

Month in Review

For the month ended February 28th, 2018

Market Volatility Continues

The late February decline in the markets, initially prompted by hawkish comments from the U.S. Federal Reserve, continued into early March. In his first speech as the new Chairman of the Fed to the House Financial Services Committee, Jerome Powell stated the health of the U.S. economy has "strengthened in recent weeks", creating speculation of potentially faster rate hikes than currently anticipated. Markets have been heavily influenced by Central Banks since the financial crisis and with a new Fed Chair at the helm, this can create uncertainty for the markets as they begin to digest and become comfortable with his plan. Markets reacted by selling off again, a little over a month since the recent correction and subsequent recovery. In addition, at the beginning of March, the U.S. protectionist movement returned as Trump *verbally* imposed tariffs of 10% and 25% on aluminum and steel imports to the U.S., respectively. Fears of global trade wars and tweets from Trump that "...trade wars are good, and easy to win" spooked the markets lower with some suggesting such actions by the U.S., and other countries in retaliation, will stifle global growth at a time when weak inflation is already a concern with investors. This is not likely the last of the U.S.'s attempts to alter the trade playing field and every tax or tariff implied will bring about volatility that will test the mettle of the markets, which has shrugged it off to continue the current unprecedented Bull run.

Overall Highlights

- TSX falls.** The S&P/TSX Composite ended the month in the red owing to a late month sell-off in crude oil and the renewed interest rate hike rumours leading up to the next FOMC meeting in March. The Liberal government tabled the third budget of its administration with equality being the governing theme and little change to taxation on investments. The Composite closed February at 15,443, a 3.2% monthly loss.
- Dollar lower.** Soft economic data at home sapped the lift from under the Loonie as the economy began to show signs of slowing. Abroad, worries of increased U.S. tariffs on key exports to the U.S., namely steel and aluminum, as well as pro-rate hike comments from new Federal Reserve Chairman Jerome Powell, pushed our currency lower. In February, the Loonie ended at US78.07cents for one Canadian dollar, a monthly decline of 4%.
- Gold dulls.** In its first monthly loss since October, the yellow metal lost its lustre on the backs of hawkish comments by the U.S. Federal Reserve, increasing the probability of a rate hike at their next meeting in March. The resource's decline was tempered as low inflation continued to hamper the American economy prompting haven buying by gold bugs. Gold closed the month at US\$1,320.20, a decrease of 2%.
- Oil sputters.** After a run of five straight monthly gains, oil futures fell in February as U.S. government data reported domestic crude production continued to edge higher. U.S. stockpiles of the commodity rose unexpectedly as increased demand experienced in the past months began to dissipate. As well, the rise of the Greenback muted prices given oil is priced in that currency. An April contract for a barrel of WTI crude ended trading at US\$61.66, a 4.9% loss for the month.
- Equality+Growth.** On February 27, Finance Minister Bill Morneau presented his third deficit budget to the House focusing on positioning Canada for future growth and success as well as aid in bridging the inequality gaps between different demographics.
- Unemployment rises.** Canada's jobless rate began the year higher as the decline in part-time (PT) employment was more than full-time (FT) hirings could compensate.
- Manufacturing sector busier.** The country's factories remained busy as manufacturing activity picked up in January to a nine month high.
- U.S. GDP revised lower.** The Commerce Department revised the Q4 GDP lower.
- Jerome Powell speaks.** The new Fed Chair spoke for the first time and indicated that the Fed will stick with gradual interest rate increases.
- U.S. CPI rises more than expected.** U.S. consumer prices increased more than expected in January.
- Euro-zone's Q4 GDP grows.** The Euro-zone economy remained robust in the fourth quarter, according to the preliminary estimate by Eurostat.
- Euro-zone inflation falls.** Inflation within the Euro-zone continued to slow down in February.
- Japan's Q4 GDP growth slows.** The world's third largest economy remained in expansion mode in the fourth quarter, albeit at a slower pace.
- China's inflation eases.** Both consumer prices and producer prices in China cooled down in January.

Index/Commodity/Currency		
Close	Month Change	YTD Change
S&P/TSX Composite		
15,442.68	-509.0	-766.5
	-3.2%	-4.7%
BMO Nesbitt Burns Small Cap		
877.52	-35.6	-58.9
	-3.9%	-6.3%
Dow Jones Industrial Average		
25,029.20	-1,120.2	310.0
	-4.3%	1.3%
S&P 500		
2,713.83	-110.0	40.2
	-3.9%	1.5%
NASDAQ Composite		
7,273.01	-138.5	369.6
	-1.9%	5.4%
MSCI-EAFE Index		
2,051.73	-101.3	0.9
	-4.7%	0.0%
WTI Crude Oil (per barrel, in \$US)		
61.66	-3.2	1.6
	-4.86%	2.6%
Gold (per ounce, in US\$)		
1,320.20	-26.5	15.2
	-2.0%	1.2%
Canadian Dollar (¢ per US\$)		
78.07	-3.3	-1.6
	-4.0%	-2.1%

Sources: Bloomberg, PC Bond

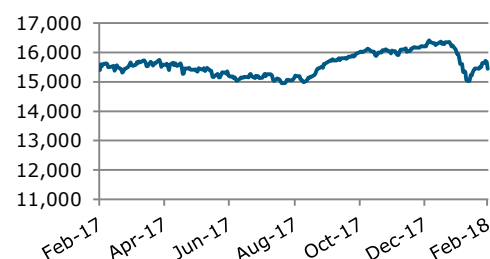
Canadian Markets

- Equality+Growth.** On February 27, Finance Minister Bill Morneau presented his third deficit budget to the House focusing on positioning Canada for future growth and success as well as aid in bridging the inequality gaps between different demographics. Some of the key highlights from the Budget include legislative change for federal pay equity, EI benefits for new fathers on paternal leave, new funding for Indigenous and First Nations, and a review of the nation's Pharmacare system. The government will direct resources to improve Canada's cybersecurity infrastructure, fight the opioid crisis, and improve drinking water on reserves. On the scientific side, research and innovation will get boost in monies and so too will Canada's waterways, conserved land, and protected wildlife, while children will be admitted into national parks for free. Mr. Morneau's budget did not make changes to the capital gains tax or GST but did clarify the taxation of passive income by private companies.
- Unemployment rises.** Canada's jobless rate began the year higher as the decline in part-time (PT) employment was more than full-time (FT) hirings could compensate. In January, the national unemployment rate climbed to 5.9%, a notch higher than the previous month's revised 5.8% reading, as 88,000 jobs were shed. During the month, the economy lost 137,000 PT jobs, built up to assist during the holiday season, while adding 49,000 FT positions. The participation rate slipped lower to 65.5%.
- Inflation higher.** The price of a notional basket of goods in Canada rose in January led by reversal in telephone service prices which fell in December. In the first month of the year, inflation rose 0.7%, topping forecasts of a 0.4% increase. Statistics Canada pointed to the new minimum wage in Ontario contributing to the rise by passing on costs to consumers as restaurant prices rose 4.9%. Annualized, prices are 1.7% higher in January, down from December's 1.9% reading, while core inflation held steady at 1.2%
- PPI rises.** After slipping the previous month, the Producer Price Index rose in January lifted by higher energy and petroleum products. Statistics Canada reported a 0.3% gain during the month, just short of analysts' expectations of a 0.5% gain as rising gasoline and diesel fuels drove the energy group up by 3.4%. A stronger Canadian dollar also contributed to the index as seven of the 21 groups followed in the index rose while ten declined.
- Wholesale sales slip.** Sales from factories fell for the first time in three months with declines seen in five of the seven sectors followed by Statistics Canada. In December, wholesale sales fell by 0.5%, contrary to the 0.4% rise expected, as receipts tallied to \$63B. The largest detractors were the personal and household goods sectors, which fell 3.3%, while building materials and supplies was the big gainer by 2.7% followed by machinery, equipment and supplies at 2.3%.
- Manufacturing sector busier.** The country's factories remained busy as manufacturing activity picked up in January to a nine month high. New orders, from both at home and abroad, rose, which also bumped up new export demand as the Markit Manufacturing PMI survey rose to 55.9 from 54.7 on a seasonally adjusted basis. The economy continues to be driven forward by this sector as respondents to the survey see business conditions and spending on the rise.
- Retails sales drop.** Expectations of ending 2017 on a high note were dispelled as retail sales fell more than expected in December. During the month, a larger pull back in electronics exceeded gains in auto sales as StatCan reported a 0.8% decline in retail sales where a 0.2% increase had been forecasted. Of the 11 sectors followed, six retreated led by a 5.3% drop in general merchandise stores. In volume terms, it also fell by 0.8% for the month.
- Canada Housing News:**
 - Housing starts lower.** Ground-breakings were reported to be less than forecasted in January as home starts increased in urban areas for detached homes. For the month, on an adjusted basis, 216,210 units were started compared to December's 216,275 units. Multi-unit dwellings were relatively unchanged with strong demand in Toronto and Vancouver, while rural home construction was stable at 17,810 units.
 - Permits up.** Applications to build rose in December more than estimate lead by single family homes in Ontario. As reported by Statistics Canada, building permits rose 4.8%, more than the 2% forecasted, with residentials, which include condominiums, climbing 8% nationally and industrial & commercial structures falling 0.6%.
 - Home sales plummet.** CREA reported that for the first month of the year, national home sales fell 14.5% as activity fell to a three-year low, with most of the declines seen in the Greater Golden Horseshoe region in Ontario. In January, the steep decline was primarily attributed to new mortgage rules that came into effect on Jan 1st and ongoing homeowner uncertainty in 2018 as governments continue to cool the housing market. Listing of homes also fell, dropping 21.6% during the month, led by the Greater Toronto Area (GTA) region also in Ontario. On a non-seasonally adjusted basis, home sales are down 2.4% from the same period a year ago.
 - New home prices steady.** The price of a new home in Canada was little changed in December, the first time in over 2½ years, as rising interest rates, government legislation, and tougher rules for purchasers exercised its toll. Hot spots Toronto and Vancouver were flat and gained 0.2%, respectively over the month, as national home prices grew 3.3% in the last 12 months.

S&P/TSX Composite Index Sector Snapshot

Sector	Month Return	YTD Return	Weight (%)
Energy	-6.43	-11.53	18.30
Telecoms	-2.14	-6.58	4.60
Industrials	1.28	-0.59	10.00
Consumer Staples	-2.75	-4.59	3.70
Utilities	-4.07	-8.41	3.70
Financials	-3.33	-3.02	35.20
Consumer Discretionary	-3.25	-3.70	5.50
Health Care	-10.09	-13.85	0.90
Materials	-4.04	-4.62	11.50
Information Technology	5.79	11.53	3.80
Real Estate	-1.11	-2.31	3.00

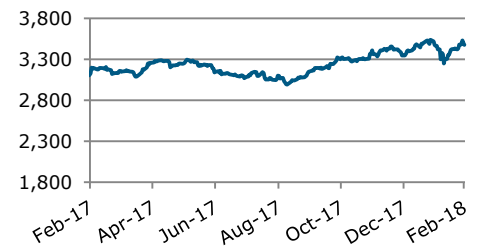
S&P/TSX Composite - 1Y Return



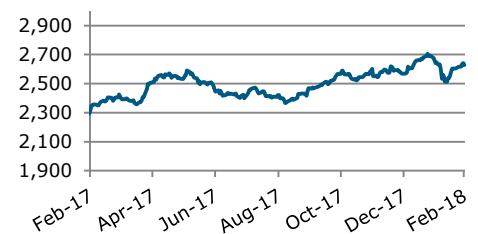
U.S. Markets

- **U.S. market tumbles.** The U.S. stock market had its first negative month in a very long time. Federal Reserve new chair Jerome Powell's first testimony to Congress sparked fear in the market that the Fed will increase interest rates at a faster pace than expected. The broad-based S&P 500, which recorded positive monthly returns for 15 straight months, lost 3.9% in February, closing just above the 2,700-level at 2,714. The Dow Jones Industrial Average was the worst performer among the three major indices, retreating 4.3%, ending the month at 25,029. Nasdaq had the smallest pullback among the three, dropping 1.9% to close the month at 7,273.
- **U.S. GDP revised lower.** The Commerce Department revised the Q4 GDP lower. The second estimate of the Q4 2017 GDP was reported to grow at an annualized rate of 2.5%, instead of the 2.6% pace reported previously. The revision was in line with economists' forecast. The decline was mostly due to a smaller inventory build than previously reported.
- **Jerome Powell speaks.** The new Fed Chair spoke for the first time and indicated that the Fed will stick with gradual interest rate increases. Jerome Powell, who took the torch from Janet Yellen as the new Federal Reserve chairman, gave his first testimony on Capitol Hill on Tuesday. "Inflation remains below our two percent longer-run objective. In the Federal Open Market Committee's view, further gradual rate increases in the federal funds rate will best promote attainment of both of our objectives", Mr. Powell said in his prepared remarks to Congress.
- **Fed's meeting minutes released.** Federal Reserve officials were expecting fast economic growth and an uptick in inflation according to the January's Fed meeting minutes. The minutes revealed that despite choosing not to raise interest rates in the January meeting, the Federal Open Market Committee (FOMC) indicated that the path ahead for rates would be higher. In the minutes, it is mentioned that "a majority of participants noted that a stronger outlook for economic growth raised the likelihood that further gradual policy firming would be appropriate."
- **U.S. gains more jobs than expected.** The U.S. economy pumped out more jobs than expected in January and wages went up. The Bureau of Labor Statistics reported that non-farm payrolls increased by 200,000 in January, beating economists' expected increase of 180,000. Unemployment stayed at the historical-low of 4.1%. Wages were up 0.3% for the month and 2.9% year-over-year; it was the strongest annual wage growth in more than 8-1/2 years.
- **U.S. CPI rises more than expected.** U.S. consumer prices increased more than expected in January. The Labor Department reported that the consumer price index (CPI) rose 0.5% from the previous month, topping economists' expectation of a 0.3% increase. On a year-over-year basis, CPI was up 2.1%, also higher than the 2.0% expected. The core CPI, which excludes food and energy prices, increased by 0.3% month-over-month and 1.8% year-over-year, both exceeding forecasts.
- **U.S. PPI rises.** Producer prices in U.S. edged up in January. The Labor Department reported that its producer price index (PPI) increased 0.4% in January, in line with forecasts. On a year-over-year basis, PPI rose 2.7%, accelerating slightly from the previous month's pace of 2.6%.
- **U.S. manufacturing activity expands.** Manufacturing activity in U.S. continued to expand in January. The IHS Markit manufacturing purchasing managers' index (PMI) for January was reported to be 55.5, up from December's reading of 55.1; economists were expecting a reading of 55.5. On the other hand, the Institute for Supply Management (ISM) reported that its manufacturing index slipped slightly from December's 59.3 to 59.1 in January; economists were expecting a reading of 58.6.
- **U.S. services sector continues to expand.** The IHS Markit service PMI eased to 53.3 in January from December's reading of 53.7 but remained above the 50-mark separating contraction from expansion; economists were expecting a January reading of 53.3. On the other hand, the Institute for Supply Management (ISM) reported that its non-manufacturing index jumped from December's reading of 56.0 to 59.9 in January, the highest reading since August 2005.
- **U.S. wholesale inventories and retail inventories rise.** Inventories rose at both wholesale and retail levels in January. The Commerce Department reported that wholesale inventories increased by 0.7% in January, much higher than economists' expected 0.3% increase. Retail inventories rose 0.8%, up from the 0.3% increase reported in December.
- **U.S. durable goods orders drop.** The Commerce Department reported that durable goods orders fell 3.7% in January, missing economists' expectations of a 2% decrease. Core capital goods orders, which exclude the volatile aircraft sector, dipped 0.2%, also missing economists' forecast of a 0.5% increase.
- **U.S. retail sales fall.** U.S. retail sales fell unexpectedly in January. The Commerce Department reported that retail sales decreased by 0.3% in January, missing economists' expectations of a 0.2% increase. It was the biggest monthly drop since February 2017. On a year-over-year basis, retail sales were up 3.6%.

S&P 500 - 1Y Return (CAD)



MSCI EAFE - 1Y Return (CAD)



U.S. Markets cont'd

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- **U.S. consumer sentiment rises.** February's Consumer sentiment unexpectedly rose in U.S., according to a report by the University of Michigan. The university's consumer sentiment index jumped to 99.9 in February, beating economists' estimate of 95.5. It was also the highest reading since October last year. The tax cuts and a strong job market were believed to be driving positive sentiment.
- U.S. Housing News:
 - **U.S. existing home sales fall.** Existing home sales unexpectedly fell in January, according to the National Association of Realtors. January's existing home sales dropped 3.2% to a seasonally adjusted annual pace of 5.38 million units; economists were expecting sales to rise 0.9%. It was the second straight month that existing home sales declined. On a year-over-year basis, existing home sales were down 4.8% in January. Limited supply in the market was believed to contribute to the decline in sales.
 - **U.S. housing starts jump.** Housing starts surged to a 16-month high in January according to the Commerce Department. January's number of housing starts rose 9.7% to a seasonally adjusted annual rate of 1.33M units, much higher than economists' estimated pace of 1.23M units. It was the highest level since October 2016. Building permits also posted strong increases, rising 7.4% to reach an annual pace of 1.4M units.
 - **U.S. home prices jump.** Home prices in U.S. surged on high demand and limited supply. The S&P CoreLogic Case-Shiller national home prices index increased 6.3% year-over-year in December. The much-watched 20-city index also rose 6.3% year-over-year, slowing slightly from November's pace of a 6.4% increase. Seattle, Las Vegas and San Francisco led the group in percentage increase.
 - **U.S. pending home sales fall.** Pending home sales fell to their lowest level in more than three years in January. The National Association of Realtors reported that its pending home sales index dropped 4.7% from the previous month to 104.6; economists were expecting an increase of 0.3%. Limited supply in the market and rising mortgage rates were believed to be some of the main factors slowing down sales.

European Markets

- **Euro-zone's Q4 GDP grows.** The Euro-zone economy remained robust in the fourth quarter, according to the preliminary estimate by Eurostat. Q4 GDP was reported to grow 0.6% quarter-over-quarter, in line with economists' estimate. In 2017, GDP expanded by 2.5%, the fastest growth rate since 2007.
- **Euro-zone inflation falls.** Inflation within the Euro-zone continued to slow down in February as indicated by the preliminary reading of Harmonised Index of Consumer Prices (HICP). HICP increased by 1.2% year-over-year in February, down from the 1.3% pace reported in January; economists were expecting a 1.2% increase. The continued sluggishness in inflation may deter the ECB from bringing an end to the massive stimulus programs that are currently in place.
- **Euro-zone 'flash' composite PMI drops.** Euro-zone businesses lost some momentum in February, according to the 'flash' composite PMI. The preliminary reading of the composite purchasing managers' index (PMI) dipped to 57.5 in February, down from January's final reading of 58.8, also missing economists' estimate of 58.5.
- **Euro-zone economic sentiment falls.** The European Commission reported that economic sentiment within the 19-member bloc fell in February. February's economic sentiment index dropped from January's reading of 114.9 to 114.1. The gauge had reached a 17-year high of 115.3 last December.

Asian Markets

- **Japan's Q4 GDP growth slows.** The world's third largest economy remained in expansion mode in the fourth quarter, albeit at a slower pace. Preliminary estimates indicated that Japan's economy grew at an annualized rate of 0.5%, down from the 2.2% pace reported in Q3, and missing economists' expected growth pace of 0.9%. Despite the slowdown, it was the eighth consecutive quarterly growth, the longest streak since the late '80s.
- **Japan's CPI increases.** Japan's consumer price index (CPI) increased at an annual rate of 1.4% in January, faster than the 1% pace reported in December last year. The core measure, which excludes food and energy prices, rose 0.4% year-over-year, up from the 0.3% pace reported in December. Despite having the longest continuous economic expansion since the 80s, the 2% inflation target set by Bank of Japan remains out of reach at the moment.
- **Japan's PPI rises.** Japanese producer pricing increased more than expected in January. The producer price index (PPI) moved up 0.3% in January, higher than economists' expected increase of 0.2%. On a year-over-year basis, PPI was up 2.7% in January, in line with forecasts, but down from December's pace of 3%.
- **Japan 'flash' manufacturing PMI declines.** Japan's manufacturing slowed in January but remained in expansion mode. February's Nikkei-IHS Markit 'flash' manufacturing purchasing managers' index (PMI) fell to 54.0 from January's reading of 54.8, which was at a four-year high level.
- **China's inflation eases.** Both consumer prices and producer prices in China cooled down in January. The National Bureau of Statistics reported that the consumer price index (CPI) climbed 1.5% year-over-year in January, in line with economists' estimate, but slowing from December's annual pace of 1.8%. The producer price index (PPI) also moderated, falling from December's pace of 4.9% to 4.3%; economists were expecting PPI to ease to 4.4% in January.
- **China's official manufacturing PMI weakens.** Manufacturing activity in China slowed down in February. The National Bureau of Statistics reported that the official manufacturing purchasing managers' index (PMI) dropped to 50.3 in February from January's reading of 51.3, missing economists' expected reading of 51.2. It was the lowest reading in 19 months. In contrast, the Caixin/IHS Markit manufacturing PMI, which focuses on small and medium enterprises, came in at 51.6, beating economists' expectation of 51.3 and reaching a six-month high.

Key Takeaways

The Power of the Dollar. Consumer spending accounts for almost two-thirds of Canada's gross domestic product (GDP) and when it lags, so too will the economy. The latest data of spending by Canadians, typically called the Retail Sales report by Statistics Canada, fell unexpectedly in December and capped off a weaker fourth quarter to an otherwise stellar year for the economy. The decline pegged Q4 growth at approximately 2%, below the Bank of Canada's (BoC) estimates of 2.5%, while annual GDP, to be reported in March, should be around 3% for 2017. However, a single data point doesn't tell the entire picture. The sluggishness in December was a result of a drop-off in electronic goods sales, which surged in November due to the Black Friday events. In addition, compared to the same period in 2016, retail sales are up 6.7%, the strongest growth in two decades. The probability of a rate hike by the BoC in March is low; however, as consumers continue to spend, thereby pushing up inflation, the central bank will likely have to step in to slow things down.

Are the Bulls back? The week ending February 9 was one for the books as markets took investors for a ride. For example, the DJIA swung within a 2,000 point range during the week, culminating with a gain on the Friday to cap off a tumultuous five days of trading. Comparisons to the Financial Crisis of 2008/09 were made, but fortunately, that bullet was dodged as recovery continued during the following week as investors sent global indices higher in their search for investment bargains as equities remain on the high side, even with the market adjustment. Hopefully a lesson can be learned from this reality check as complacency can create a false sense of security—especially when the markets were falling. The Bulls may be back, but so too are the Bears and they're ready to trip up any attempts for another rally at any given opportunity.

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