CIBC Asset Management

December 2019

MARKET SPOTLIGHT

GLOBAL MARKETS

Investors entered the final month of the year with some optimism, despite the overhang of the U.S.–China trade war, no Brexit solution and stagnant economic data from most developed markets. Instead, the focus was on a trade war resolution and the potential boost to growth coming from low interest rates. The strength of the U.S. consumer is another bright spot. In November, global equity markets gained 2.8% (USD) and 3.9% (CAD), as the Canadian dollar weakened.

U.S. broad equity markets were higher by 3.6%, with the Nasdaq 100 up 4.1%. While not robust, corporate earnings results beat pessimistic expectations in many cases. Economic reports pointed to slowing in both manufacturing and services, but November jobs numbers surprised with their strength.

International developed equity markets gained 1.1% (USD), with Japanese equities higher by 1% (USD). Investors were watching the December U.K. election for clues to the future of Boris Johnson. His Brexit deal now appears inevitable after an election win. The ECB left interest rates unchanged at its first meeting under new president Christine Lagarde.

Emerging markets lost 0.1% (USD), while China gained 1.8% (USD) for the month and 14% in 2019—performance that lagged most major developed nations this year. Chinese growth has been slowing and we expect a continued decline of Chinese GDP to below 5.5% over the next four quarters (compared to 6% reported in September).

The view from our Chief Investment Strategist:

LUC DE LA DURANTAYE

In collaboration with Éric Morin, Senior Analyst, Multi-Asset & Currency Management

CANADIAN TRADE UPDATE

Democrats have approved the new U.S.-Mexico-Canada trade agreement (USMCA) and the U.S. is the relative winner—the deal will likely provide a modest gain of 176,000 U.S. jobs after six years[1]. Note that the timing of implementation in the U.S. is uncertain owing to political factors. For Canada, the deal further opens the Canadian market to U.S. poultry, dairy, and eggs. This will negatively impact Canadian producers, who already suffer from weak productivity by global standards. In Mexico, the manufacturing sector is the most negatively impacted, as the new deal requires stronger enforcement of labour standards.

Keep in mind that the most important long-term impediment for Canada is its broad-based low relative productivity and competitiveness, not USMCA.

TOP FORECASTS FOR THE 2020s

- **The global economy will grow slowly.** Changing demographics, such as the aging of the workforce, will be a lingering headwind. Although central banks will attempt to keep interest rate increases gradual and modest, the increases will still have a negative effect on growth, magnified by elevated indebtedness.
- **Government bonds in developed economies will deliver low returns**—the result of low starting yields and the negative effects of slightly higher interest rates. Better, but riskier, prospects will be found in emerging market (EM) sovereign bonds and U.S. high-yield bonds, where rates are currently higher and duration is lower.
- For equity, the **current valuation of stocks (relative to their long-term fair value) varies across regions and will have an uneven impact on expected returns.** In the U.S. and developed economies, current valuation exceeds long-term fair value estimates. This will be a negative for future capital gains. For EM equity, valuation is cheaper relative to long-term fundamentals and earnings growth prospects are better.

[1] According to the U.S. International Trade Commission.

FIXED INCOME

The bond market put in another mixed performance in November, as short-term yields moved modestly higher and longer-term yields dipped slightly. The main driver of asset prices in the month was the to-and-fro on U.S./China trade talks. When it looked like progress was being made, yields rose, and when hopes declined, yields generally declined. The Bank of Canada and Federal Reserve squashed hopes for rate cuts in December, resulting in short-term yields moving a bit higher. Although both central banks profess to be on hold for quite some time, the futures markets see rate cuts next summer in both countries.

CANADIAN EQUITY

Canadian equities gained 3.6% in November, mirroring the strength in U.S. markets. Every major industry sector was strong (gains of 3%+) with the exception of the materials group (-0.1%). The approval of the USMCA in early December removes an area of uncertainty for Canadian trade and the overall economy. The third quarter (annualized) GDP of 1.3% matched both consensus expectations and the Bank of Canada forecast and showed strong gains in homebuilding and business capital spending.

Source for all data: CIBC Asset Management, Bloomberg, Dec. 2019

SOUND BITES

Chase Bethel
Equity Analyst, Consumer Sector

What are some important and investable consumer themes for 2020? Recent earnings reports from North American consumer companies provide some clues.

1. With macroeconomic uncertainty, **Business to Consumer models are proving more resilient than Business to Business models.** Bellwether consumer companies like Canadian Tire and Walmart aren't seeing notable changes in consumer behaviour. However, they're still taking precautions by reducing inventory and other working capital requirements.

2. **Understand your key customers and how to keep them happy.** Costco, Dollar General, Nike and Chipotle have achieved strong success in growing both revenue and earnings and a common thread is their focus on their core customer. The market continues to reward these companies with a higher valuation multiple as a result.

3. **Migrating to "Direct to Consumer" from wholesale can be very beneficial** for brands that do it well. With ongoing store closures, declining mall traffic and the risk that platform owners (e.g. Amazon, Google, Facebook) could use customer data to their advantage, more brands are establishing direct relationships with their customers. Nike achieved better results last quarter by driving more direct sales and Canada Goose is pursuing a similar strategy.

4. Aggregators such as **Uber Eats and Skip The Dishes are disrupting casual dining and challenging the dominance of pizzerias.** Consumers have ever-increasing options for food delivery as a result of apps such as Skip The Dishes. This poses a threat to pizzerias and to casual dining restaurants that may be losing visits and alcohol beverage transactions, which typically carry higher margins.

5. **Consumers love a good deal**—clear value creates loyalty and drives consistent store traffic. Discounters (Walmart, Target), Dollar Stores (Dollarama, Dollar General, Dollar Tree) and off-price retailers (TJX (Winners/Marshalls/HomeSense), Ross Stores and Burlington Stores) continue to enjoy the advantage of being well positioned to benefit from the secular theme of consumers seeking value.

6. **Plant-based meat looks like more than just a fad.** The category is attracting both vegetarians and meat-eaters who are looking to reduce their meat intake. We expect protein price inflation (dairy and meat) in 2020 and increasing competitive intensity in quick-service restaurants. We may also see a step-up in competition as Wendy's attempts to re-enter breakfast in the U.S. and McDonald's may introduce a new chicken sandwich.