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Justwealth 3rd Quarter 2017 Market Commentary

Interest rates are officially on the rise! The Bank of Canada raised the target for the overnight rate twice by 0.25% in the past quarter, moving it off the 0.50% level where it has been since 2010. This closely follows the pattern of the U.S. Federal Reserve which also raised the U.S. key lending rate by 0.25% in March and June of this year. Both countries have exhibited strong GDP growth and generally positive economic data points with no imminent signs of runaway inflation. The respective central banks have taken the measures to be pre-emptive of inflation and as a means to restore interest rates closer to historically "normal" levels.

While increasing interest rates are not good for bond prices, the combination of strong economic growth and controlled inflation should be good for equities. This has certainly held true for U.S. equities and global equities in general. The Canadian equity market has been held back somewhat due to its high exposure to commodities which have not benefitted from the robust global growth. As we mentioned last quarter, the strength of the Canadian dollar has had a negative impact on U.S. equity returns reducing the total return of the S&P 500 ($Cdn) by almost 6% over the past year! We often remind clients and others that in the long run, currency returns are dwarfed by the impact of stock markets as currencies tend to "even out" over time.

Given the disappointing returns for bonds over the past year, and messages in the media generally indicating that the weakness will continue, we thought it would be helpful to provide a bit of our insight on the topic. Without trying to predict whether interest rates will go up or down, we structure the fixed income components of our portfolios to be less vulnerable to rising interest rates compared to simply investing in an ETF that replicates the performance of the overall bond market. We reduce our overall interest rate exposure by investing in shorter-term bonds, and diversify our risk by incorporating a wide range of corporate issuers which also enhances the yield paid out to investors. As evidence that this strategy can be effective, we can report that our pure (or almost pure) fixed income model portfolios had modestly positive returns for the one-year period ending September 30, 2017, compared to a -2.97% return for the FTSE TMX Canadian bond benchmark index.

To provide some further comfort for fixed income investors, we can look at historical returns for the Canadian bond market going back to 1980. Looking at rolling monthly 1-year time periods, bond returns have been lower than -2.97% just 7 times out of 442 measurements. That's just over 1.5%! Furthermore, the last time a return was below -2.97% was in 1995! Historical data of course does not guarantee future outcomes, but it at least provides some practical experience into helping manage expectations. We will be posting more detailed information on fixed income returns on our blog page within the coming months to provide more facts and figures worth considering.

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Here is a recap of market performance as of September 30, 2017*

Asset Class	Market Index	Quarter	1 Year	3 Years	5 Years	10 Years
Fixed Income	FTSE TMX Canada Universe Bond	-1.84%	-2.97%	2.79%	2.66%	4.74%
Canadian Equity	S&P/TSX Capped Composite	3.68	9.18	4.54	8.06	4.06
U.S. Equity	S&P 500 ($Cdn)	0.61	12.87	15.04	19.84	9.93
Int'l Equity	MSCI EAFE ($Cdn)	1.50	13.34	9.05	13.71	3.70

** Performance annualized for periods greater than 1 year*