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Market review: 2019

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Regional equity indices	2018	Index level		2019	
	Total return*	31-Dec-18	31-Dec-19	Full year price return	Full year total return*
S&P/TSX	-8.9%	14,322.86	17,063.43	19.1%	22.8%
Dow Jones Industrial	-3.5%	23,327.46	28,538.44	22.3%	25.3%
S&P 500	-4.4%	2,506.85	3,230.78	28.9%	31.5%
Nasdaq	-2.8%	6,635.28	8,972.60	35.2%	36.7%
MSCI All Country World	-8.9%	455.66	565.24	24.0%	27.3%
MSCI Europe	-10.1%	114.20	139.60	22.2%	26.8%
MSCI EAFE	-13.3%	1,719.88	2,036.94	18.4%	22.8%
MSCI Emerging Markets	-14.3%	965.78	1,114.66	15.4%	18.6%

Currencies	31-Dec-18	31-Dec-19	% change
CAD/USD	0.73	0.77	5.0%
CAD/EUR	0.64	0.69	7.4%
EUR/USD	1.15	1.12	-2.2%
GBP/USD	1.28	1.33	3.9%
USD/JPY	109.69	108.61	-1.0%

Bond yields	31-Dec-18	31-Dec-19	bps change
10 yr Canada Govt.	1.97%	1.70%	-27
10 yr U.S. Treasury	2.68%	1.92%	-77
10 yr Germany Govt.	0.24%	-0.19%	-43
10 yr Japan Govt.	0.00%	-0.01%	-1
30 yr Canada Govt.	2.18%	1.76%	-42
30 yr U.S. Treasury	3.01%	2.39%	-62

Commodities	31-Dec-18	31-Dec-19	% change
Gold USD/oz.	1282.49	1517.27	18.3%
Oil USD/bbl.	45.41	61.06	34.5%

Source: Bloomberg. Index returns are in local currency.
*Total return is price return plus re-investment of dividends

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Canadian equities

The S&P/TSX Composite Index (S&P/TSX) gained 22.8% in 2019, rebounding sharply after the global equity sell-off in late 2018 that was mostly a result of the U.S.-China trade war. Canadian equities, like equity markets in other developed economies, saw double-digit gains this past year in anticipation that a global economic recession has been pushed further into the future. Hope emerged that the aggressive trade stance initiated by the U.S. administration would result in an agreement that was mutually advantageous to both the U.S. and China. As well, equities worldwide benefitted as central banks – especially the U.S. Federal Reserve Board (Fed) – provided insurance against economic weakness via low interest rates.

S&P/TSX Composite Index – for the 1 year ending December 31, 2019

17,500
15,500
13,500
14,323
14,213
17,180
17,063
Dec. 2018
Mar. 2019
Jun. 2019
Sep. 2019
Dec. 2019

Source: Bloomberg

S&P/TSX Composite Index – for the 10 years ending December 31, 2019

18,500
14,000
9,500
11,746
11,093
17,180
17,063
Dec. 2009
Dec. 2011
Dec. 2013
Dec. 2015
Dec. 2017
Dec. 2019

Source: Bloomberg

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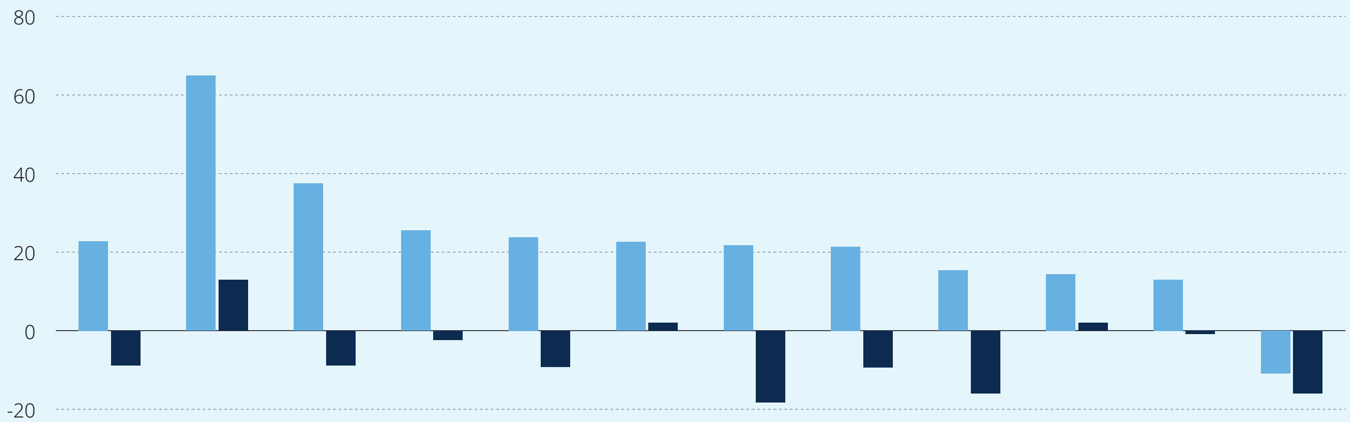
Returns across the 11 S&P/TSX sectors were stellar, except for Health Care. Stocks in the Canadian Health Care sector were down 10.9%, led by the "return to earth" performance of many of the previous year's "high-flying" cannabis stocks. Best returns in 2019 were in the Information Technology, Utilities, Industrials, Materials and Financials sectors. One of the common themes across the best-performing sectors was that it remains a market that favours "bonds that look like stocks (investment-grade and high-yield bonds), and stocks that look like bonds (high-yielding sectors such as Utilities and Financials)." As well, stellar performance by standout Shopify Inc. (39% of the Information Technology sector's gains, and up 173.5% over the year) aided returns.

S&P/TSX returns by sector (%)



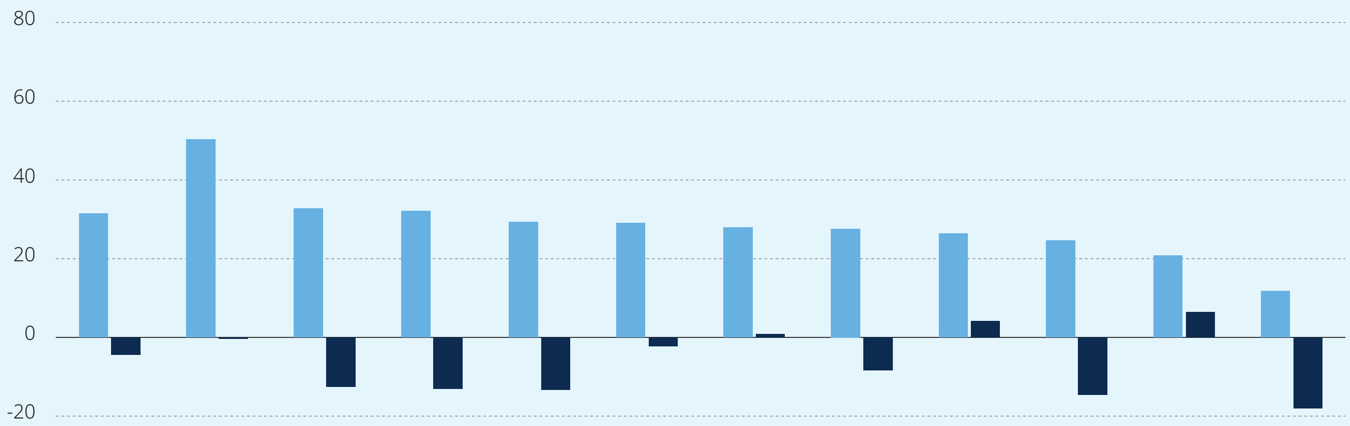
	S&P/TSX Composite Index	IT	Utilities	Industrials	Materials	Real Estate	Energy	Financials	Consumer Disc.	Consumer Staples	Telecom Services	Health Care
FY 2019	22.8	64.9	37.5	25.5	23.8	22.6	21.7	21.4	15.3	14.4	13.0	-10.9
FY 2018	-8.8	12.9	-8.9	-2.4	-9.2	2.0	-18.2	-9.3	-15.9	2.0	-0.8	-15.9

Source: Bloomberg. FY 2019 - for the 1 year ending December 31, 2019; FY 2018 - for the 1 year ending December 31, 2018

U.S. equities

U.S. equities, as represented by the S&P 500 Index (S&P 500), climbed the proverbial “wall of worry” in 2019 and gained a healthy 31.5%. While equity markets in the U.S. and around the world were spooked by trade concerns, the Fed came to the rescue with three “insurance” interest rate cuts. By doing so, the Fed provided assurance that it stood ready to offset the challenges created by trade tensions to extend the global economic recovery. There is concern that the strength of the S&P 500 in 2019 has pulled forward returns from 2020 as gains in 2019 came almost completely as a result of the expansion of price-earnings multiples, rather than due to earnings growth. In fact, earnings growth was virtually flat in 2019. It is our view at Mackenzie that U.S. stock gains will be positive but limited to earnings growth plus dividends in 2020. Best returns by sector in 2019 were: Information Technology (up 50.3%), Communication Services (up 32.7%), Financials (up 32.1%) and Industrials (up 29.3%).

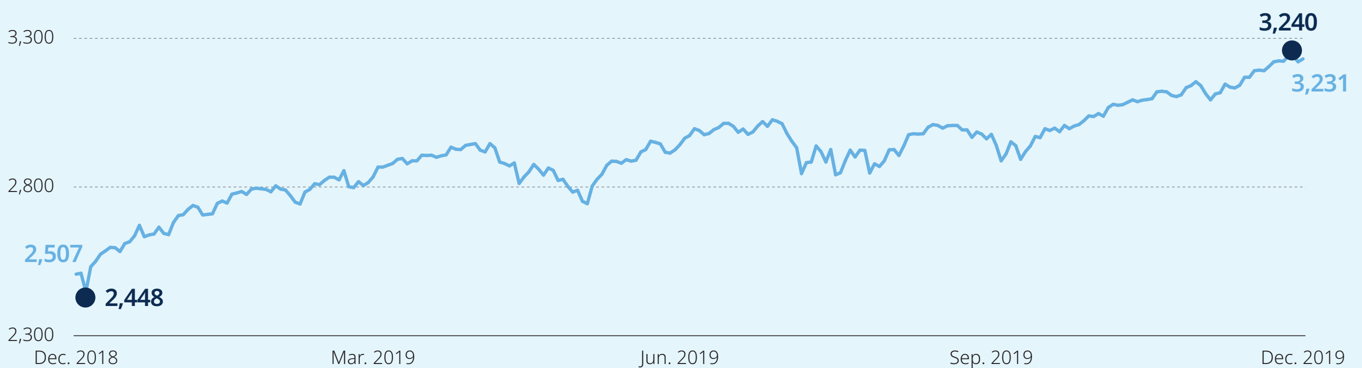
S&P 500 returns by sector (%)



	S&P 500	IT	Telecom Services	Financials	Industrials	Real Estate	Consumer Disc.	Consumer Staples	Utilities	Materials	Health Care	Energy
FY 2019	31.5	50.3	32.7	32.1	29.3	29.0	27.9	27.6	26.4	24.6	20.8	11.8
FY 2018	-4.4	-0.3	-12.5	-13.0	-13.3	-2.2	0.8	-8.3	4.1	-14.6	6.4	-18.0

Source: Bloomberg. FY 2019 - for the 1 year ending December 31, 2019; FY 2018 - for the 1 year ending December 31, 2018

S&P 500 – for the 1 year ending December 31, 2019



Source: Bloomberg

U.S. small-capitalization stocks, as represented by the Russell 2000 Index (Russell 2000), were up 23.7%, while the technology-heavy NASDAQ Composite Index (NASDAQ) was up 35.2%. While small-cap stock returns were quite strong, they trailed their large-cap brethren, primarily owing to sector differences versus the S&P 500. The Russell 2000 allocation to Information Technology is lower (Russell 2000: 14.4%, S&P 500: 21.5%), and thus the Russell 2000 participated less in the very strong return of technology stocks. Conversely, for the NASDAQ the higher allocation to Information Technology (NASDAQ: 38.6%, S&P 500: 21.5%) was a source of meaningful outperformance in 2019.

Dow Jones Index – for the 1 year ending December 31, 2019

Source: Bloomberg

Nasdaq Index – for the 1 year ending December 31, 2019

Source: Bloomberg

Russell 2000 Index – for the 1 year ending December 31, 2019

Source: Bloomberg

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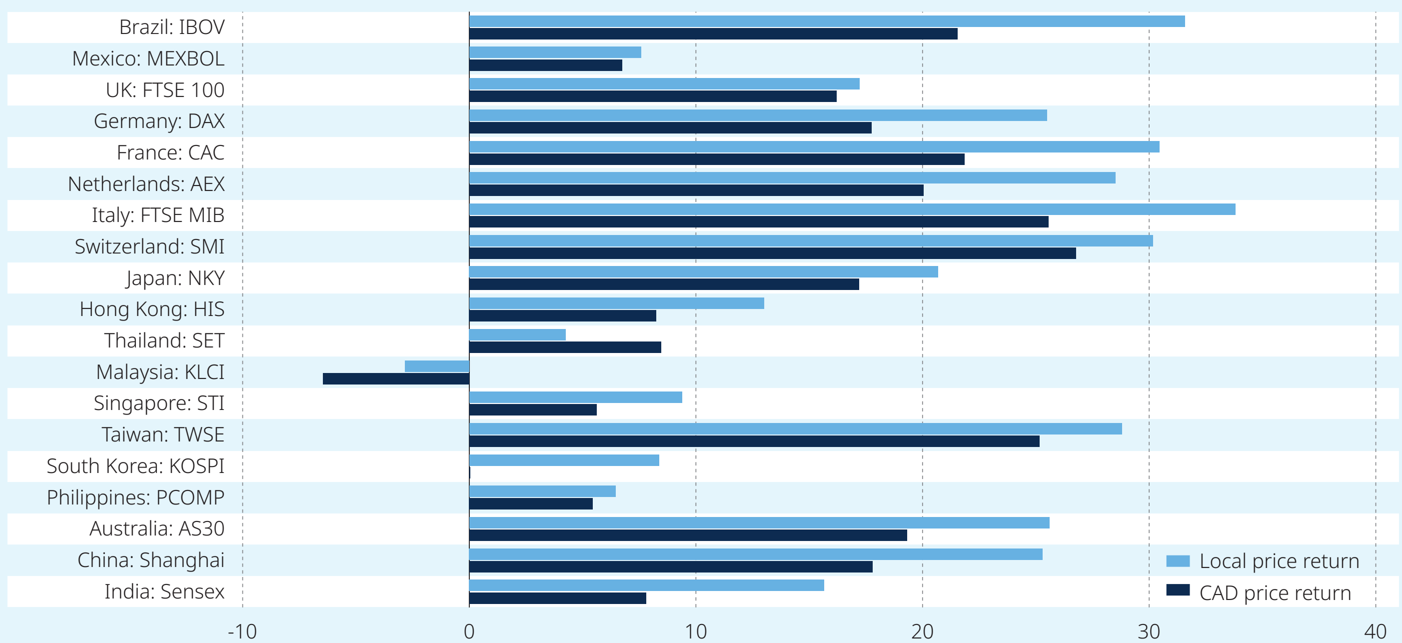
Global equities

In general, 2019 was an exceptionally rewarding year for financial assets, particularly global equities. As measured by the MSCI AC World Index, global equities registered one of the best total-return years, up 27.3%, since the recovery from the Great Financial Crisis. The strong rally, particularly late in the year, reflects a perceived moderation of political risks (regarding trade tensions, hard Brexit and a more extreme U.S. presidential election outcome) and a reduced likelihood of a global economic recession. Leaders of the pack in 2019, in local-currency terms, were Italy (FTSE MIB Index up 33.8%), France (CAC 40 Index up 30.5%), Germany (DAX Index up 25.5%) and Japan (Nikkei 225 Index up 20.7%).

It was an interesting time in emerging markets (EM) as there were many cross signals that buffeted returns through the year. On one hand, there were challenges as economic growth decelerated in China to just above 6.0%, which was an enormous issue as so many of the EM economies are highly levered to the health of demand in China. For instance, the manufacturing sector represents just 11% of U.S. economic activity but 21% of EM economic activity. Therefore, it should have been no surprise that EM equities declined so sharply in the fourth quarter of 2018, when trade tensions arose between the U.S. and China. The positive factor that developed in 2019 to support EM equity prices was the Fed's "mid-cycle adjustment," three interest rate cuts of 25 basis points each implemented mid-summer through mid-fall to ensure that trade "noise" did not derail the global economic recovery. This provided a bid to global equity prices and EM equities traded sharply firmer.

Global Market Equity Index performance (net total return) for the 1 year ending December 31, 2019 (%)



Impact of currency of global market returns - for the 1 year ending December 31, 2019

	Canada	U.S.	Euro Asia	Japan	Emerg. Markets	China	World
	S&P/TSX	S&P 500	MSCI Europe NR	MSCI Japan NR	MSCI EM NR (USD)	MSCI China NR (in HKD)	MSCI World (in USD)
Local currency returns	22.88%	31.48%	26.82%	18.93%	18.63%	23.04%	28.44%
Canadian $ based returns	22.88%	25.24%	18.46%	15.49%	13.01%	17.85%	22.35%

Source: Bloomberg. Net total return in local currency and Canadian dollars.

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Interest rates

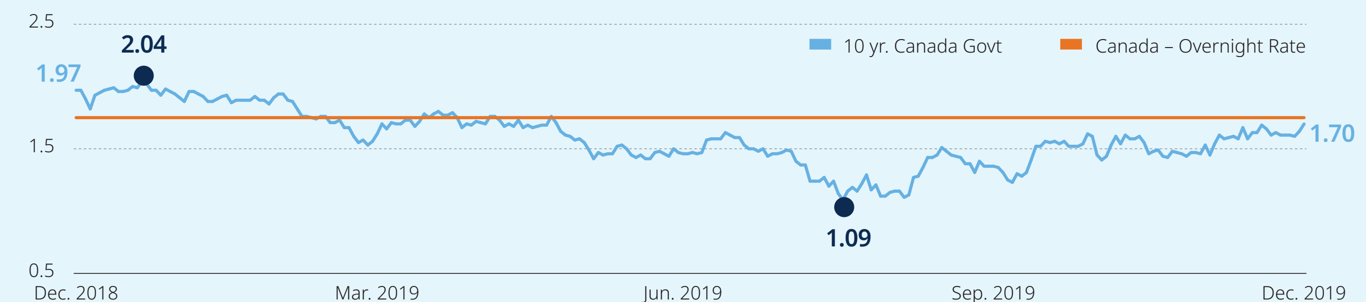
The key trendsetter among central banks during the year was the Fed. In a reversal of policy, the Fed initiated a "mid-cycle adjustment" by cutting interest rates three times mid-summer through the mid-fall. This move was an about-face from 2017 and 2018, when the Fed pushed the bellwether federal funds rate higher to "normalize" interest rates and provide the ammunition with which to fight future inflation battles. The mid-year move to lower short-term borrowing costs in 2019 flattened the yield curve after the curve had temporarily inverted. Given that an inverted yield curve has very often been a precursor to economic recession, the Fed's actions to lower short-term rates (and thus re-steepen the yield curve) provided relief to equity investors worldwide. The 10-year U.S. Treasury bond yield opened the year at 2.68%, trading as high as 2.78% and before closing the year at 1.93%.

The Bank of Canada (BoC) was a bystander in 2019, with no change to its bellwether rate, which remains fixed at 1.75%. Outgoing BoC Governor Stephen Poloz was content to wait and see if domestic economic conditions worsened before cutting interest rates. There remain concerns that generationally low interest rates have already spurred Canadian consumers to lever up their personal balance sheets and further interest rate cuts would only exacerbate the problem. It wasn't clear as the fourth quarter closed whether the BoC will be compelled to follow the Fed and lower interest rates as economic indicators are mixed. Signals from the labour market were weak as the quarter closed, but Poloz appears content to be patient until clear signs of weakness or strength emerge. The 10-year Government of Canada bond yield opened the year at 1.97%, traded as high as 2.04% and closed the year at 1.70%.

As for other central banks, it has been and will be a time of transition. At the European Central Bank, Mario Draghi stepped back after having completed his eight-year term to hand the reigns over to former International Monetary Fund head Christine Lagarde. At the Bank of England, Mark Carney is leaving his post early in 2020. Finally, as previously mentioned, Stephen Poloz has already announced his retirement from the BoC in early June. With monetary policy still deeply in unconventional territory, it remains a risk to investors that this new cohort of central bank heads has a tall task ahead of them. Let's hope that they are up to the job!

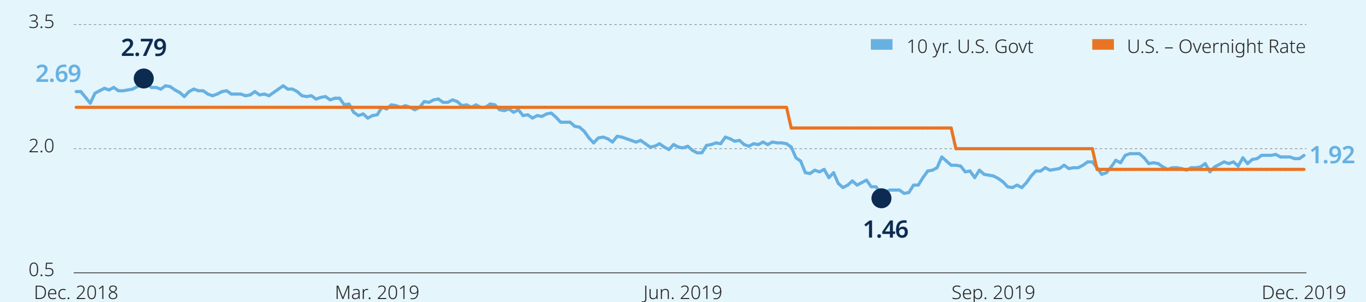
Central bank rates and 10 year government bond yields – for the 1 year ending December 31, 2019 (%)

Canada



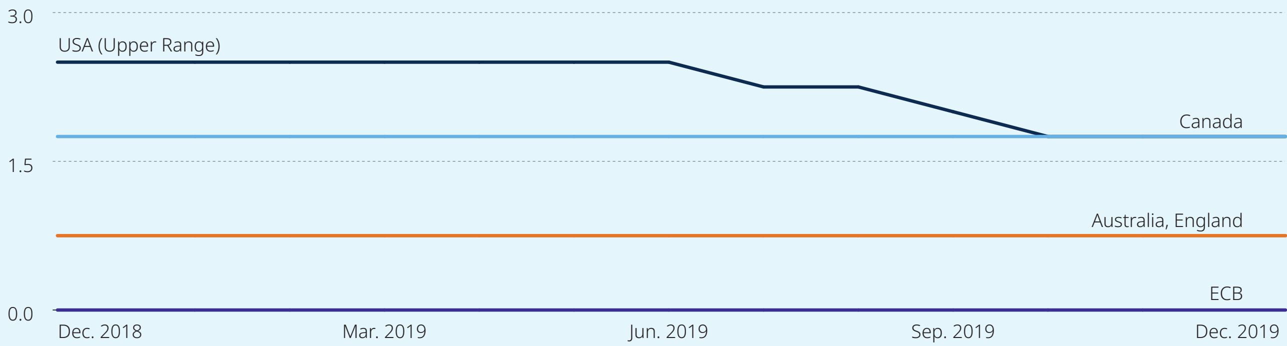
Source: Bloomberg

U.S.



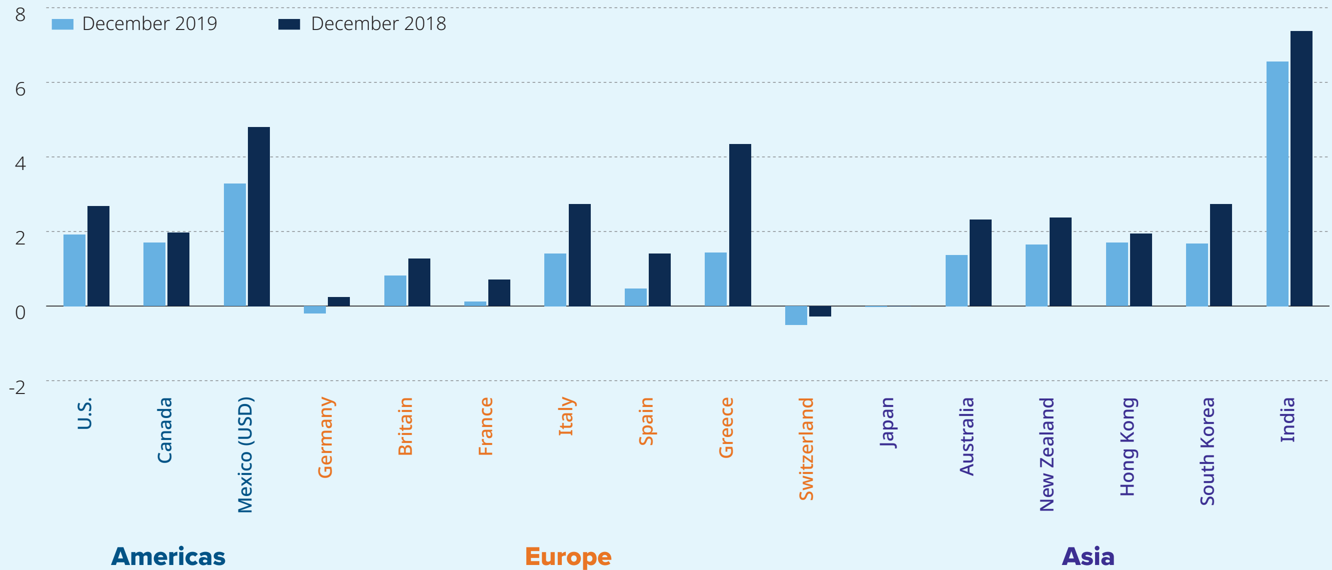
Source: Bloomberg

Central bank rates (%)



Source: Bloomberg

10 year government bond yields (%)



Source: Bloomberg

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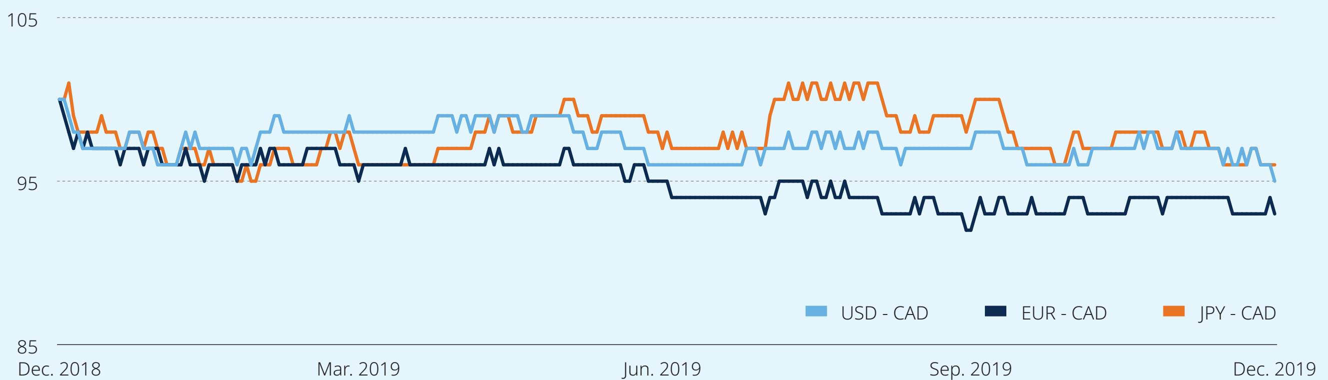
Currencies

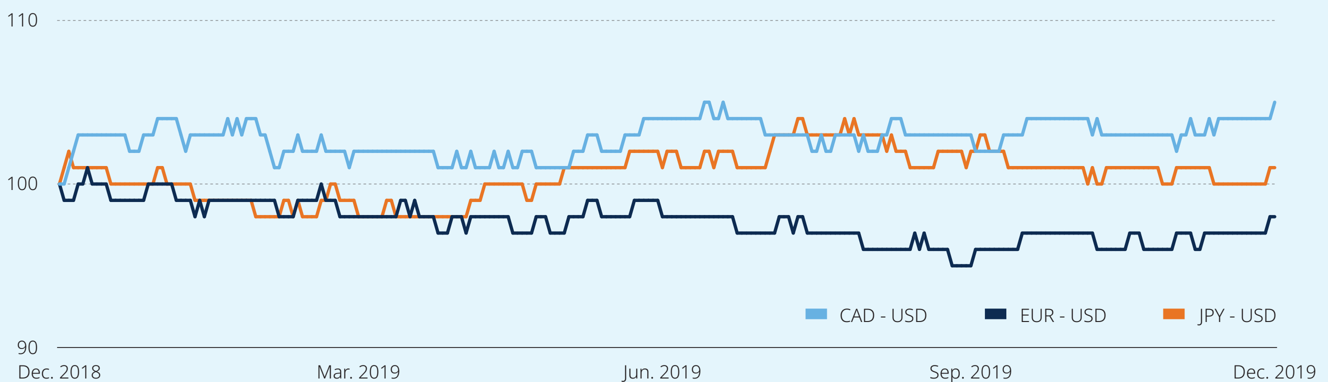
In the past year, there were many reasons why the U.S. dollar should have weakened, including: a large and rising U.S. federal budget deficit, a large U.S. trade deficit, Fed easing and the U.S. administration pushing the dollar lower. Against this backdrop, the U.S. dollar did not weaken much; in the end, the dollar functioned as the "best house in a bad neighbourhood." Yes, there were challenges to face, but investors preferred the certainty of U.S. dollars to the uncertainty of the alternatives. This was not the case for the Canadian dollar, as it was relatively strong during the year, gaining 5.0% versus the U.S. dollar and 7.4% versus the euro. Key to that outperformance was the lack of interest rate easing by the BoC. That decision left short Canadian rates (2-year bonds) above U.S. rates and well above rates almost everywhere else. The other strong currency was the British pound, which traded firmer late in the year alongside a Conservative majority win for Boris Johnson.

CAD comparisons – indexed to 100 on December 31, 2019



Source: Bloomberg

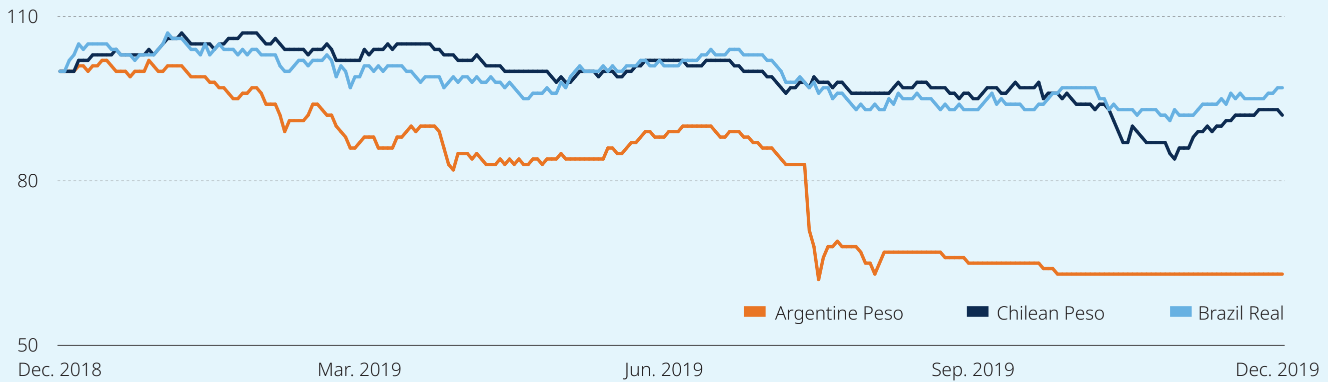
USD comparisons – indexed to 100 on December 31, 2019



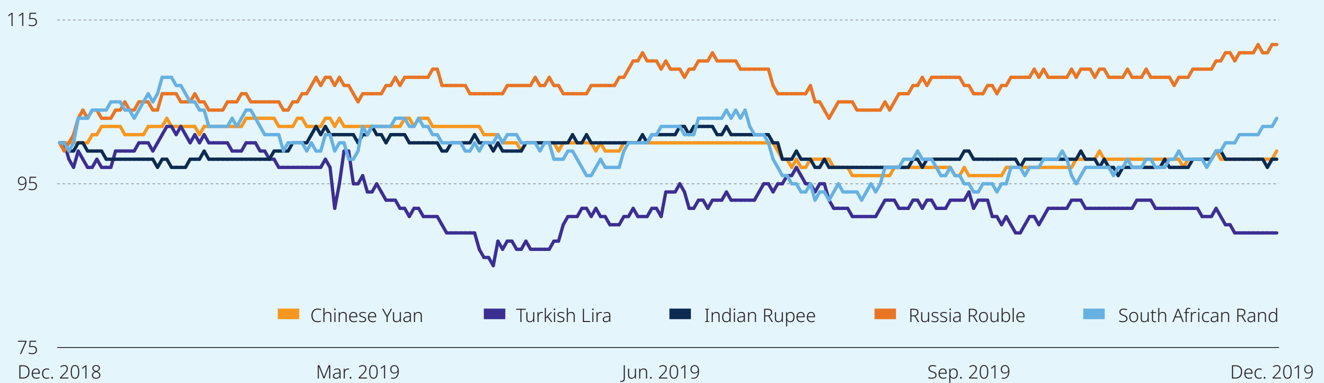
Source: Bloomberg

Within EM currencies, the biggest movers were the Argentine peso and the Turkish lira. Both of these currencies weakened considerably, with the peso down 37.2% and the lira down 11.1%. Argentina's currency collapsed on election results that snubbed President Mauricio Macri's market-friendly austerity approach in favour of Alberto Fernandez's state-involvement, interventionist economic policy. As for the lira, the embattled currency has been negatively impacted by government intervention in central bank policy, which has largely held back on tightening interest rates despite an official inflation rate in the mid-double digits.

Emerging market currencies against the U.S. dollar – indexed to 100 on December 31, 2019



Source: Bloomberg



Source: Bloomberg

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Commodities

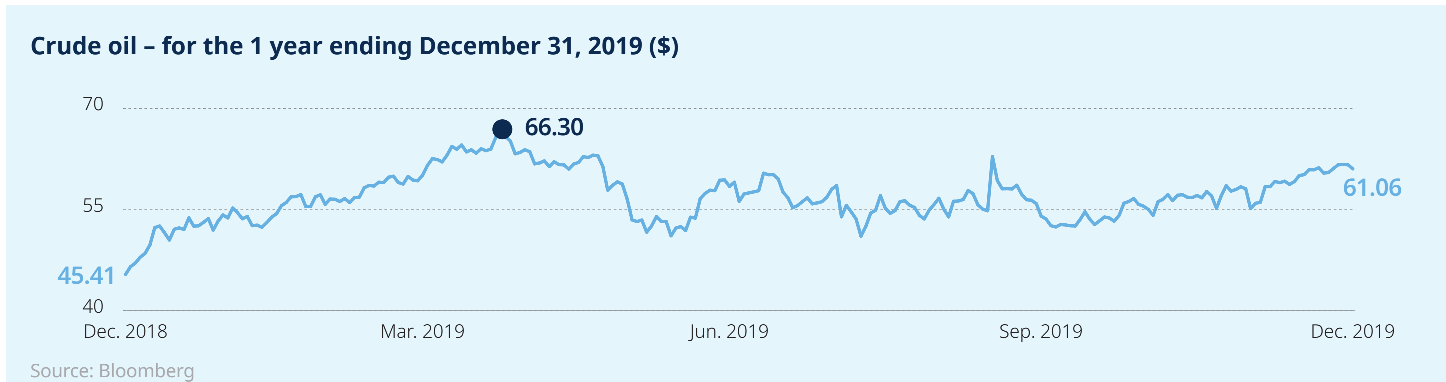
The Bloomberg Commodity Index gained 5.4% in 2019. Support from the Fed's three interest rate cuts underwrote the global economy in 2019 and sent the signal that concerns that had emerged late in 2018 about an end-of-cycle scenario were overblown. In fact, "global reflation" was the buzzword late in the year and commodity prices rose sharply.

Bloomberg Commodity Index – for the 1 year ending December 31, 2019

Source: Bloomberg

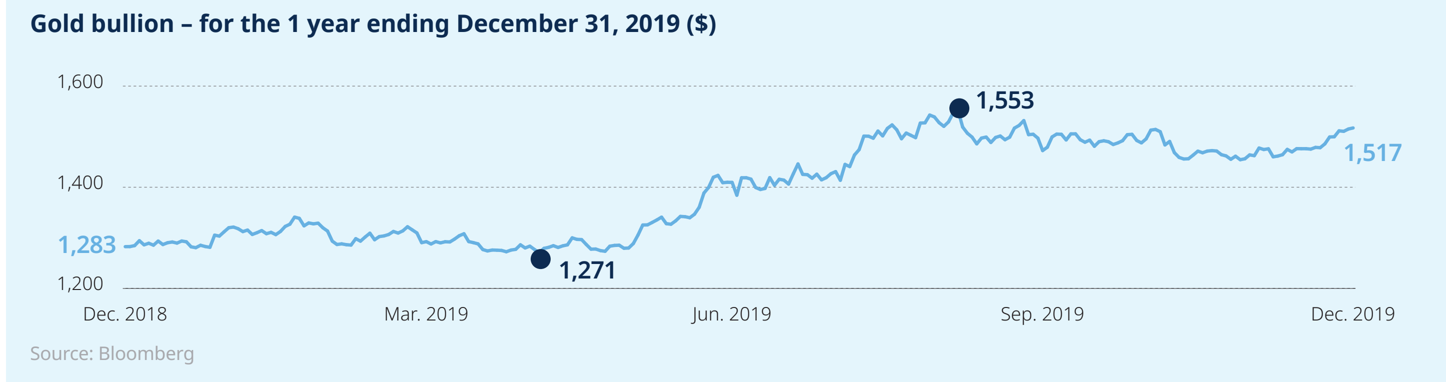
Of particular note was the price of oil and gold. Oil prices rose owing to better visibility on the continued strength of global demand and continued supply discipline from the OPEC+ cartel countries. Gold rose as a hedge against geopolitical risk and as a store of value. For many investors, it makes sense to hold gold as a portfolio asset representing a substitute for sovereign (government) bonds. In an environment where, for example, eurozone sovereign bond yields are negative (where investors have to pay the issuer for the "privilege" of holding their capital), gold retains its value and is typically a better alternative.

Crude oil – for the 1 year ending December 31, 2019 ($)



Source: Bloomberg

Gold bullion – for the 1 year ending December 31, 2019 ($)



Source: Bloomberg

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