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REVIEW AND COMMENTARY- 2019

2019 in Review

What a difference a year makes. Last January the SP TSX Composite was coming off a severe pullback in the last quarter of 2018 retracing over 10% in December alone. During the last quarter of 2018 Oil prices had dropped from the mid $70's to the mid $40's. Volatility increased not only in terms of the nominal value but also the frequency of these swings in equity prices. In 2018 there were 64 moves of 1% or greater (in either direction) of the SP500. In 2019 there were only 38. It will be interesting to see if volatility increases in 2020 given the various primaries in the US and the election in November 2020. While volatility in the previous two US elections years have been lower than the preceding the election, it would seem unlikely this trend will continue in 2020.

Our predictions last year were the following:

1) President Trump will not be impeached
2) Oil prices will trend higher in 2019
3) Canadian equities prices will outperform fixed income
4) Equity markets in the US will bottom in the first quarter of 2019.

Slightly better than last year, we were comfortably on the winning side with 3 of our 4 predictions. Equity prices in the US and North America were at their lows in January 2019. Certainly, we were not expecting such a significant return in US equities but lowering of the Fed Funds by the US Federal Reserve made equities far too attractive relative to bonds. International investors, in some cases faced with negative rates domestically, looked opportunistically at the US where capital market liquidity could easily accommodate significant inflows on cash. If US rates remain low, and the US administration continues to keep tax rates low for individuals and corporations, US equities may continue to provide positive returns. However, if this is not the case then the US equity markets may come under pressure particularly if the Democrats were to take over the White House.

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Canadian markets improved nicely outperforming all major fixed income barometers. Given a relatively constructive economic back drop it was surprising that Canadian equities didn't fair better. Oil prices retraced significantly in the second quarter of 2019 and despite the recovery in crude prices, Canadian oil companies didn't respond meaningfully until the last quarter. Given the Energy sector is such a significant part of the SPTSX index it partially explains why our index did not perform as well as its US counterparts. For the most part, it was not really until the last quarter of 2019 where Canadian equities, lead by the energy sector, started to show signs of getting traction. We consider the SPTSX better value than the SP500 but most major indices tend to follow those in the US.

As we discussed earlier there was a major retracement in oil prices in the last quarter of 2018. Prices started the year in the low $40 range ending the year in the low $60's for an approximate increase of 36%. Energy company shares on average trailed crude prices, however, recent activity suggests some relative strength which appears to be gaining momentum. Saudi production cutbacks, along with the co-operation of other OPEC members, was a constructive influence on prices. Some feel that now the Saudi private oil company, Aramco, has gone public that there may be some easing in these cutbacks. However, it is important to be mindful that the tense US / China trade relations negatively impacted the outlook for demand and while comments of a positive outcome are presently circulating, few details have been provided. If crude prices were able to increase with these background distractions, then the present levels may not be as vulnerable as some may think. In fact, if a productive and sustainable US China trade agreement is achieved then Oil demand may surprise investors.

President Trump was impeached (by the House of Representatives) but it presently appears that he will be acquitted by the Senate. While technically he was impeached, without support from the Senate, he will not be removed from Office. It would have been hard to predict the events that seemed to turned House leader Pelosi toward impeachment, namely the "quid pro quo' phone call to the Ukraine President mid year 2019, it would have been equally difficult to assume that given the amount of information now available, that Republicans would be as unified in defiance. One of our presumptions was that if the impeachments did proceed, they would be done closer to the election. Understandably, with the information brought to light, Democrats could not afford to wait.

So, three correct isn't bad. Here are our predictions for 2020:

1) Volatility in the North American equity markets will increase in 2020

2) Interest rates will remain low

3) Despite U.S. equity valuations being relatively expensive they will provide a positive return but more defensive stocks will outperform.