RBC Wealth Management
Dominion Securities

George Stedman, CFA

RBC Dominion Securities Inc.
1501 McGill College, Suite 2150
Montreal, QC H3A 3M8
Tel: 514-840-7626
Fax: 514-840-7639
george.stedman@rbc.com
www.georgestedman.com

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Second Quarter 2018

Our portfolios were little changed in the second quarter and in much of the first half. After two years of strong gains and a good January, for the past five months stock markets have been consolidating. The S&P 500 has traded in a range of about 8% since early February. There is an old saying on Wall Street – "buy on rumor, sell on news". Perhaps stocks spent 2016 and 2017 going up in anticipation of corporate tax cuts and the resulting strong corporate profits. Now that strong earnings are upon us, markets are consolidating. (Cutting taxes to produce trillion-dollar deficits during a period of record low unemployment will likely lead to higher inflation, interest rates and, taxes sometime in the future, but perhaps that is a worry for another day and, another election cycle.)

In the first half of this year the resource segment of the Canadian stock market has provided most of the gain. The Energy component of the S&P TSX is up 15.8% year to date. The Information Technology sector is up 10.9%. By contrast, companies challenged by rising interest rates or rising fuel prices have been a drag on our performance. For example, a reliable dividend payer, like phone company BCE Inc., was down -9.4% in the first half of this year and the electric utility Fortis was down -7%. Air Canada was down -17.9%. In the US, the S&P 500 continues to be dominated by FAANG mega technology stocks.

As much as tax cuts are good for profits and stock prices, trade wars are not. The buy on rumor of good news and sell on the event itself might also have played out over the last several weeks, but in reverse. Stocks were weak for the last couple of weeks in anticipation of China's retaliatory tariffs and, now that they have been announced, today, July 9, stock prices are up. The threat that tariff wars might metastasize into a trade war and a global recession is a classic example of the uncertainty that financial markets dislike.

The C.D. Howe Institute economists Dan Gurak and Meredith Crowley in their memo "Weaponizing Uncertainty under the Trump Administration" (June 20) argue that uncertainty is exactly Trump's strategy. "Uncertainty acts like a non-tariff barrier that impedes trade and investment… Uncertainty is being deliberately deployed as a non-tariff barrier with the stated purpose of bringing US companies to repatriate manufacturing activity that has been moved abroad – including automobile production that moved to Mexico, a NAFTA partner – and to reduce incentives for US firms to invest abroad by raising the risk of their facing restrictions on their access back to the US market." You can't bring a charge of uncertainty before the WTO World Trade Organization either.

I don't expect much clarity at least on North American trade agreements until after the mid-term elections this fall. The threat of tariffs and, the much higher interest rates in the United States, may be why the Canadian dollar has not risen with oil prices.

Corporate earning reporting season starts this week. Profits for the S&P 500 companies, what with the recovery in energy prices and the tax cuts, are expected to be up some 19%. So, on the one hand stocks are supported by strong profits and, on the other, threatened by a possibly escalating trade war. Perhaps stocks will meander for a few more months during the traditionally quiet summer before the usually more volatile fall. By then we may have an idea whether talk of a trade war is more bluster than reality and, if weaponized uncertainty is going to be a continuing strategy.

Meanwhile, I have just spent the past week organizing Quebec's largest sailing regatta for youth, TRY Training Regatta Youth, at Pointe Claire Yacht Club. Based on my anecdotal experience from being outdoors a lot last week, reports that the entire world is sweltering under unprecedented global warming hardly seem exaggerated. Enjoy your summer.

Sincerely,

George Stedman, CFA
Portfolio Manager, Vice-President
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