Market special: 2018 Review and 2019 Outlook

January 4, 2019

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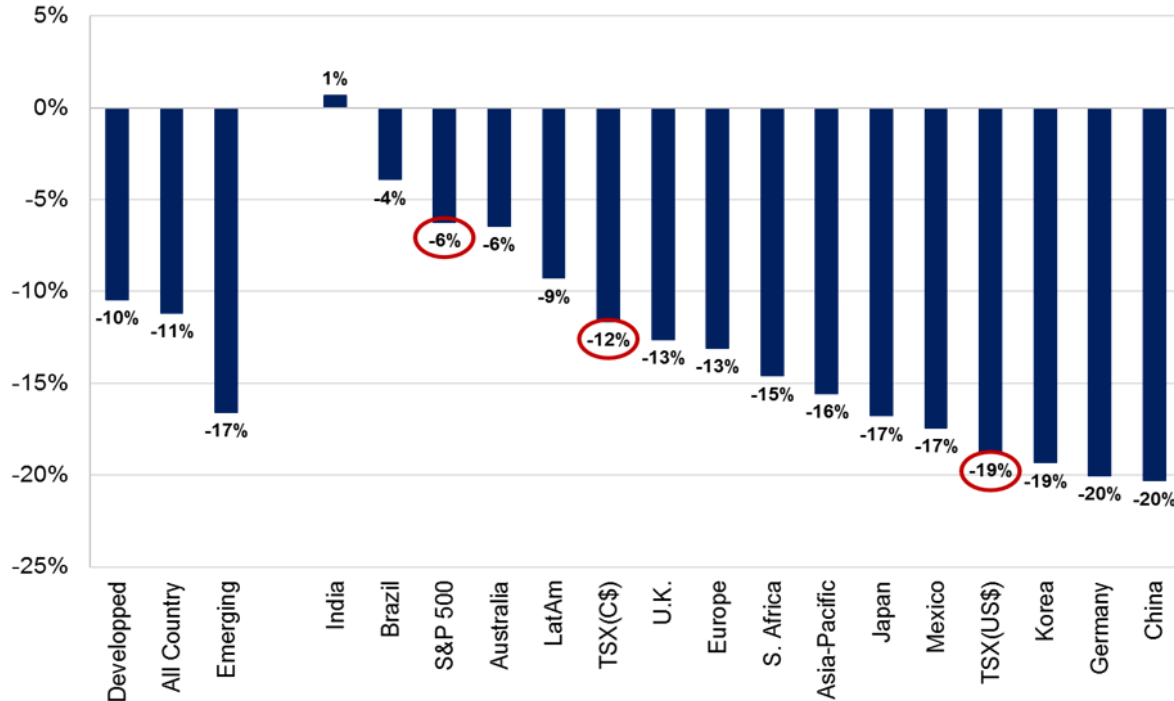
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Global Equities: Performance 2018
Local returns, December 31, 2018

Market	Return
Developped	-10%
All Country	-11%
Emerging	-17%
India	1%
Brazil	-4%
S&P 500	-6%
Australia	-6%
LatAm	-9%
TSX(C$)	-12%
U.K.	-13%
Europe	-13%
S. Africa	-15%
Asia-Pacific	-16%
Japan	-17%
Mexico	-17%
TSX(US$)	-19%
Korea	-19%
Germany	-20%
China	-20%

Source: Bloomberg, iAGP, December 31, 2018

The Canadian stock market was no exception!

Canadian Equities: Size & Style (2018)   31-Dec-18

We used MSCI indices to track performance of Value/Growth.
Source: Scotiabank GBM Portfolio Strategy, Bloomberg.
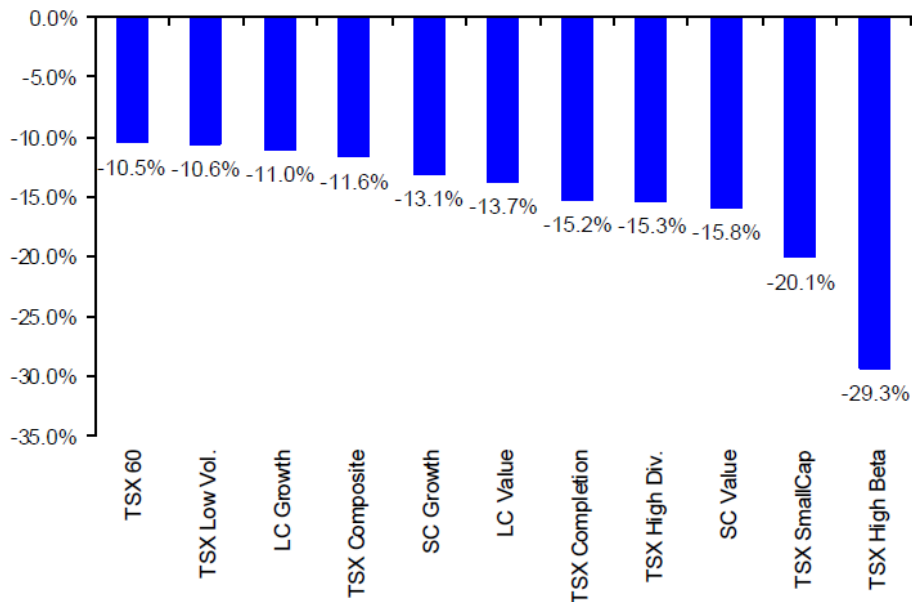
Canadian Asset Performance (TR%)
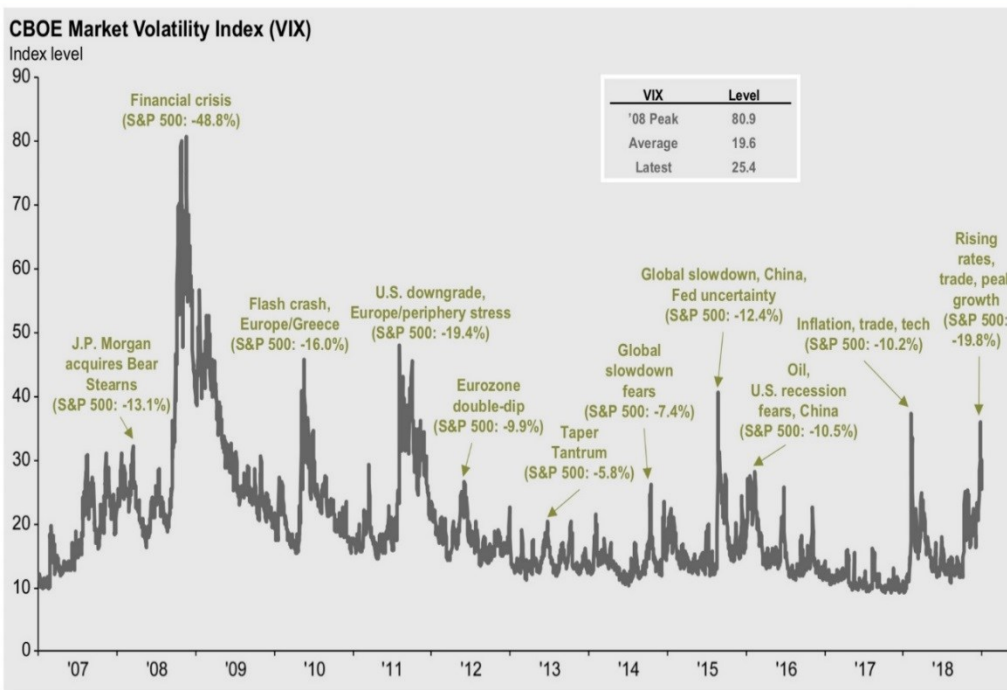
31-Dec-18	Total Return (%)		
	MTD	3-M	YTD
Canadian Equities			
TSX Composite	-5.4%	-10.1%	-8.9%
TSX 60	-5.5%	-8.9%	-7.6%
TSX Completion	-4.9%	-13.7%	-12.9%
TSX SmallCap	-3.5%	-14.4%	-18.2%
Canadian Bonds			
FTSE TMX Universe Bond	1.4%	1.8%	1.4%
FTSE TMX Government Bond	1.5%	2.1%	1.5%
FTSE TMX Corporate Bond	1.1%	0.9%	1.1%
Cash			
Tbills (91-d)	0.0%	0.5%	1.4%

Source: Scotiabank GBM Portfolio Strategy, FTSE TMX

Asset Class Total Return by Year (USD)

Ranking	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	
1- Highest	MSCI EM	MSCI China	MSCI China	Gold	MSCI EM	Gold	US TIPS	Global REITs	Russell 2000	US REITs	MSCI Japan	Russell 2000	MSCI China	US T-bills	1.8%
2	MSCI Japan	Global REITs	MSCI EM	US Agg. Bond	MSCI China	US REITs	Gold	MSCI China	S&P 500	Global REITs	US REITs	US HY	MSCI EM	US Agg. Bond	0.0%
3	MSCI China	US REITs	Gold	Global Agg. Bond	Global HY	Russell 2000	US Agg. Bond	Global HY	MSCI World SC	S&P 500	S&P 500	Global HY	MSCI Europe	Global Agg. Bond	-1.2%
4	Gold	MSCI Europe	MSCI Europe	US T-bills	US HY	MSCI World SC	US REITs	MSCI Europe	MSCI Japan	MSCI China	Global REITs	MSCI World SC	MSCI Japan	US TIPS	-1.3%
5	Commodities	MSCI EM	US TIPS	US TIPS	MSCI World SC	Global REITs	Global Agg. Bond	MSCI EM	MSCI Europe	US Agg. Bond	US Agg. Bond	S&P 500	MSCI World SC	Gold	-1.6%
6	MSCI World SC	Gold	Commodities	US HY	MSCI Europe	MSCI EM	US HY	MSCI World SC	US HY	Russell 2000	US T-bills	MSCI EM	S&P 500	US HY	-2.1%
7	US REITs	MSCI World SC	Global Agg. Bond	Global HY	Global REITs	Commodities	Global HY	US REITs	Global HY	US TIPS	MSCI World SC	Commodities	Russell 2000	US REITs	-3.4%
8	Global REITs	Russell 2000	MSCI World SC	MSCI Japan	US REITs	MSCI Japan	S&P 500	Russell 2000	MSCI China	US HY	US TIPS	Gold	Gold	Global HY	-4.1%
9	MSCI Europe	S&P 500	US Agg. Bond	Russell 2000	Russell 2000	US HY	Global REITs	S&P 500	Global REITs	MSCI World SC	Global HY	US REITs	Global HY	S&P 500	-4.4%
10	S&P 500	Global HY	S&P 500	Commodities	S&P 500	S&P 500	US T-bills	US HY	US REITs	Global Agg. Bond	MSCI Europe	Global REITs	Global REITs	Global REITs	-4.8%
11	Russell 2000	US HY	US T-bills	S&P 500	Gold	Global HY	Russell 2000	MSCI Japan	US T-bills	US T-bills	Global Agg. Bond	US TIPS	US HY	Russell 2000	-11.0%
12	Global HY	Global Agg. Bond	Global HY	US REITs	Commodities	US Agg. Bond	MSCI World SC	Gold	US Agg. Bond	Global HY	Russell 2000	MSCI Japan	Global Agg. Bond	MSCI Japan	-12.6%
13	US T-bills	MSCI Japan	US HY	MSCI World SC	US TIPS	US TIPS	MSCI Europe	US TIPS	MSCI EM	Gold	US HY	US Agg. Bond	US REITs	Commodities	-13.0%
14	US TIPS	US T-bills	Russell 2000	Global REITs	Global Agg. Bond	Global Agg. Bond	Commodities	Global Agg. Bond	Global Agg. Bond	MSCI EM	MSCI China	Global Agg. Bond	US Agg. Bond	MSCI World SC	-14.0%
15	US HY	US Agg. Bond	MSCI Japan	MSCI Europe	MSCI Japan	MSCI China	MSCI Japan	US Agg. Bond	US TIPS	MSCI Japan	Gold	MSCI China	US TIPS	MSCI EM	-14.2%
16	US Agg. Bond	US TIPS	Global REITs	MSCI China	US Agg. Bond	MSCI Europe	MSCI EM	US T-bills	Commodities	MSCI Europe	MSCI EM	US T-bills	US T-bills	MSCI Europe	-14.9%
17- Lowest	Global Agg. Bond	Commodities	US REITs	MSCI EM	US T-bills	US T-bills	MSCI China	Commodities	Gold	Commodities	Commodities	MSCI Europe	Commodities	MSCI China	-18.8%

Source: Scotiabank GBM Portfolio Strategy, Bloomberg.

Volatility returned in 2018 on Wall Street

CBOE Market Volatility Index (VIX)
Index level

VIX	Level
'08 Peak	80.9
Average	19.6
Latest	25.4

Financial crisis (S&P 500: -48.8%)

J.P. Morgan acquires Bear Stearns (S&P 500: -13.1%)

Flash crash, Europe/Greece (S&P 500: -16.0%)

U.S. downgrade, Europe/periphery stress (S&P 500: -19.4%)

Eurozone double-dip (S&P 500: -9.9%)

Taper Tantrum (S&P 500: -5.8%)

Global slowdown fears (S&P 500: -7.4%)

Global slowdown, China, Fed uncertainty (S&P 500: -12.4%)

Oil, U.S. recession fears, China (S&P 500: -10.5%)

Inflation, trade, tech (S&P 500: -10.2%)

Rising rates, trade, peak growth (S&P 500: -19.8%)

Sources: CBOE, FactSet, J.P. Morgan Asset Management.
Stock market returns are based on calendar year peak to trough declines experienced during VIX spike, except for J.P. Morgan acquires Bear Stearns, which is based on the calendar year peak to the acquisition date. Average is based on the period shown from 12/31/2006 to 12/31/2018.
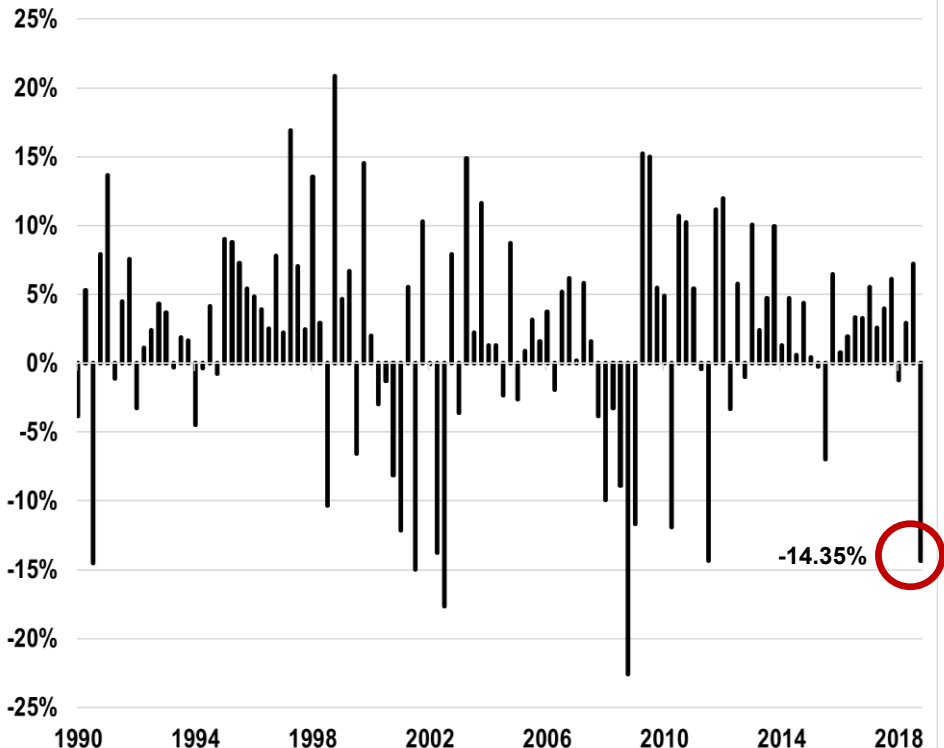*Guide to the Markets – U.S.* Data are as of December 31, 2018.

J.P.Morgan
Asset Management

Daily Market Moves

	# of Trading Days		
Year	**1 - 2 %**	**> 2 %**	**All-Time Highs**
2013	38	4	45
2014	38	6	53
2015	72	10	10
2016	48	9	18
2017	8	0	62
4Q18	28	12	0
2018	64	20	19
Annual Avg	**52**	**11**	**26**
2013-17 Avg	**41**	**6**	**38**

Source: Credit Suisse, January 2019

S&P 500 : Worst quarter since 2008!

-14.35%

S&P 500 : Worst returns for the month of december

Year	Return
1981	-3.0%
1980	-3.4%
1957	-4.1%
1968	-4.2%
1941	-4.7%
1937	-5.0%
2002	-6.0%
1930	-6.3%
2018	-9.2%
1931	-14.5%

Worst month of December since the 1930!!!

Source: Bloomberg, iAGP, December 31, 2018
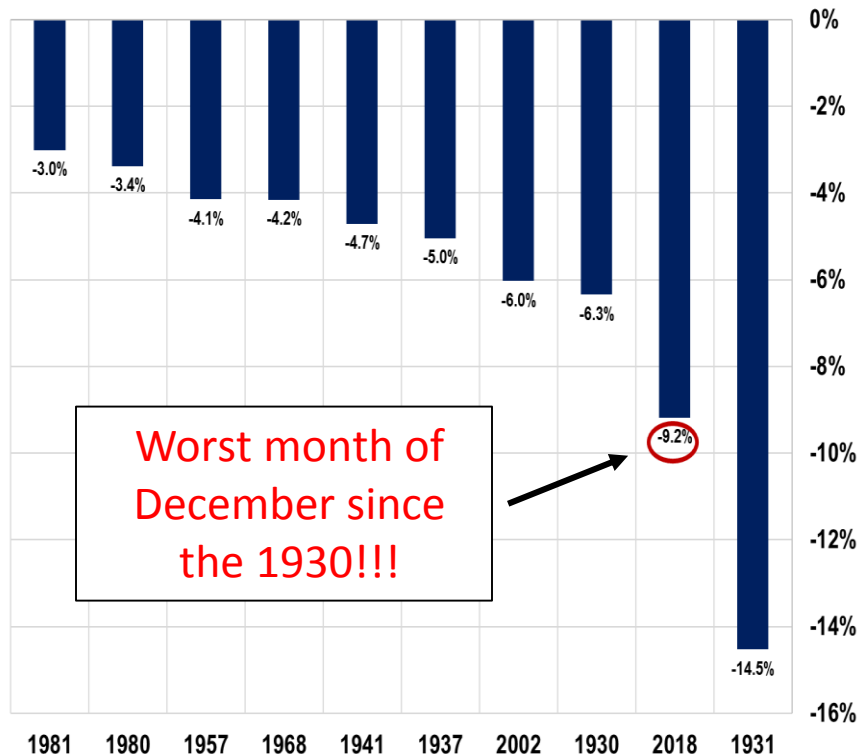
S&P 500: Strong earnings growth in 2018 but ... with a contraction of the P/E ratio at the same time!

Earnings Revisions

2018 EPS Revisions

Taxes and stronger fundamentals contributed to positive 2018 revisions
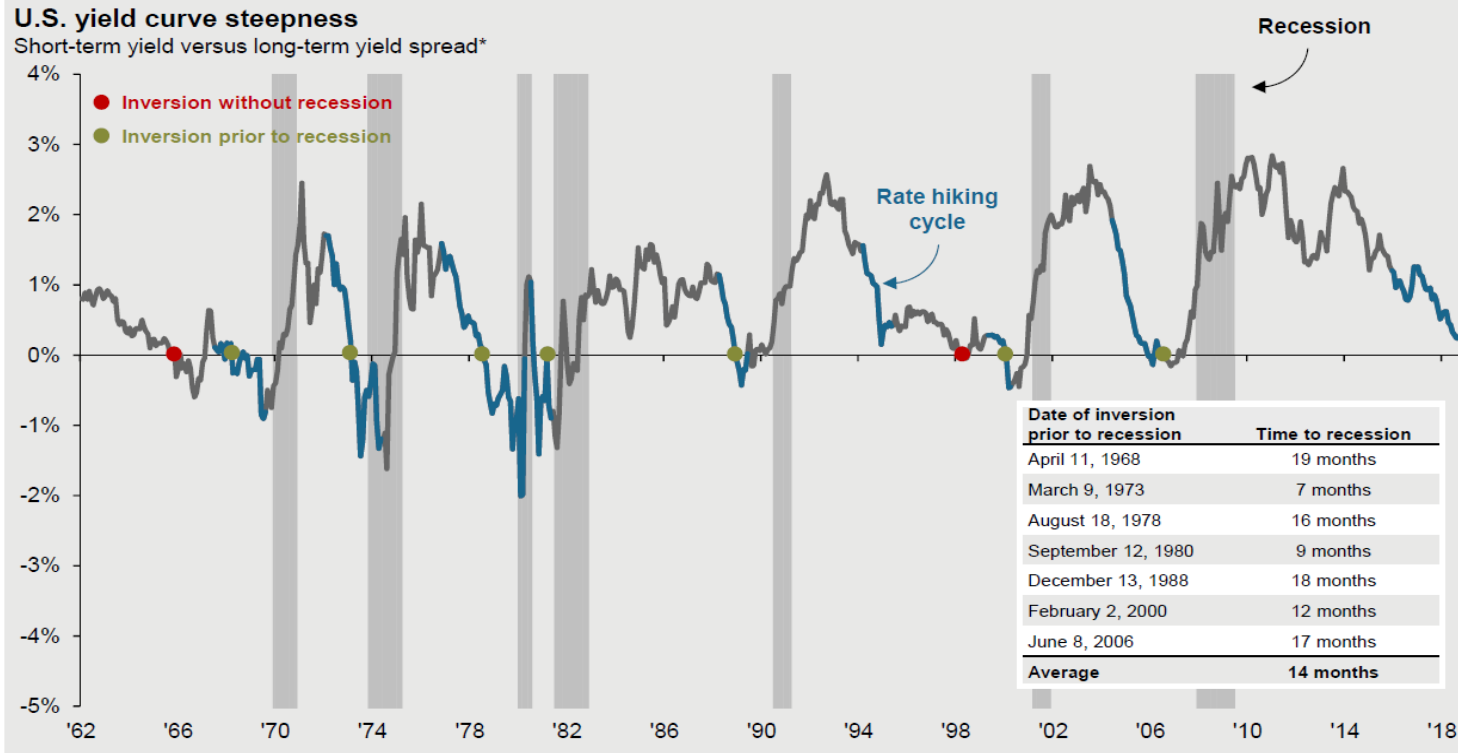
Better economics

◄ 2018

Taxes

◄ Historical Trend
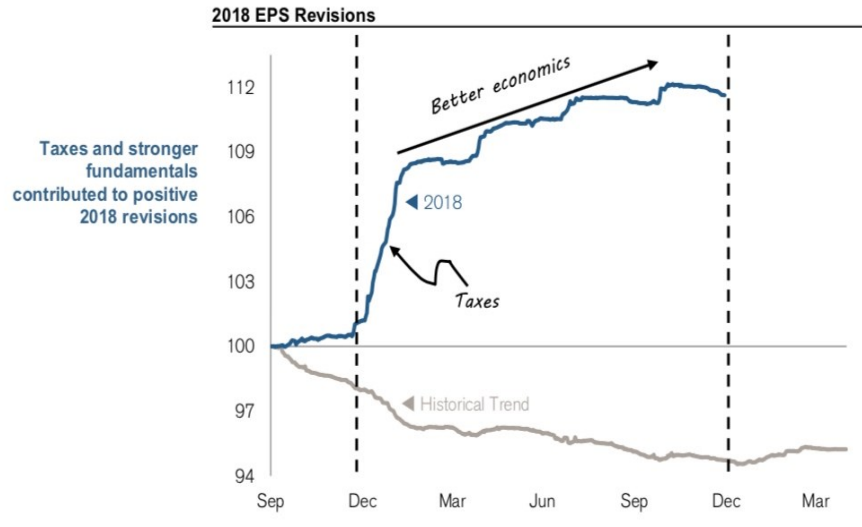
Note: Average historical path of next-year revisions from 2011-2017, indexed to 100 on 9/30 of prior year
Source: Standard & Poor's, Thomson Financial, FactSet, Credit Suisse

Change in Calendar Year PEs

2018: Third largest decline in PEs in over 40 years
Only '02 and '00 were worse
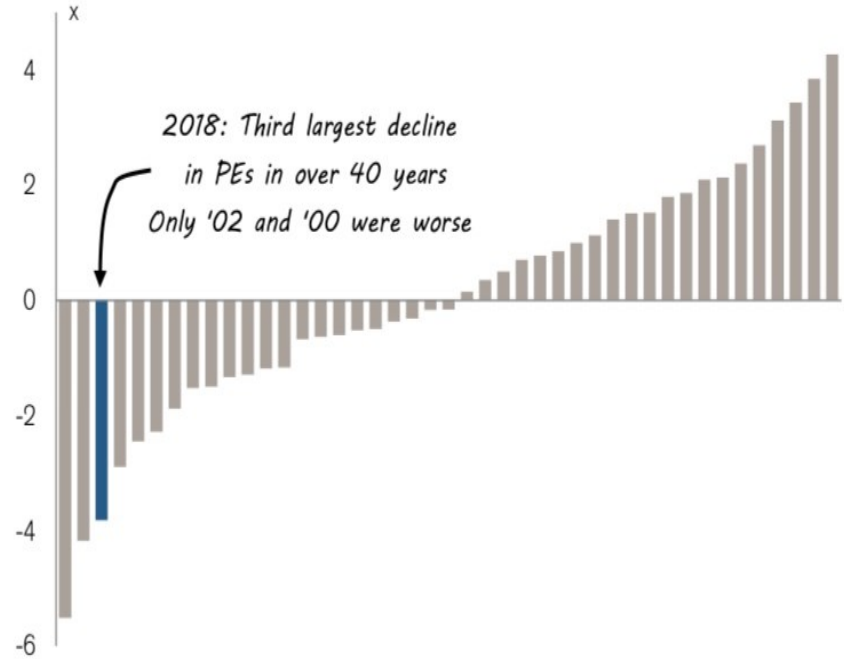
Note: Change in multiple points over calendar year; 1976 to present. 2002 and 2000 were the worst two years
Source: Standard & Poor's, Thomson Financial, FactSet, and Credit Suisse

Source: Credit Suisse, January 2019

An almost inverted 10/2 yield curve: A recession signal?

U.S. yield curve steepness
Short-term yield versus long-term yield spread*

● Inversion without recession
● Inversion prior to recession

Recession

Rate hiking cycle

Date of inversion prior to recession	Time to recession
April 11, 1968	19 months
March 9, 1973	7 months
August 18, 1978	16 months
September 12, 1980	9 months
December 13, 1988	18 months
February 2, 2000	12 months
June 8, 2006	17 months
Average	**14 months**

Source: FactSet, Federal Reserve, J.P. Morgan Asset Management. *From January 1962 to May 1976 short-term bond is U.S. 1-year bond. Short-dated bond is 2-year from June 1976. Time to recession is calculated as the time between the final sustained inversion of the yield curve prior to recession, and the onset of recession.

Source: JP Morgan, December 31, 2018

Good news: Most leading indicators suggest that recession probabilities are relatively low

Recession Dashboard

Start of Recession	Yield Curve	Inflation Trends	Job Creation	Credit Perform	ISM Mfg.	Earnings Quality	Housing Market
Nov-73	⬇	⬇	⬇	⬇	⬇	--	⬇
Jan-80	⬇	⬇	⬇	⬇	⬇	--	⬇
Jul-81	⬇	⬆	⬆	⬇	⬇	--	⬇
Jul-90	⬇	⬇	⬇	⬇	⬇	⬇	⬇
Mar-01	⬇	⬇	⬇	⬇	⬇	⬇	↔
Dec-07	⬇	⬇	↔	⬇	⬇	⬇	⬇
Present	⬆	↔	⬆	⬆	⬆	⬆	↔

Key: ⬇ Recessionary ⬆ Expansionary ↔ Neutral

Source: Standard & Poor's, Federal Reserve, BLS, National Statistical Agencies, NBER, ISM, Census Bureau, Haver Analytics®, Credit Suisse

Source: Credit Suisse, December 2018

With such low real rates, it is premature to predict a recession

Since 1960, we have never had a recession unless we had real rates of at least 2%

U.S. Real Fed Funds Rate
(Effective Fed Funds Rate Less Core PCE Y/Y)
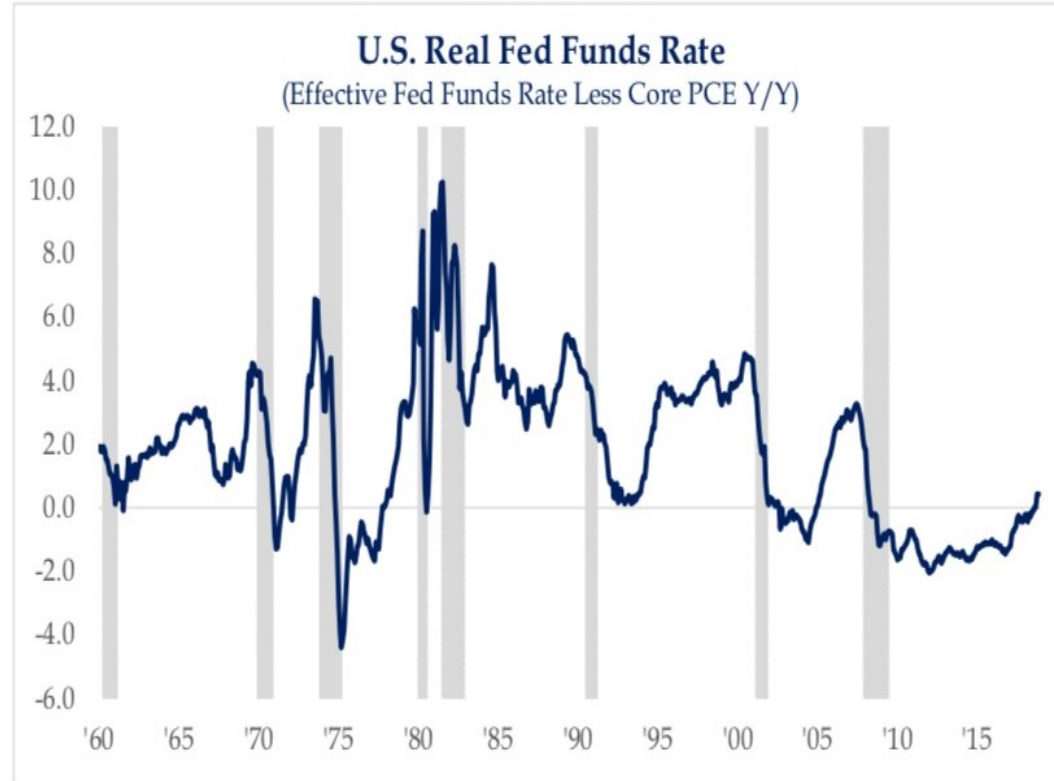
Real Fed Funds Rate At The Start of Recession	
Apr-60	1.91
Dec-69	4.22
Nov-73	5.18
Jan-80	5.58
Jul-81	10.25
Jul-90	4.08
Mar-01	3.54
Dec-07	1.91

Source: Strategas, December 2018

U.S. : Corporate spreads
Investment Grade (IG), in %

Mean
2000-2008 : 1.3

Mean
2010-2008 : 1.4

Real GDP vs IG effective yield

04-Jan-2019
@SoberLook

$y = -0.0129x + 3.9806$
$R^2 = 0.3537$

Latest observation

Q3 2008

Q3 2009

Q2 2009

Q4 2008   Q1 2009

Real GDP, y/y %

BofAML Corporate Master IG Effective yield - 10 year note yield, bps
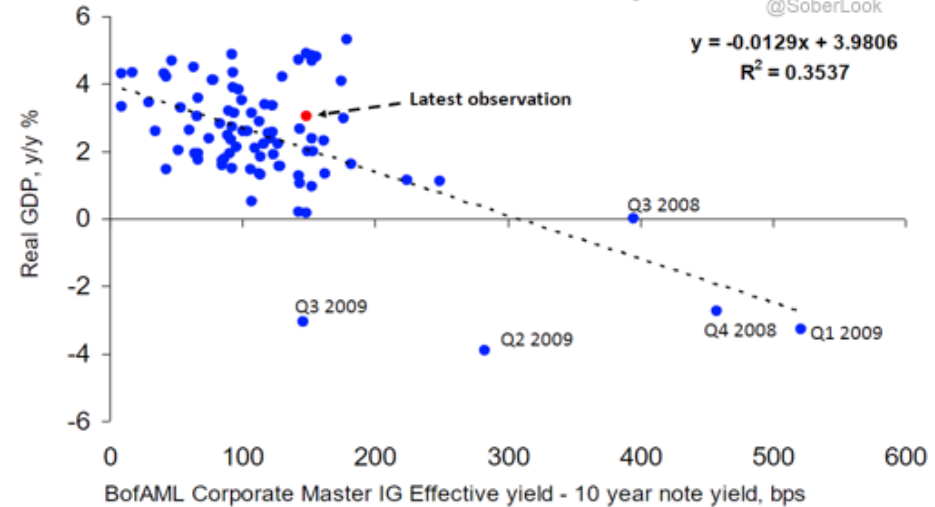
Source: BEA, ICE/BAML, Haver Analytics, DB Global Research

Source: iA Economics, data via Bloomberg

Bottom line: Despite this correction of nearly 20%, we should not predict a recession too quickly!

S&P 500 Index Bear Markets Since WWII

Month of Peak	Month of Trough	% Decline	Recession?
05/1946	05/1947	-29%	No
08/1956	10/1957	-22%	Yes
12/1961	06/1962	-28%	No
02/1966	10/1966	-22%	No
12/1968	05/1970	-36%	Yes
01/1973	10/1974	-48%	Yes
09/1976	03/1978	-19%	No
11/1980	08/1982	-27%	Yes
08/1987	12/1987	-34%	No
07/1990	10/1990	-20%	Yes
07/1998	08/1998	-19%	No
03/2000	10/2002	-49%	Yes
10/2007	03/2009	-56%	Yes
04/2011	10/2011	-19%	No
Avg (All)		-31%	
Avg (Recessions)		-37%	
Avg (No Recession)		-24%	

Posted on WSJ: The Daily Shot 02-Jan-20 @SoberLook

Source: LPL Research, FactSet   12/20/18

Other risk factors to monitor

China-U.S. trade tensions

Wage acceleration in the U.S.
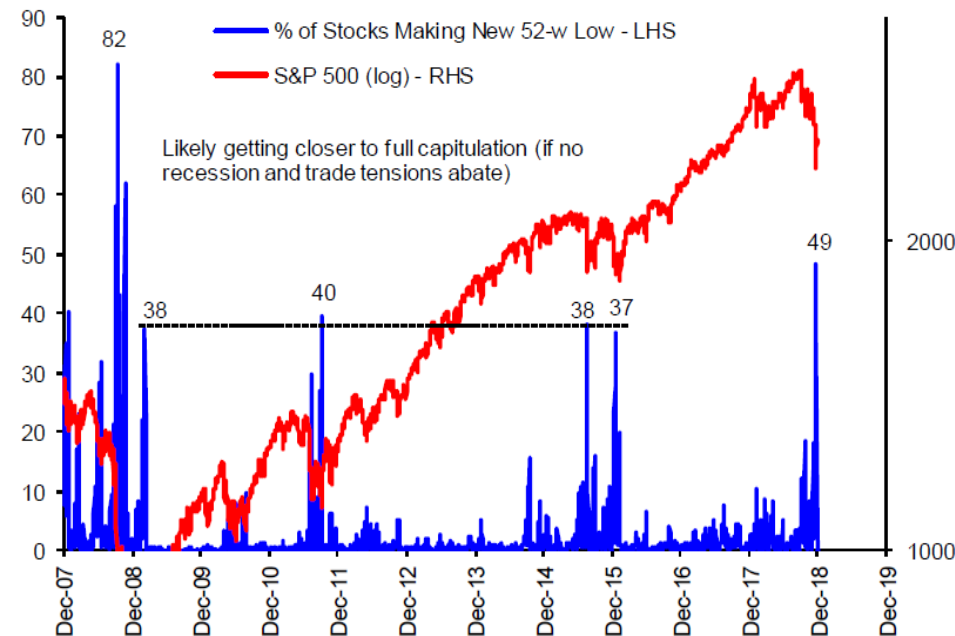
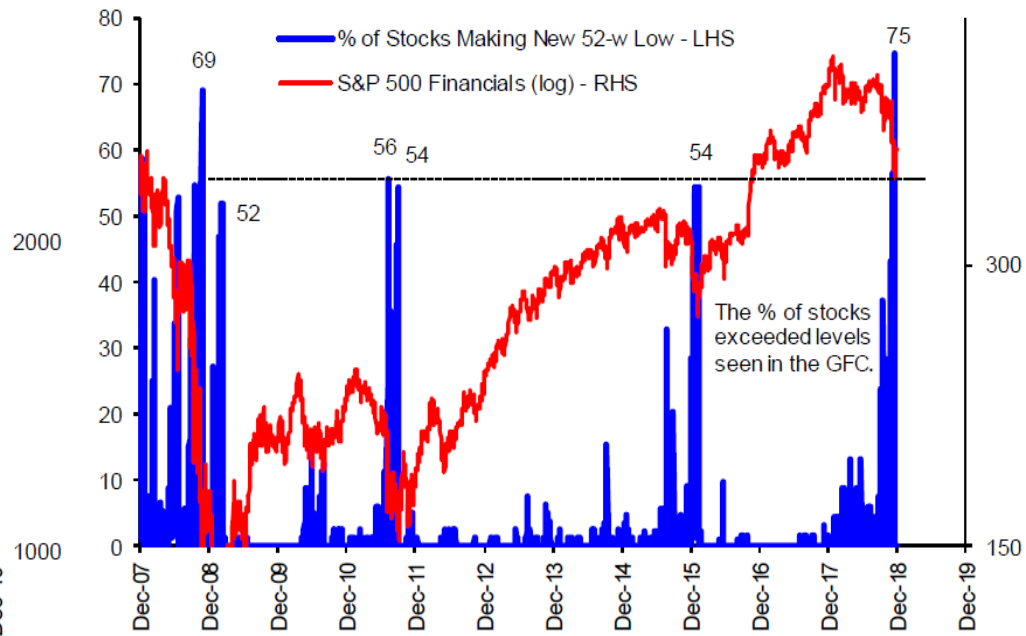Relationship between Trump and Congress

Messy end to Brexit

Wall Street: Obvious signs of capitulation?
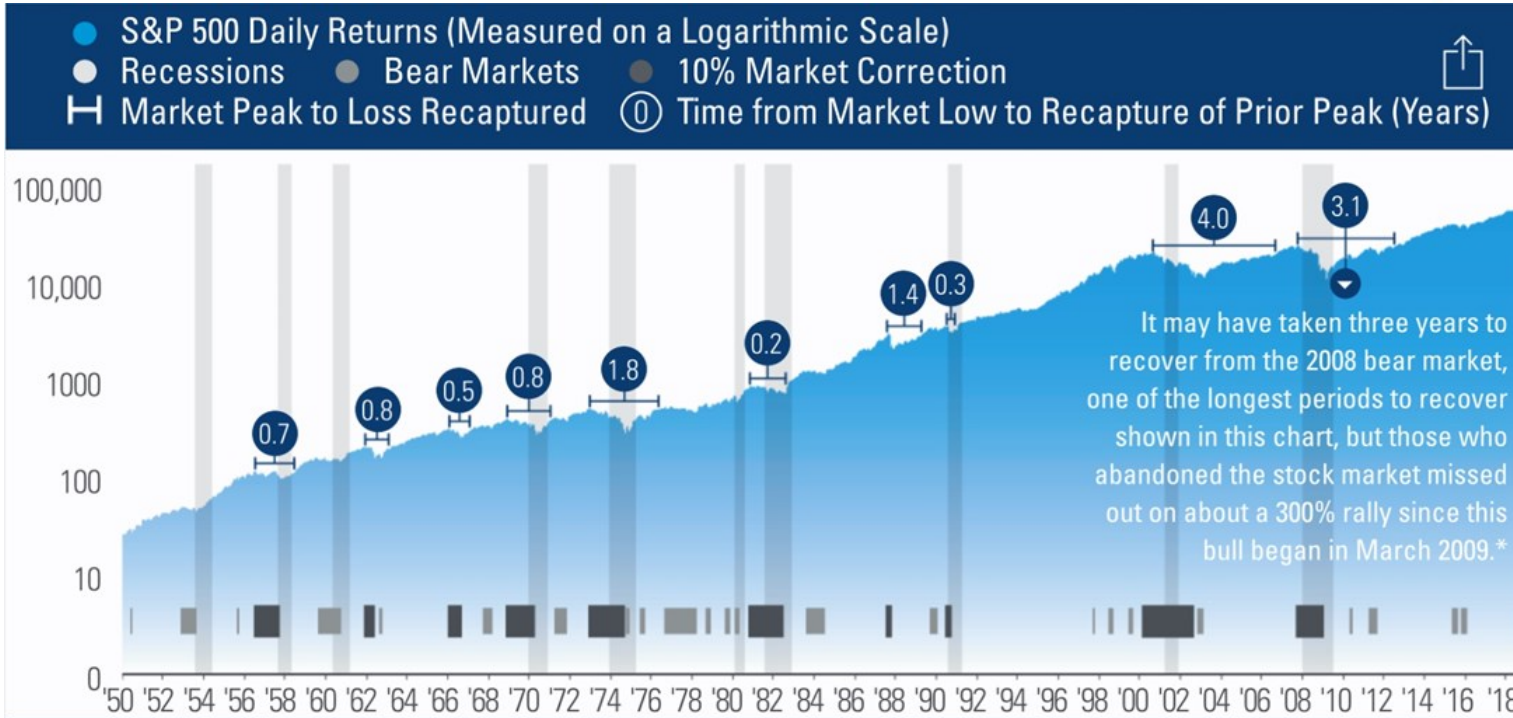

S&P 500 - % of Stocks Making New 52-w Lows

Likely getting closer to full capitulation (if no recession and trade tensions abate)

US Financials - % of Stocks Making New 52-w Lows

The % of stocks exceeded levels seen in the GFC.

Source: Scotiabank GBM Portfolio Strategy, Bloomberg

In the absence of a recession, the market tends to recover its losses faster

**S&P 500 Daily Returns (Measured on a Logarithmic Scale)**
- Recessions
- Bear Markets
- 10% Market Correction
- Market Peak to Loss Recaptured
- Time from Market Low to Recapture of Prior Peak (Years)

It may have taken three years to recover from the 2008 bear market, one of the longest periods to recover shown in this chart, but those who abandoned the stock market missed out on about a 300% rally since this bull began in March 2009.*

S&P 500 Equity Risk Premium
(Earnings Yield less 10-Year Treasury Yield, bps)

Average Forward 12 Month Return by ERP Tranche
(1960 - Current, Quarterly)

Source: Strategas, December 2018
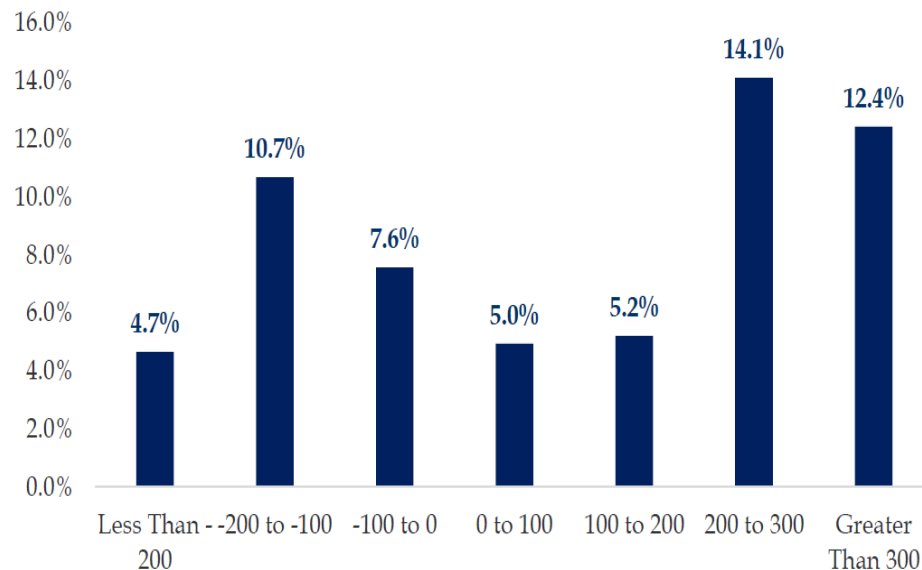
What to favour in 2019? Overseas markets expected to benefit from a weak greenback

MSCI All Country World ex-U.S. and S&P 500 Indices
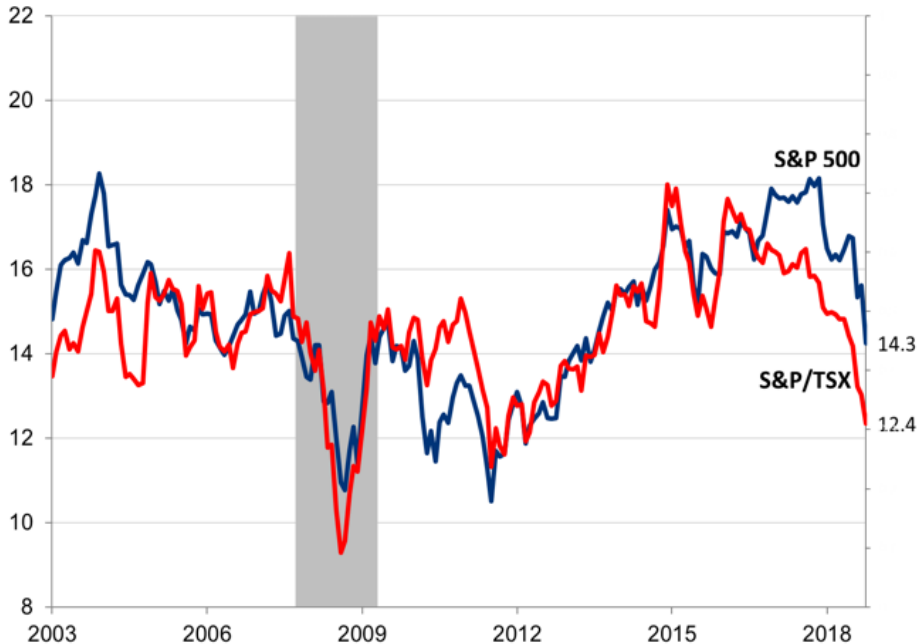Dec. 1996 = 100, U.S. dollar, price return

	P/E	20-yr. avg.	Div. Yield	20-yr. avg.
S&P 500	14.4x	15.8x	2.3%	2.0%
ACWI ex-U.S.	11.5x	14.2x	3.8%	3.0%
As % of U.S.	*80%*	*90%*	*165%*	*149%*

Dec. 31, 2018
P/E (fwd.) = 14.4x

Dec. 31, 2018
P/E (fwd.) = 11.5x

+106% -49% +101% -57% +271%
+48% -52% +216% -62% +90%
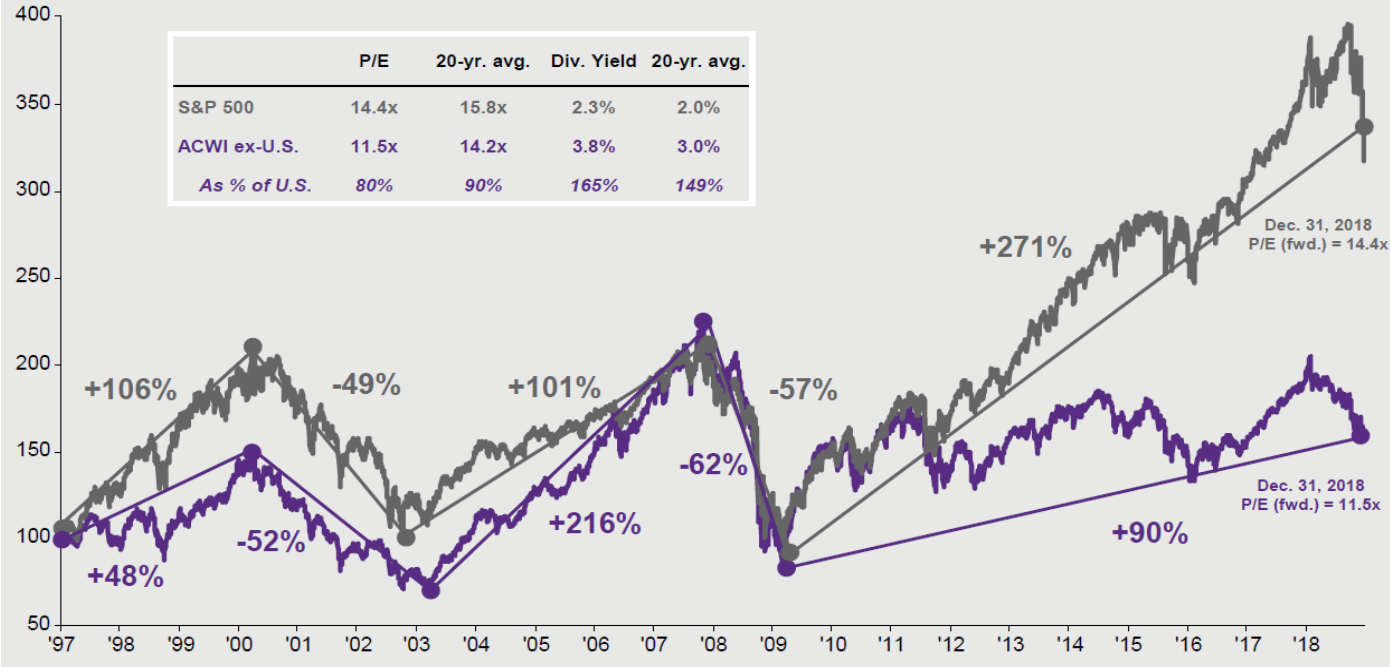
Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
Forward price to earnings ratio is a bottom-up calculation based on the most recent index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on price movement only, and do not include the reinvestment of dividends. Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by FactSet Market Aggregates. Past performance is not a reliable indicator of current and future results.
Guide to the Markets – U.S. Data are as of December 31, 2018.

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S&P 500 vs S&P/TSX: Forward P/E ratio

S&P/TSX: P/E ratio of the financial sector

Source: iA Economics, data via Bloomberg

"Wow, I feel great about this investment."

Point of maximum financial risk

"Temporary setback. I'm a long-term investor."

Thrill
Euphoria
Anxiety
Excitement
Denial
Optimism
Fear
Desperation
Panic
Point of maximum financial opportunity
Relief
Capitulation
Hope
Despondency
Depression
Optimism

"Maybe the markets just aren't for me."
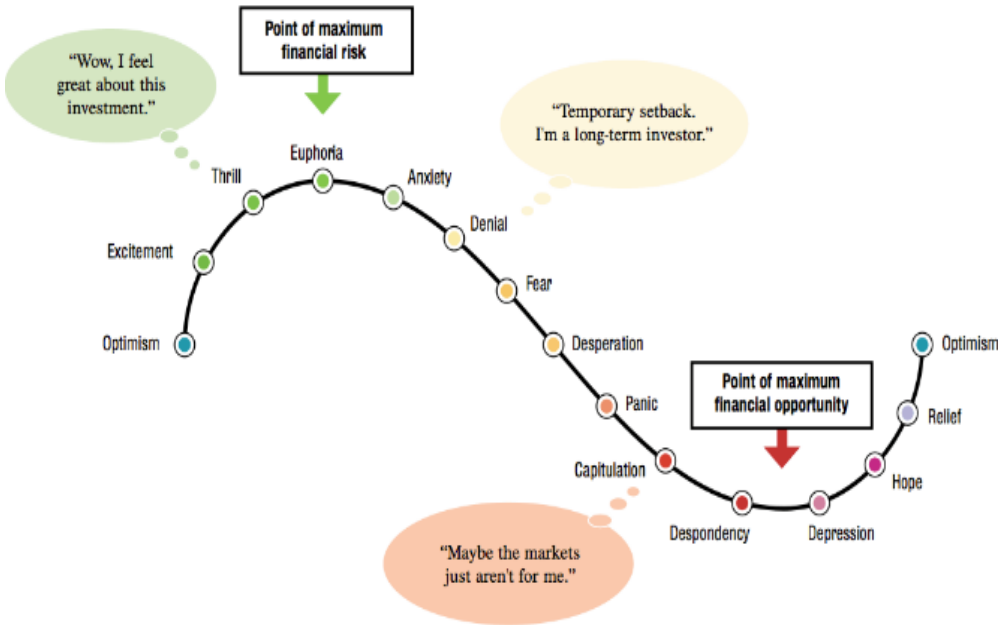
Source: Option Alpha

Range of stock, bond and blended total returns
Annual total returns, 1950-2017
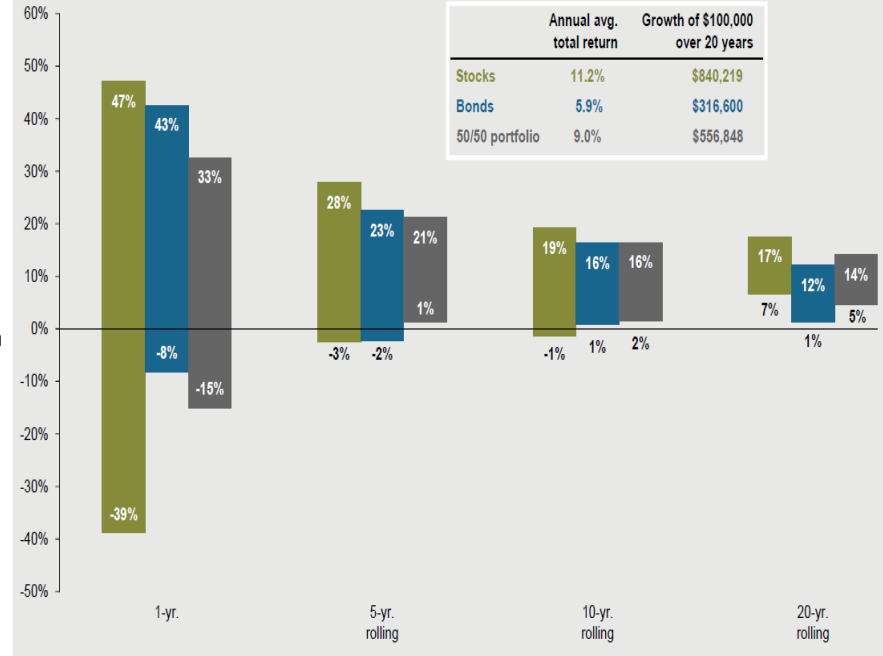
	Annual avg. total return	Growth of $100,000 over 20 years
Stocks	11.2%	$840,219
Bonds	5.9%	$316,600
50/50 portfolio	9.0%	$556,848

1-yr.: 47%, 43%, 33%, -8%, -15%, -39%
5-yr. rolling: 28%, 23%, 21%, 1%, -3%, -2%
10-yr. rolling: 19%, 16%, 16%, -1%, 1%, 2%
20-yr. rolling: 17%, 12%, 14%, 7%, 1%, 5%

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