Mackenzie Fixed Income Team

Q3-2018 COMMENTARY

Outlook & Positioning

This year, US stock markets seem to have given investors somewhat distinctive price action in each quarter. In Q1 there were large swings in volatility and prices, after what had been a low volatility experience in 2018. The second quarter saw prices moving mostly sideways on stock indices as investors perhaps tried to digest the budding global trade wars alongside a strong US economy. The third quarter brought around a steady and significant rise in US stock indices as markets seemed to embrace the strong domestic growth story, while shrugging off increased geopolitical tensions and a slightly more hawkish monetary policy leaning from the Fed.

It was a different story during Q3 for many non-US markets, both developed and emerging. For these regions, total returns were largely flat, or in some cases, quite negative, reflecting rising risks around increasing trade tensions with the US, as well as the cumulative effects of Fed policy tightening since 2015. Including the 0.25% hike at the end of September, there have now been eight hikes in total, with four delivered over the past 10 months. Continuing tight labor market conditions, and measures of core inflation hovering above the 2% target, have the Fed projecting a tightening path through 2019 and into 2020.

Emerging markets, especially those with either larger current account deficits or where the market has a consensus dim view of political and economic governance, have perhaps begun to feel the pinch of the stronger US Dollar and higher US Dollar funding costs. For some of these countries – especially those that are significant commodity importers – the weakening of their currencies in USD terms creates an economic and sometimes political headwind at home. In general, EM debt indices, both in USD and local currencies, have underperformed other forms of credit.

The good economic growth picture in North America, particularly in the US, provided a good backdrop for corporate credit spreads to narrow during the third quarter. Company profitability remains strong and cash flow is quite adequately covering interest payments, leading to little near-term debt servicing risks, in general. Leverage across the corporate sector has started to rise, but has not reached levels considered dangerous.

Unless market volatility, and economic risks, for the domestic US markets rise notably during the fourth quarter, the Fed, and President Trump, should be expected to continue to focus policy almost solely on the US agenda. This means that the Fed will follow through with another rate hike by December, as Chairman Powell pushes the rate toward the yet to be determined neutral level for this cycle. The yield curve is likely to continue to flatten as this occurs. With the NAFTA renegotiation now out of the way, subject to ratification, the Bank of Canada will follow the Fed to higher policy rates here, with a lag due largely to their previously stated concerns with higher household debt levels.

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Index performance does not include the impact of fees, commissions, and expenses that would be payable by investors in the investment products that seek to track an index.

To the extent the Fund uses any currency hedges, share performance is referenced to the applicable foreign country terms and such hedges will provide the Fund with returns approximating the returns an investor in a foreign country would earn in their local currency.

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