

Monthly Market Commentary

Equity Strategy

Advantage U.S.A. (for now)

The BMO Nesbitt Burns Portfolio Advisory Team (“the team”) believes their long-standing strategic overweight stance on U.S. stocks is still appropriate when looking at recent economic momentum data across the globe. It is a tale of two cities, with the U.S. continuing to see economic acceleration and most other markets slowing, particularly China. The team has been advocating that clients increase the quality of their portfolios by focusing on lowering cyclicity (recall that the U.S. has the most defensive stock market in the world), improving revenue visibility, and emphasizing dividend growth and rock solid balance sheets. While the team has been arguing that there might be a catch-up trade for the Canadian market, progress on the North American Free Trade Agreement (“NAFTA”) renegotiations will have to happen first, so we are likely in a holding pattern until then. Also hurting the TSX and loonie is the aforementioned economic slowdown in China. Canada’s high exposure to commodities makes our market and currency particularly sensitive to Chinese economic momentum. This has had a negative impact on the price of copper, which of course, is strongly related to the Canadian market given its economic sensitivity.

Also, the usual correlation between oil prices and the Canadian dollar has not worked this year. Even as West Texas Intermediate prices have increased, the loonie has weakened. This is mainly due to the high discount Western Canadian Select oil is suffering, the result of pipeline constraints to move it south.

U.S.A. economy still close to peak levels, unlike most other economies

BMO Economics writes that the U.S. Institute for Supply Management Manufacturing Index rose more than expected in August, up 3.2 points to 61.3 — the highest since May

2004. The headline increase is the third in the past four months, and was supported by gains in the five equally-weighted components. Real world commentary from the survey tells us that demand is still strong across most industries, and tariffs are not yet having a big negative impact, but they could compound the slowdown in the U.S. when it happens (and it is a matter of *when*, not *if*).

With consumer confidence this high, it’s hard to bet against the U.S. stock market

U.S. consumer confidence just hit an 18-year high (supported by a hot jobs market), which is one of the key reasons stocks keep making new highs and that retail stocks are staging a comeback. In the U.S., consumer spending represents 70% of the US\$20 trillion economy. In Canada – which is more dependent on exports – consumer spending is still a very significant 58% of our C\$2 trillion economy. Despite the team’s concerns on trade and the economic slowdown in China, a silver lining for Canada is that consumer confidence, while not quite as strong as in the U.S., is still in the upper range seen in the last decade.

Fixed Income Strategy

Staying the course

By the time this monthly market commentary is published, Canada and the U.S. may reach a trade agreement; but for the moment, trade uncertainty remains a primary focus for corporations and investors. This issue has also been identified by the Bank of Canada (“BoC”) as a key economic risk, which likely weighed on its decision to leave the benchmark rate unchanged at 1.50% at its early September meeting.

The BoC’s view has not changed yet; acknowledging the economy is growing close to, or at, capacity and higher inflation still supports further reduction in monetary stimulus. The possibility of speeding up policy tightening was discussed, but this could certainly not be considered in the absence of a trade deal.

On inflation, the spike in the July Canadian Consumer Price Index (“CPI”) was attributed more to transitory factors, as it was primarily led by a 15% rise in gasoline and transportation costs. Looking at core CPI instead, which strips some of the noise created by the most volatile items, inflation remains within the BoC’s target of 2%. Furthermore, the economy may be running closer to capacity, but overall economic growth has been decelerating since peaking in the first half of 2017. Finally, wage gains continued to slow after peaking around 4% in May, as the latest labor report showed the Canadian economy actually lost jobs on a net basis in the first eight months of 2018.

The bottom line is that the BoC is staying the course, and is committed to gradually raising rates, assuming the economic data is supportive. The BoC would need a compelling argument to deviate from that path. With the hope of a trade deal, the odds remain elevated for a rate hike in October, but this could change quickly.

This helps explain why the Government of Canada yield curve resumed its flattening trend in August, with the yield spread between two-year and 10-year terms narrowing further. From a domestic perspective, short-term yields are continuously adjusting to the expected tightening path, while the risk of slower growth and inflation, along with global uncertainties, is weighing on longer-term yields. In this environment, the BMO Nesbitt Burns Portfolio Advisory Team continues to believe that a mix of shorter-term (three-to-six years), quality investment grade corporate bonds and floating rate investments should be accretive to investment portfolio returns.



Please contact your BMO Nesbitt Burns Investment Advisor if you have any questions or would like to discuss your investments.



General Disclosure

The information and opinions in this report were prepared by BMO Nesbitt Burns Inc. Portfolio Advisory Team (“BMO Nesbitt Burns”). This publication is protected by copyright laws. Views or opinions expressed herein may differ from the views and opinions expressed by BMO Capital Markets’ Research Department. No part of this publication or its contents may be copied, downloaded, stored in a retrieval system, further transmitted, or otherwise reproduced, stored, disseminated, transferred or used, in any form or by any means by any third parties, except with the prior written permission of BMO Nesbitt Burns. Any further disclosure or use, distribution, dissemination or copying of this publication, message or any attachment is strictly prohibited. If you have received this report in error, please notify the sender immediately and delete or destroy this report without reading, copying or forwarding. The opinions, estimates and projections contained in this report are those of BMO Nesbitt Burns as of the date of this report and are subject to change without notice. BMO Nesbitt Burns endeavours to ensure that the contents have been compiled or derived from sources that we believe are reliable and contain information and opinions that are accurate and complete. However, BMO Nesbitt Burns makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions contained herein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this report or its contents. Information may be available to BMO Nesbitt Burns or its affiliates that is not reflected in this report. This report is not to be construed as an offer to sell or solicitation of an offer to buy or sell any security. BMO Nesbitt Burns or its affiliates will buy from or sell to customers the securities of issuers mentioned in this report on a principal basis. BMO Nesbitt Burns, its affiliates, officers, directors or employees may have a long or short position in the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. BMO Nesbitt Burns or its affiliates may act as financial advisor and/or underwriter for the issuers mentioned herein and may receive remuneration for same. Bank of Montreal or its affiliates (“BMO”) has lending arrangements with, or provides other remunerated services to, many issuers covered by BMO Nesbitt Burns’ Portfolio Advisory Team. A significant lending relationship may exist between BMO and certain of the issuers mentioned herein. BMO Nesbitt Burns Inc. is a wholly owned subsidiary of Bank of Montreal. Dissemination of Reports: BMO Nesbitt Burns Portfolio Advisory Team’s reports are made widely available at the same time to all BMO Nesbitt Burns investment advisors. Additional Matters TO U.S. RESIDENTS: Any U.S. person wishing to effect transactions in any security discussed herein should do so through BMO Capital Markets Corp. (“BMO CM”) and/or BMO Nesbitt Burns Securities Ltd. (“BMO NBSL”) TO U.K. RESIDENTS: The contents hereof are intended solely for the use of, and may only be issued or passed onto, persons described in part VI of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001. BMO Wealth Management is the brand name for a business group consisting of Bank of Montreal and certain of its affiliates, including BMO Nesbitt Burns Inc., in providing wealth management products and services.

BMO Nesbitt Burns Inc. is a Member-Canadian Investor Protection Fund. Member of the Investment Industry Regulatory Organization of Canada.

BMO CM and BMO NBSL are Members of SIPC. © BMO and the roundel symbol are registered trade-marks of Bank of Montreal, used under license. © “Nesbitt Burns” is a registered trade-mark of BMO Nesbitt Burns Inc. If you are already a client of BMO Nesbitt Burns, please contact your investment Advisor for more information.