REVIEW AND COMMENTARY
1ST QUARTER – 2019

One of the issues we discussed at the beginning of last year, and reiterated at the beginning of 2019 was the possibility of increased volatility of equity prices. The most recent quarter certainly reinforced this as equity prices rebounded strongly in North America. While it is becoming increasingly difficult to accurately explain this increased volatility, part of it appears to be that an increasingly significant amount of money is invested with a diminishing time horizon. In other words, long term investors are becoming less influential in the markets. Algorithms have taken over from balance sheets and income statements and the old mocking adage of ‘shoot first, ask questions later‘, is more relevant these days. So while the first quarter of 2019 was positive on most fronts of the North American capital markets what might be in store for the markets in the upcoming quarter?

Certainly a significant factor that could directly influence equity prices would be the successful negotiation of a China US trade deal. Making any prediction regarding trade deals with the US is difficult. The new NAFTA deal (Canada- United States-Mexico Agreement or CUSMA) has yet to be ratified by any of the members and the Trump administration recently upped the trade rhetoric with Mexico regarding immigration. Canada would like some, if not all, of the tariffs eliminated. If the new CUSMA is not ratified it will certainly put pressure on North American equity markets. It would appear that the markets are expecting the agreement to be signed by all parties so if talks fail the surprise will be to the downside. While handicapping these outcomes is difficult, with the upcoming US election in 2020 a strong economy will favour the incumbent and it would be logical that the present administration will do everything possible to provide positive outcomes.

The price performance of oil (WTI) has been strong in the past quarter and presently trades approximately 50% higher than the lows established last December. Continued economic growth will increase demand for oil and positive outcomes for the various

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trade deals will most likely increase demand further. But there are more immediate reasons crude has been and may remain strong for the remainder of the year. Saudi Arabia, whose influence in the pricing of global oil remains significant, continues to reduce supply through ongoing production cuts. They have been able to influence other members of OPEC as well as other large producers to comply. The Saudi's prefer prices north of $70 USD which makes it easier to balance their budgetary requirements. Further supply pressures come from falling production in Venezuela due to political unrest and aging infrastructure as well as the US Administration's sanctions on Iran. In contrast, US production of oil and gas is at all- time highs and becoming increasingly influential in the pricing of the commodity. But there have been some recent concerns about the US shale industry that have helped move oil prices higher. Profitability concerns are on the increase as recent drilling results have been disappointing. These concerns led two large oil service companies, Schlumberger and Halliburton, to predict that shale producers will likely cut spending by up to 10% this year. We do not expect a significant increase in oil prices this year from present levels, but even if the OPEC group and their oil allies are unable to remain in full compliance with the production cutbacks they appear determined not to visit the lower prices of 2018.

One of the factors affecting the significant downturn in equities in December was the potential of interest rates increasing quickly in 2019. While the uptick in rates was marginal last year, many short term investors overreacted in our opinion. While the US Federal Reserve has moderated their expectations regarding the normalization of interest rates, they cannot remain at historic lows for ever. If CUSMA and a China American trade are successfully negotiated and signed into law, global economic demand will increase putting upward pressure on interest rates. Generally, economic strength leads to higher interest rates. However, if rates were to move up quickly and unexpectedly it will send a chill into the equity markets particularly by those how have borrowed heavily or whose investment style employs excessive leverage. A gradual increase in interest rates is simply part of the business cycle and should not pose a significant threat to capital markets. If rates do start to rise, it will be important for Central bankers to use the proper narrative in order for investors to react reasonably. As we seen all too often reason and common sense are not always at the forefront with short term investors. In the long term investors with those attributes prevail.