2016 Market Review – Surprise, Surprise!

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2016 will go down on record as the year of surprises: Brexit, Trump, gold, central banks, oil, yields, and eventually equities all did the unexpected.

As we entered 2016, equity valuations were elevated and global growth concerns took center stage. Here are some market highlights (and lowlights) from 2016.

A (really) bad start

The first six weeks were marked by unpleasant surprises and risk-off selling. In some cases, the beginning of the year wasn't just a bad start for equity benchmarks; it was the worst ten day start in history (e.g. S&P 500). All major global equity markets suffered losses to start 2016. The disorderly manner with which the Chinese handled their currency and equity market correction early in 2016 led to an increasingly worrisome view of the Chinese authorities' ability to manage core economic levers. Not only did equity markets stumble, but the 18-month slide in oil prices accelerated as oil prices plummeted to the mid-US$20.

Central banks responded to the early year market anxiety with more accommodation: the Fed backed-away from hikes; the European Central Bank fired additional salvos of negative interest rates (NIRP); and the Bank of Japan fired its own NIRP bazooka for the first time. Yields on 10-year Japanese and German bonds turned negative for the first time in history and by mid-July in excess of $12 trillion dollars of global bonds traded at a negative yield. Volatility extended into other fixed income markets as the 'risk-off' environment drove 10-year Government of Canada yields down to an all-time low in July, below 1%, a level they would re-visit come late September. The safe haven appeal of gold created a surge in gold stock values (up 93% and accounting for half of the S&P/TSX Composite's 8% gain in the first half of 2016).

Market Summary

12.31.2016

North American Equities			2016 (%) Local[1]	2016 (%) CAD
S&P/TSX Composite	15,287.59	▲	17.5	17.5
S&P/TSX Small Cap	658.66	▲	35.2	35.2
S&P 500	2,238.83	▲	9.5	6.4
NASDAQ	5,383.12	▲	7.5	4.4
Global Equities				
STOXX 50	3,290.52	▲	0.7	-5.3
FTSE 100	7,142.83	▲	14.4	-7.0
Nikkei 225	19,114.37	▲	0.4	0.2
Shanghai Composite	3,103.64	▼	-12.3	-20.4
MSCI Emerging Markets (USD)	862.27	▲	8.6	5.5
Canadian Fixed Income				
FTSE TMX Canada Universe Bond Index	1,011.39	▲	1.7	1.7
FTSE TMX Canada All Corporate Bond Index	1,137.38	▲	3.7	3.7
Currency				
Canadian Dollar (USD/CAD)	0.74	▲	3.0	3.0

Price only equity returns
1.Local currency unless otherwise specified
Source: Bloomberg | 31 Dec 2016

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A surprisingly happy ending (but not for all)

By June the S&P 500 Index recouped its 2016 losses, while Canada bested its neighbour, as the S&P/TSX Composite held near the top of the list of best performing global equity markets all year long. On June 23rd, UK citizens voted to leave the European Union, tripping up capital markets. The swoon was brief, as the initial emotional sell-off was soon followed by an impressive two week recovery. A lasting recovery ensued as signs arose that the global economy (including the UK) was improving. With Brexit fading from the forefront, the summer was one of the lowest volatility and lowest trading volumes on record. Post Labour Day saw attention turn to politics once again with the US election and markets drifted sideways to lower. Between the day before Brexit and the day before the US election the S&P 500 moved +18 points, less than 1%. An OPEC (Organization of the Petroleum Exporting Countries) supply deal in November helped oil move above $50 at the end of 2016. December's last Federal Reserve FOMC meeting of the year became the only rate hike of the year.

Canadian bond markets experienced a wild ride in 2016. Returns rose into the mid-single digits by October, then skidded hard through the fall. The shift in investor sentiment and an improving global economic outlook, coupled with expectations for higher inflation saw yields rise from October through to mid-December. A quick snap-back for yields in late December allowed the benchmark to post a slight positive for the year (see exhibit 1.1). Government of Canada 10-year bond yields rose 0.33% and 30-year's 0.16% on the year.

While it is tempting to point to the US election as the turning-point for markets, that is not the case. Rising yields and the rotation out of defensive, yield-oriented sectors into cyclical, growth-oriented sectors began well before the surprise US election result. The moves were accelerated post-election, as markets chose to embrace a less bombastic President-elect Trump and focus on the potential positive policy moves that the market perceives will spell higher growth, higher inflation, government stimulus, tax and regulatory reform. The sectors of the market that stand to benefit most from these outcomes are many of the cheapest sectors and they rallied hard, while those sectors who lose under Trump were punished (e.g. post-election: financials up 16.5%, construction and engineering up 17.2%, heath care facilities down 11.2%). More broadly, and on both sides of the border, an examination of the first half sector performance vs. the second half illustrates that winners and losers switched places (see exhibit 1.2). In Canada, the biggest shift saw gold miners retreat (down 24% July through December), as Canadian banks picked-up the slack. Banks responded to rising rates and a steepening yield curve with the Canadian bank index up 18% in the second half.

For 2017 we see the world entering a period where modest global growth and modest inflation can lead to a normalization of yields and modest results for equity markets. Our asset mix recommendation favours equities over fixed income. For more on what capital markets may hold for 2017, see GLC's 2017 Capital Market Outlook.

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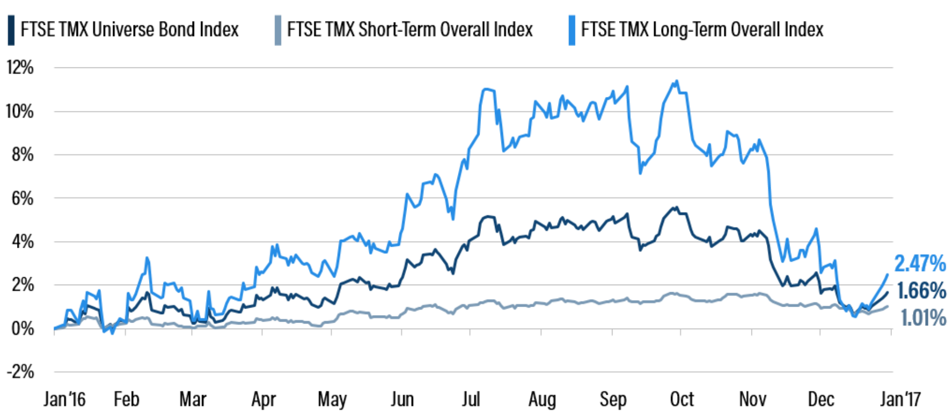
Exhibit 1.1

2016 Canadian Bond Market Performance



Source: Bloomberg | 31 Dec 2016

Canadian Interest Rates

12.31.2016

Treasury Bills

3-month	0.46%

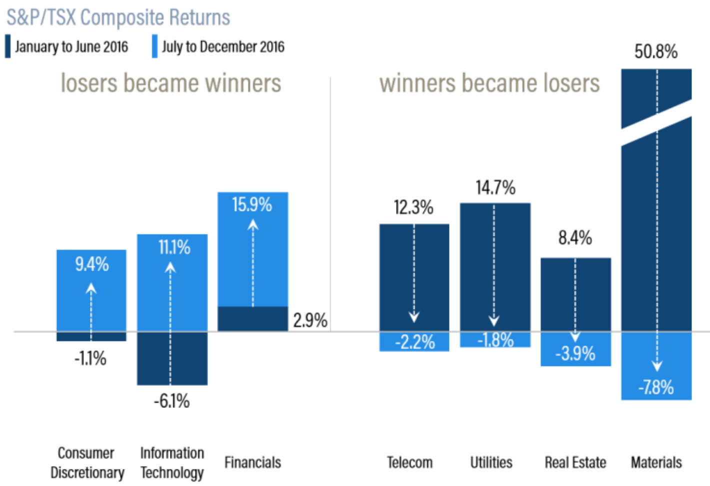
Government of Canada Bonds

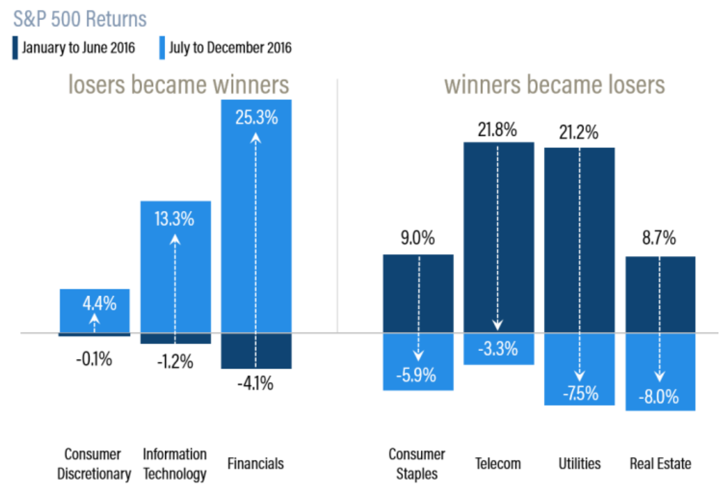
2 Year	0.74%
10 Year	1.72%
30 Year	2.31%

Source: Bloomberg

Exhibit 1.2

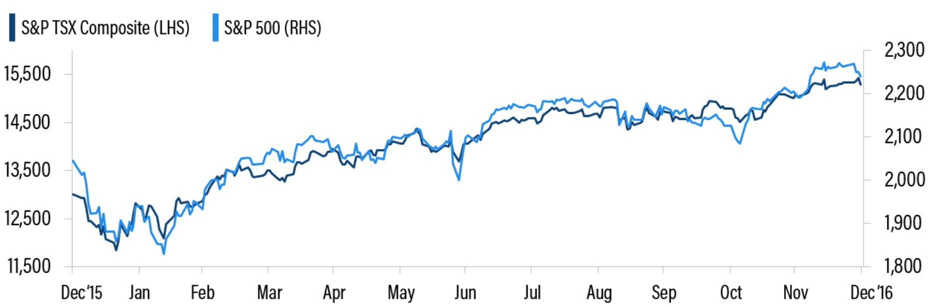
Sector winners and losers switch places halfway through the year





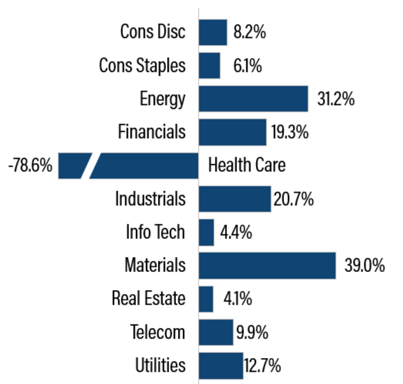
Source: Bloomberg | 31 Dec 2016

Canada and US Equity Markets



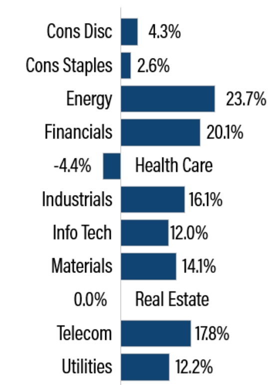
Source: Bloomberg | 31 Dec 2016

S&P/TSX Composite – 2016 Sector Returns (CAD)



Source: Bloomberg | 31 Dec 2016

S&P 500 – 2016 Sector Returns (USD)



Source: Bloomberg | 31 Dec 2016