The PFP Quarterly

Wealth Management
Dominion Securities

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Quarterly update

Bears, bulls, Brexit, trade discussions, negative yields, and elections. Another quarter rolls by with the same thesis as the last and the one prior to that – volatility. As the summer months come to a conclusion, the issues that remained present globally were not resolved. China and U.S. trade discussions are still at a standstill, Brexit is no further along, negative yielding debt continues to rise and economic indicators continue to worsen. Markets continue to hover around their all-time highs, while having a tough time breaking out to the upside. A lot of that resistance is predicated on some of the unresolved issues. In the meantime, short-term volatility will be present until some clarity surfaces on those issues.

Economic scorecard

In September, the Federal Reserve cut short-term rates by 25 bps and moved the neutral range to 1.7%-2.0%. At the time of writing this, even with the reduction in overnight rates, the yield curve remains inverted. The one key distinction from this yield curve versus other historical yield curve inversions is how we got to this point. In past scenarios, the yield curve has inverted by the Federal Reserve raising short-term rates to cool down an overheating economy. This time around is different with investors in both Europe and Japan fleeing to U.S. treasuries in the attempt to preserve positive returns in their “safe assets”. As we mentioned in previous quarterly notes, this cannot be the only indicator that we follow but this has been one of the more reliable recessionary indicators and tends to predict recessions on average 14 months prior. Other indicators like ISM manufacturing data is now flashing yellow (See on next page) but at the end of the day, consumers in the U.S. are extremely strong and account for almost 70% of

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RBC Wealth Management U.S. economic recession scorecard

Indicator	Status		
	Expansion	Neutral	Recessionary
Yield Curve (12-month to 10-year)	–	–	✓
Unemployment Claims	✓	–	–
Unemployment Rate	✓	–	–
Conference Board Leading Index	✓	–	–
ISM New Orders Minus Inventories	–	✓	–
Fed Funds vs. Nominal GDP Growth	✓	–	–

Source - RBC Wealth Management, Bloomberg, FRED Economic Data St. Louis Fed

GDP. Unemployment claims and the unemployment rate are still at all-time lows and by virtue of that, consumers continue to spend. Until there are signs of cracking in the American consumer, this current market cycle will continue to muddle along.

Brexit

One of the countries that continues to linger in the balance of an important decision is the United Kingdom. Even with ongoing discussions and a change in leadership, there has not been a lot of progression with regards to Brexit in the last three years. With a new leader at the helm, there is more uncertainty on whether his threat to pull the U.K. out of the European Union with or without a deal is more than just a negotiation tactic. The U.K. Prime Minister has wasted little time in office; cleaning house with his own staff and preparing on delivering a Brexit decision by October 31. On top of the uncertainty stemming around whether a deal or no deal will happen, the United Kingdom has to also take into account that the economy is continuing to weaken (which contracted by 0.2% q/q in Q2). This is on top of extremely low interest rates, a weakening pound and an exorbitant amount of negative yielding debt. So where do we go from here? The Prime Minister and conservative party has announced billions of fiscal spending and proposed tax cuts in order to spur on the economy. However, the British government is currently formulated as a minority government and the country is very much divided. The likelihood of a general election has increased with the sole intention of pursuing a majority government. Needless to say, a lot of eyes will be on the U.K. over the short-term to see if they can come to a resolution.

Going forward

Over the next year, there are some important decisions both domestically and internationally that need to be made. We have federal elections for both Canada and U.S., continuing Brexit negotiations and ongoing trade tariff discussions. At this point in time, it is inconclusive on whether the Liberals and Republicans will remain as the parties in charge. Brexit could go a multitude of different ways which will produce a multitude of outcomes. As much as we believe a trade deal will come to fruition, it is uncertain on when it will be completed. As we have written in previous quarterly notes, this trade deal comes on the backs of slowing global growth, low inflation and low global interest rates. ISM manufacturing data has fallen to the lowest level in a decade and the Federal Reserve appears like they will cut rates once again by the end of the year.

What does all of this mean? It means that the landscape is changing. It is becoming more evident that we are nearing the end of the cycle. Similar to our previous quarterly notes, we have been actively reducing our equity exposure and increasing our fixed income and cash holdings. The shift from capital growth to capital preservation in the short-term derives from the underlying economic conditions and unresolved global issues. This is done with the intent of creating a more defensive portfolio and the best risk-adjusted return.

Thank you for your continued support and confidence.

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