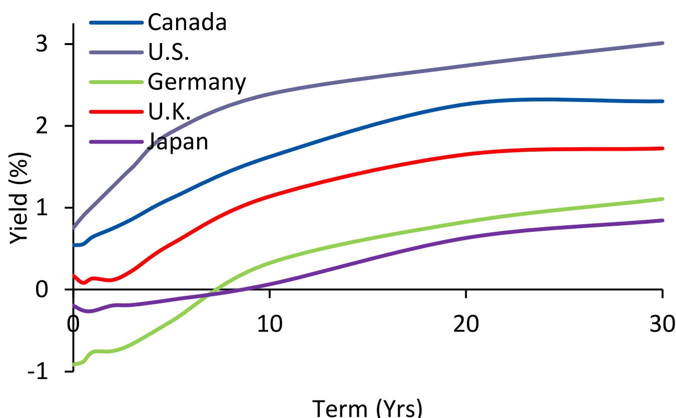
Market Statistics

	Mar/17	Dec/16	Sep/16	Mar/16
Yields (%)				
90 Day T-Bill	0.52	0.46	0.53	0.45
10 Yr. Canada Bond	1.62	1.72	1.00	1.23
30 Yr. Canada Bond	2.30	2.31	1.66	2.00
Rates (%)				
C.P.I. (annual)	2.05	1.50	1.34	1.27
US$/C$	0.75	0.74	0.76	0.77
Euro/C$	0.70	0.71	0.68	0.68
Prices (US$)				
Crude Oil (bbl.)	51	54	48	38
Natural Gas (mm)	3.19	3.72	2.91	1.96
Gold (oz.)	1,250	1,152	1,315	1,235

Market Returns

	Periods Ending Mar. 31/17			
			Annualized	
	3 Mo.	1 Yr.	5 Yrs.	10 Yrs.
S&P/TSX	2.4	18.6	7.8	4.7
S&P 500 (C$)	5.3	20.4	20.0	9.1
S&P 500 (US$)	6.1	17.2	13.3	7.5
MSCI EAFE Net (C$)	6.4	14.7	12.1	2.5
MSCI EAFE Net (US$)	7.2	11.7	5.8	1.1
MSCI World Net (C$)	5.6	17.9	15.8	5.7
MSCI World Net (US$)	6.4	14.8	9.4	4.2
FTSE Universe Bond	1.2	1.5	3.5	4.8
FTSE 91 Day T-Bill	0.1	0.5	0.8	1.3

Yield Curves



The Economy

Global economic growth remains modest with even the most optimistic forecasters, such as the International Monetary Fund, expecting rather pedestrian gross domestic product (GDP) results for the 2017-18 period.

Real GDP (%) Growth Rates

	2014	2015	2016E	2017F	2018F
World	3.4	3.2	3.0	3.4	3.6
U.S.	2.4	2.6	1.6	2.3	2.5
Canada	2.6	0.9	1.3	1.9	2.5
Euroland	1.2	2.0	1.6	1.6	1.6
U.K.	3.1	2.2	2.0	1.5	1.4
Japan	0.3	1.2	1.0	0.7	0.5
China	7.3	6.9	6.6	6.5	6.0

Source: International Monetary Fund

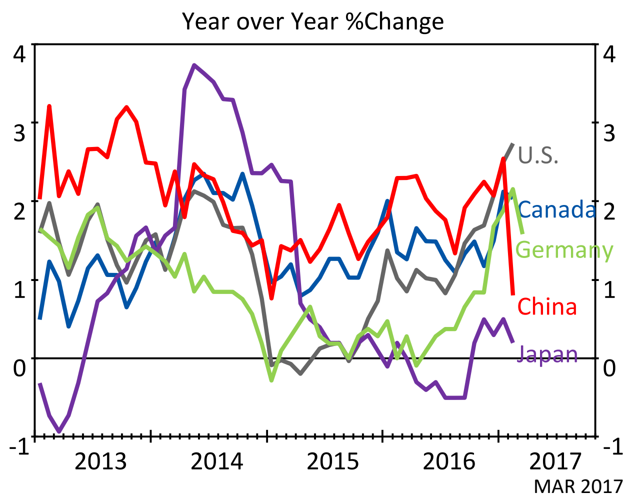
It has also been suggested that, as a result of rising interest rates, growth in 2018 will in fact be slower than in 2017. So far, only the U.S. appears to be reaching full employment with a current unemployment rate of 4.7%. Other countries are experiencing much higher unemployment and any argument for rising interest rates would most likely be tied to an acceleration of inflation. The top chart on the next page indicates inflation is up in the major economies and breaching the 2.0% level that central bankers view as the high end of the preferred range. Low, and in some cases negative, short term interest rate policies along with quantitative easing by central bankers have worked. Deflationary concerns are now in the past and the world is reflating.

Among developed countries, the U.S. is leading in terms of inflation and GDP growth, and not surprisingly, also in monetary tightening. The U.S. Federal Reserve has raised rates twice since the 2007-08 recession and the expectation is for at least two more modest moves before year end.

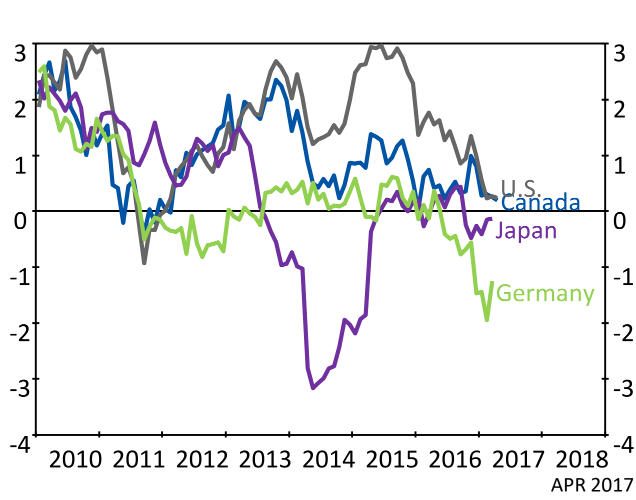
Real long term government bond yields (yield minus inflation) tend to average between 1.5 - 2.0% over the longer term (see chart 2 on page 2). Current U.S. inflation rates exceeding 2.5% would therefore imply that long bond yields will rise from 3.0% to the 4.0 - 4.5% level. We would in turn expect that short-term interest rates may have to eventually increase by 1.0 - 1.5%.

Increasing fiscal stimulus, aimed at improving muted GDP growth, could also further fuel inflation presenting a potential risk that would lead to a more aggressive move upward in interest rates. President Trump is adamant that he wants lower taxes. In Canada, we are reaching a deficit of $28.5 billion at the federal level this year with no plan for a balanced budget in the foreseeable future. The governments in Euroland, the U.K. and Japan are also spending again but admittedly inflation remains a limited concern in these countries. China, India and other lesser developed economies remain susceptible to overspending.

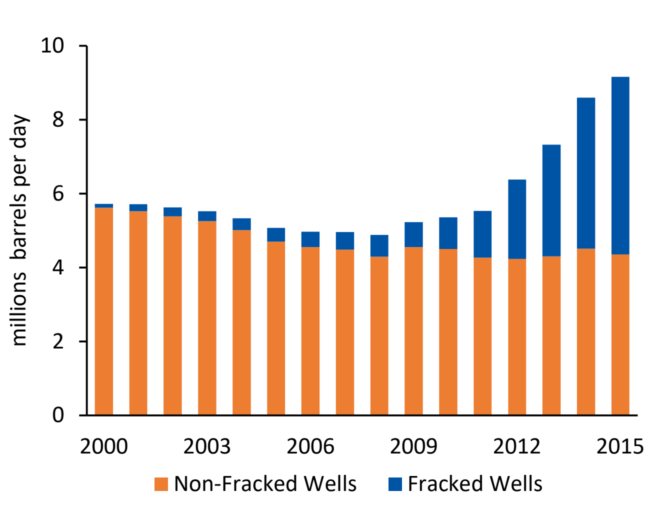
Global CPI Inflation



Real Long-Term Government Bond Yields (%)



Oil Production in the United States



The Markets

Equity markets continued to rise in the first quarter as earnings surprises outnumbered disappointments. The MSCI EAFE index provided the strongest performance reflecting a "bounce off of the bottom" rather than evidence of the foreign economies exceeding U.S. growth rates. The MSCI EAFE index returned 6.4%, the S&P 500 5.3% and the S&P/TSX 2.4% for the quarter. A pullback in the price of oil and President Trump's trade agenda have brought some concern back into the Canadian equity market and returns were more restrained. The Bank of Canada has also been reluctant to follow the U.S. and raise interest rates driving some funds back into bonds as the FTSE Universe Bond Index returned 1.2% in the first quarter.

Share price/earnings multiples have expanded. If corporate earnings continue to increase and any rise in interest rates is small and gradually implemented, there should not be a significant pullback in equity prices. The pause in stock market gains in the latter half of March indicates that investors are indeed now in a "wait and see" mode after pushing stock prices up in recent months. The non-cyclical nature of the companies we own in accounts and their steadier earnings profile suggests less disappointments and therefore less volatility in their share prices.

With regard to oil prices, the bottom chart on this page indicates that the supply of U.S. shale oil has transformed the global oil market. Shale is profitable in the $40-50 per barrel range and production has now reached over 4.0 million barrels per day (bpd); almost doubling total U.S. production from levels just eight years ago. As a result, OPEC's announced supply cuts of 1.2 million bpd are partially offset by the continued climb in shale production. It is now a question of how much market share OPEC is willing to give up to sustain prices. Oil consumption continues to track global GDP growth as there have been relatively small changes in usage intensity (oil conservation and substitution). Environmental and political events can of course change all of this. Oil investments should be limited to companies with the demonstrated ability to increase production.

Our fixed income exposure is now very short in term and duration. We do not own long-term bonds and therefore are mostly insulated from the effects of a rise in interest rates on our fixed income sections. Our equity exposure is lower than it has been in recent years but this reflects our primary concern for protecting capital in case of economic or earnings disappointments.

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Sources: TD Securities Inc., Scotia McLeod, International Monetary Fund, U.S. Energy Information Administration