Global Asset Management

Uncovering market movements

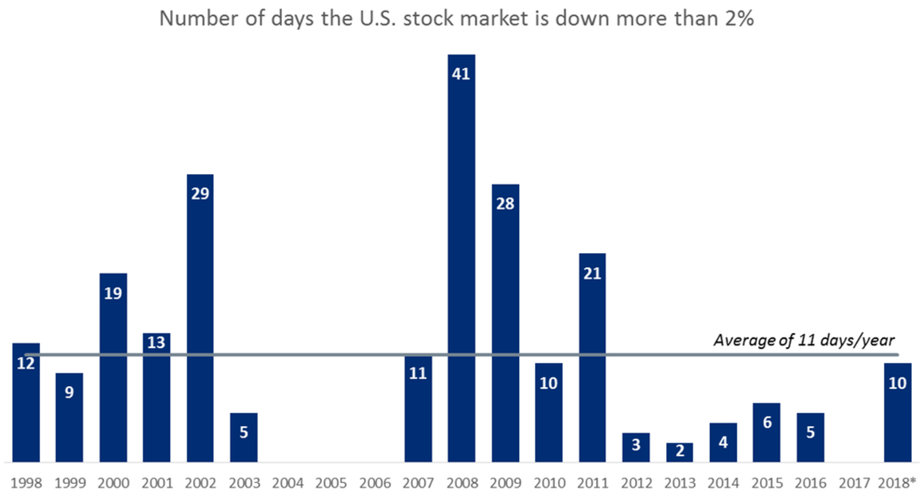
At the start of October, financial markets were given a number of reasons to be cheerful. For starters, the tentative deal that produced the United States-Mexico-Canada Agreement (USMCA) reduced a significant protectionist risk. In addition, an increase in foreign investment activity has signaled that Canada is indeed open for business. However, despite these positives, markets have stumbled in the time since.

What's weighing on markets?

The reality is that there is always a mix of good and bad things happening in the global economy at any given time. Notwithstanding a number of positive developments, investors have also had to digest news that the International Monetary Fund (IMF) was cutting its global GDP growth forecast from 3.9% to 3.7%, driven by their view that there may be a number of economic clouds on the horizon. In particular, growing trade tensions between the U.S. and China threaten the loss of economic activity for the world's two largest economies.

Trade tensions between the U.S. and China are also taking center stage as companies in the U.S. report their quarterly earnings. The U.S. stock market fell by 2% on October 23 after two large manufacturers downgraded their profit outlook on concerns surrounding tariffs and slower growth in China. While these companies later clarified that tariffs would have a limited drag on results, the initial market reaction highlighted the sensitivity to trade tensions that exists in the current climate.

At the same time, equity markets are absorbing signals from the bond market. Strong economic data has driven interest rates higher, with the 10-year U.S. Treasury yield rising by more than 1.0% since September 2017 to its current level of 3.1%. And while economic data remains strong, recent statements from the U.S. Federal Reserve and the Bank of Canada have hinted central bank rates will continue to grind higher, leaving some investors concerned that borrowing costs may be rising faster than previously anticipated.



Source: RBC GAM, Bloomberg. U.S. stock market represented by the S&P 500 (USD). *As of October 24, 2018.

The recent pullback may be weighing more on investors simply because markets have been unusually calm in recent years with the exception of a brief correction in February. For instance, in 2017 the S&P 500 didn't experience a single day when prices fell more than 2%. However, if we look back over 20 years, we can see that daily pullbacks over 2% happen on average 11 times each year. So even after the most recent slide, the ups and downs of the market in 2018 look fairly average in that context.

If you are a long-term investor, the higher growth potential offered by equity markets is a key ingredient for most financial plans. However, you pay a premium for this growth potential in the form of short-term fluctuations. So while a large movement in the market is uncharacteristic of recent times, it shouldn't be a reason to panic. The economy is still growing at a decent pace and the outlook for corporate profits remains solid.

Barring any deterioration in the outlook, these fundamental factors should provide support for equity markets. If you have concerns, remember that periods of volatility can be an excellent time to review your financial plan to ensure it remains on track and ensure your portfolio is aligned with your long-term goals and risk tolerance.

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