of Canada and the Federal Reserve have been raising interest rates which have resulted in a slightly positive return in Canada and a negative return in the US year to date. The preferred share component of the portfolios is also slightly negative for the year.

Click on the links to view the results of all our portfolios, as well as a breakdown of performance of the individual assets classes.

Looking Ahead

Corporate earnings will dominate the headlines this month, which means potentially large moves for North American equities. Wall Street is expected to post its best quarter of earnings growth since 2011, according to financial research firm FactSet.[v] At the time of writing, 61 S&P 500 companies have issued negative per-share earnings guidance for Q2 2018 compared with 47 companies to have issued positive guidance.

Trade policy and the way forward on NAFTA negotiations will also impact investor sentiment over the next four weeks. The election of a new populist president in Mexico is expected to jumpstart NAFTA talks, according to a top advisor to new President Andres Manuel Lopez Obrador.[vi]

The current bull market remains intact after an unprecedented 10 years. It would be unreasonable to expect that it will continue for another decade without a correction, especially in light of ongoing interest rate hikes which tend to slow down an overheated economy. At some point, demand for stocks and other ‘risk” assets will change. When they do, we will adjust our portfolios accordingly to become more defensive.

If you have any questions regarding this summary, or your investment portfolio, please call us.

Enjoy the balance of the summer.

Sincerely,

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[i] Bob Davis (June 25, 2018). "U.S. Investment Restrictions Won't Name China but Will Apply Broadly, Mnuchin Says." The Wall Street Journal.
[ii] European Central Bank (June 14, 2018). Press Conference: Mario Draghi, President of the ECB & Luis de Guindos, Vice-President of the ECB, Riga, 14 June 2018."
[iii] Myra P. Saefong (June 22, 2018). "5 things investors need to know about OPEC's decision to lift oil output." Market Watch.
[iv] Sam Bourgi (July 3, 2018). "Market Update: U.S. Stocks Fall in Holiday-Shortened Session; Technology Shares Tumble 1.4%." Hacked.com.
[v] FactSet (June 15, 2018). Earnings Insight.
[vi] Julia Love and Frank Jack Daniel (July 2, 2018). "Mexican election will jumpstart NAFTA talks, adviser says." Reuters.

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