

## Market review

After a strong first quarter, markets continued their rally in April as equities climbed across the regions. This year's rebound has been driven by accommodative central banks, the expectation of a recovery in Chinese growth and the anticipation of a resolution to Sino-American trade negotiations. In April, the S&P/TSX Composite Index and the S&P 500 Index returned 3.22% and 4.51% (C\$) respectively. Internationally, markets also continued their positive trend. The MSCI EAFE recorded a gain of 3.37% (C\$) while the MSCI Emerging Market Index was also up, returning 2.58 (C\$). On the currency front, the Canadian dollar weakened against the U.S. dollar, dropping -0.44% in April.

**Canadian economy shrinks.** Statistics Canada reported that harsh weather and cool foreign demand contributed to a surprising 0.1% decline in gross domestic product (GDP) in February. The report showed that while 11 of 20 industry sectors posted growth, the economy was dragged down by a slump in transportation, as well as declines in resource extraction and manufacturing. The Bank of Canada announced last month that it was leaving its key interest rate unchanged at 1.75%. The bank also announced a major downgrade in its forecast for growth this year to 1.2%, from 1.7%.

**U.S. economy grew 3.2% in first quarter.** The U.S. economy started 2019 positively, growing rapidly despite multiple headwinds. Gross domestic product increased at a 3.2% annual rate from January through March, the strongest rate of first-quarter growth in four years, according to the U.S. Commerce Department. Rising exports, falling imports and higher inventory investment drove much of the growth, helping to offset weaker gains in consumer spending and business investment. The strong report marked a turnaround from a gloomy start to the year, when the economy looked close to stalling due to challenges including a partial U.S. government shutdown, market turmoil in late 2018 and slowing global growth.

**Trade disputes holding back European economy.** The European Central Bank (ECB) said that global headwinds are still holding back the eurozone economy. The ECB has kept its policy promises on keeping its interest rates and stimulus settings unchanged as they weigh looming risks to the economy from Brexit, protectionism and trade disputes. The ECB said that it is facing a conundrum: sagging trade and manufacturing are slowing the economy, though an improving jobs market has been propping it up.

### IN THIS ISSUE

- < Canadian economy shrinks
- < Latest rally dominated by huge valuation lift
- < Higher prices will need greater support from earnings

Index (C\$)	Change (%)				Index Level
	1 Mth	3Mth	YTD	1Yr	
FTSE TMX Canada 60 Day T-Bill	0.14	0.39	0.54	1.53	163.07
FTSE TMX Canada Bond Universe	-0.10	2.43	3.80	6.07	1,091.43
S&P/TSX Composite	3.22	7.55	16.94	9.60	16,580.73
S&P 500	4.36	11.68	16.40	18.68	3,950.65
MSCI EAFE	3.37	8.58	11.50	1.73	2,576.92
MSCI Emerging Markets	2.58	5.43	10.49	-0.32	1,447.37
Commodities	1 Mth	3Mth	YTD	1Yr	Price (US\$)
Gold Spot (\$/oz)	-0.68	-2.85	0.08	-2.42	1283.53
Oil WTI (\$/barrel)	6.02	17.05	36.18	2.37	63.91
Natural Gas (\$/MMBtu)	-5.09	-8.62	-5.23	-0.23	2.58
Currencies	1 Mth	3Mth	YTD	1Yr	FX rate
C\$/U\$	-0.31	-1.98	1.85	-4.08	0.7468
C\$/Euro	-0.27	0.06	4.14	3.30	0.6660
C\$/Pound	-0.28	-1.41	-0.26	1.33	0.5731
C\$/Yen	0.24	0.32	3.52	-2.23	83.2390

Source: Bloomberg. As at April 30, 2019

**IMF raised its 2019 growth forecast for China.** The International Monetary Fund (IMF) upgraded its 2019 growth forecast for China, citing Beijing's effort to support the economy and improved outlook for its tariff fight with the U.S. In its latest World Economic Outlook report, the IMF said that China is projected to grow 6.3% this year, higher than the fund's previous forecast of 6.2%. In the short-term, it is expecting China's economy to stabilize and rebound in the next couple of quarters. China economy, the second-largest in the world, grew by 6.6% last year, its worst performance in 28 years.

## Current Outlook

Global equity prices have increased 16% this year, led by the 18% advance in the U.S. Taken from the December 24, 2018 low, these returns are an even more impressive 21% and 26%, respectively. The pace of gains is expected to slow from here, with the magnitude of the adjustment determined by the eventual strength shown by corporate earnings delivery; the better the earnings, the less likely share prices are to roll over in a meaningful way.

The latest rally has been dominated by a huge valuation lift that has occurred across all of the major markets. The earnings contribution to the equity return profile has not been helpful. We have estimated that the deterioration in the earnings outlook has led to global equity returns which are 4.5%-5% lower than they otherwise would have been. Policy makers and their efforts to shut the door on open-ended cyclical risks have helped drive share prices higher.

Several technical indicators have moved into the overbought domain which means that the risk of a pullback has increased. However, a pullback might have to wait until the end earnings season. With over half of the S&P 500 companies having reported, earnings growth is tracking about +2.5% on a year-over-year basis. More importantly, 77% of companies have beaten estimates and the stocks have been acting well after the surprise. This high rate of positive surprise is likely to persist because companies did a great job at lowering the bar on expectations by guiding negatively just before entering into the reporting period.

What about after earnings season? The next wave higher in stock prices will probably need even greater support from earnings. It can't simply be left to the soft type of support we are seeing, like beating expectations on a lowered bar. Roughly flat earnings-per-share growth (even if better than expected) can only carry share prices so far. Earnings growth rates need to accelerate.

The big-picture set-up says that earnings acceleration is increasingly likely to come from three areas over the coming two-three quarters:

- 1) **Buybacks:** De-equitization remains a big theme, particularly in the United States. There has been US\$213 billion in buybacks in 2019, with the lion's share being carried out by technology, industrials and consumer discretionary companies. Buybacks may hit US\$850 billion this year, topping the US\$818 billion seen during 2018. A lower share count, at least at the margin, increases earnings-per-share.
- 2) **Efficiencies:** Corporations have worked hard to get lean. Productivity growth has accelerated and is at its highest level in this decade-long expansion. Not only do these efficiencies create somewhat of an earnings buffer against rising input costs, like wages and raw materials, but their benefits will be magnified by any improvement in top-line growth.
- 3) **Top-line recovery:** This represents the main engine for corporate earnings. It is driven, in large part, by the overall health of the global economy. In our opinion, revenue momentum should begin to improve within the next few months in response to generous policy settings and eventual improvements in global trading relationships.

In conclusion, the excitement surrounding global policy stimulus has helped to drive share prices higher this year. As it currently stands, we expect volatility to heighten given the speed and magnitude of the equity market rebound following the lows reached in late December 2018. For this rally to remain sustainable, we believe earnings growth will need to improve

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