Global Asset Management

Uncovering market movements

At the start of October, financial markets were given a number of reasons to be cheerful. For starters, the tentative deal that produced the United States-Mexico-Canada Agreement (USMCA) reduced a significant protectionist risk. In addition, the announcement of a $40-billion liquefied natural gas project from Royal Dutch Shell and partners signaled that Canada is indeed open for business. This was welcome news following the delays related to the Trans Mountain Pipeline expansion. However, despite these positives, markets have stumbled in the time since.

What's weighing on markets?

This week, investors had to digest news from the International Monetary Fund (IMF) that it's cutting its global GDP growth forecast from 3.9% to 3.7%. The logic behind the move related to a number of clouds on the economic horizon. In particular, trade tensions are growing between the U.S. and China as escalating tariffs threaten the loss of economic activity for the world's two largest economies. At the same time, Chinese policymakers are now actively delivering stimulus to counter its slowing economy, reintroducing concerns related to the country's debt levels.

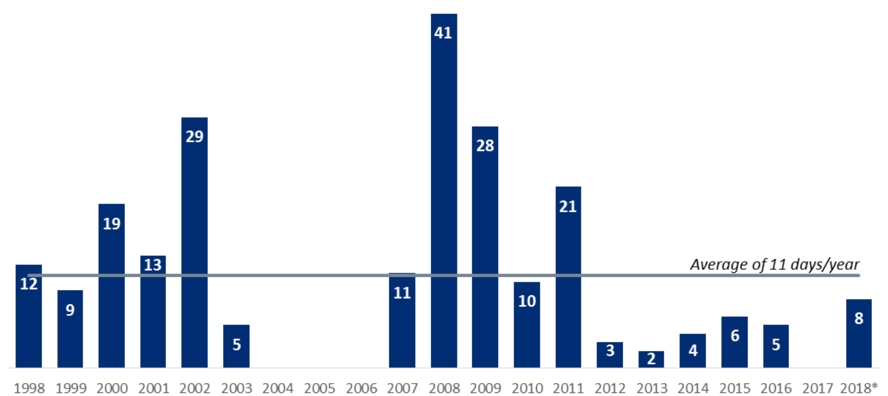
Equity markets are also absorbing signals from the bond market. The yield on the 10-year U.S. Treasury continues to move higher in light of strong economic data. In addition, the U.S. Federal Reserve has hinted at their intention to return its target interest rate to neutral (the rate at which interest rates are seen as not helping or hurting the economy) in the next year so that it can better respond to unexpected moves in the economy. These signals have investors worried that the Fed may raise rates faster than previously anticipated.

One of the top concerns surrounding higher interest rates is that they increase borrowing costs. Our indicators suggest we are in the late stages of the business cycle and with elevated valuations in the U.S., growth in earnings is critical to sustaining the current bull market in stocks. Higher borrowing costs, on top of a strong U.S. dollar, tight labour market conditions and higher oil prices all may affect earnings growth in 2019 and beyond – factors investors are currently weighing.

Drawdowns are nothing new

The recent pullback may be having a larger effect on investors simply because, outside volatility in February, markets have been calm in recent years. For instance, in 2017 the S&P 500 didn't experience a pullback larger than 2%. And if we look back farther to 1998, we've seen an average of 11 drawdowns of 2% or more each year. Even after the most recent slide, the ups and downs of the market in 2018 look fairly average when compared to the past 20 years.

Number of days S&P 500 is down more than -2%



Source: Bloomberg, RBC GAM. Data from January 1, 1998 to October 10, 2018*

If you are a long-term investor, equity markets are beneficial due to their potential for higher growth. However, you pay a premium (risk) for increased return potential. So, while a large movement in the market is uncharacteristic of recent times, it shouldn't be a reason to panic. The economy is still growing at a decent pace and the outlook for corporate profits remains solid. Barring any deterioration in the outlook, these fundamental factors should provide support for stocks. If you have concerns, remember that periods of volatility can be an excellent time to discuss your portfolio positioning with your advisor. Now, more than ever, it's vital to ensure your positioning aligns with your long-term goals and risk tolerance.

Publication Date: October 11, 2018

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