Q4 Market Commentary

For investors in U.S. equities, 2016 has been a roller coaster of a year. January opened with a heart-stopping drop in valuations, followed by a slow but steady recovery. Next came the Brexit Surprise. Equities tanked at the news of the "Leave Referendum" victory, then rebounded sharply with the S&P 500 soon climbing to a record high level. More recently, markets tumbled at the shock of the U.S. election result, only to slingshot higher at the prospect of reduced financial regulations and increased infrastructure spending under a Trump presidency.

Canada, meanwhile, has been one of the world's top-performing domestic equity markets since January 2016. In Q3, the S&P/TSX Composite returned +4.7%. Of the 248 stocks that were in the TSX Composite at some point during the quarter, 163 (66%) increased in value. The biggest Q3 gainers were in economically sensitive sectors such as information technology, industrials and consumer discretionary, suggesting an increase in investor optimism about stronger economic growth ahead.

Economic outlook

China's consistent stimulus since late 2014 has helped create stability in the international economy. Despite sluggish growth, the global expansion remains intact. In the U.S. and much of the rest of the world, economies are in the mid to late stages of economic expansion. In the U.S., typical of late cycles, bank standards for business loans have been growing tighter and wage increases have begun putting pressure on cyclical productivity growth.

As we move through the final quarter of 2016, the odds of a recession remain low due to tightness in the labour market and upside wage pressure, but the potential for further volatility remains a concern. The rise in oil prices and record-low bond yields suggest that the possibility of a surprise uptick in inflation has not been fully priced in.

Political unrest

Another factor creating uncertainty is the political unrest in many areas of the world. South of the border, the long and fractious 2016 election cycle has concluded with Donald Trump emerging victorious, but many questions remain about how exactly the new president-elect will govern the U.S. and manage the country's $19 trillion economy.

Across the Atlantic, Europe's economy, including the U.K. market, has shown resilience following the disrupting impact of Brexit. But the process of disentangling the U.K. from the EU has yet to begin. Article 50, which details how a country can exit the EU, is scheduled to be triggered in March 2017, kicking off a whole new round of political and market uncertainty.

In the meantime, Euroskeptic forces have been emboldened by Britain's support for Brexit, creating concerns about the EU's underlying political stability. Italy is slated to hold a referendum on constitutional reform on December 4, and Germany and France will hold elections in 2017.

If the Euroskeptic political parties attract increased support, the euro's viability as a shared currency will again come into question, making investors less likely to commit capital to the region and ultimately hindering growth.

U.S. equities: cyclicals outperformed, “bond proxies” weakened

The modest risk-on environment in Q3 boosted investor interest in cyclical equity sectors, like information technology, financials and industrials. Due to rising bond yields during the quarter, we saw outright declines in bond-proxy sectors, such as utilities, staples and real estate.

Recently, bond-proxy sectors have shown acute sensitivity to the change in yields. Although history suggests that some of these sectors, based on their earnings stability, will outperform during the late stage of a business expansion, the potential for rising yields could be a headwind that constrains their performance in the near term.

Emerging markets

After slowing growth over the past several years, emerging economies have shown some life, principally in response to China's massive boost in economic stimulus. While China is expected to continue stimulating growth in the near term, its credit spending may lead to a day of reckoning in the future.

Anticipated recoveries from recessionary conditions in Brazil and Russia could help drive further emerging-market growth.

Bullish Sentiment on Canadian Equities Increases for Q4

Looking ahead, the global economy is faced with significant challenges and impediments to growth. But according to the Q4 2016 Advisor Sentiment Survey conducted by Horizons ETFs Management (Canada) Inc., Canadian investment advisors expect Canadian and U.S. equities to deliver positive returns for the fourth quarter of 2016. Advisors were bullish on eight of 14 asset classes, overall a very bullish sentiment. This included favourable bullish sentiment on six of the seven equity indices tracked by the survey.

Getting Advice

Are you looking for additional perspective on the financial markets and how they might affect your portfolio?

We encourage you to talk to us. Speak to your Financial Advisor or contact investor services at 1 800 608 7707.