GP WEALTH MANAGEMENT

After years of counting their pennies, governments are spending again. And with unemployment rates near or at historical lows, private-sector consumption is solid as well. Against this backdrop, the global economy continued to expand in the last quarter, creating a helpful tailwind for equities.

That said, investors should beware that looming risks such as the U.S.–China trade war or the U.S. Federal Reserve's ongoing interest rate hikes could dampen economic growth and stifle confidence in the markets.

## Global economic outlook

The trade tensions between the U.S. and China have the potential to get much worse before they get better. This unpredictability presents an obvious near-term risk to the global economy. To date, the U.S. has imposed tariffs on about $250 billion of imports from China, and China has responded with tariffs on about $110 billion of U.S. exports to China. In January, tariff rates are already scheduled to increase further unless an agreement is reached, and the Trump White House has threatened to widen its tariffs to encompass all of China's exports to the U.S.

If this bilateral trade war is not resolved soon, it has the potential to impede global growth, while simultaneously pushing prices higher on a broad range of manufactured goods.

On a positive note, the U.S., Mexico and Canada have announced a tentative trilateral trade deal to replace NAFTA. Yet to be ratified by the U.S. Congress, the new trade agreement, dubbed United States-Mexico-Canada Agreement, or USMCA for short, removes the threat of tariffs on Canadian auto exports to the U.S., at least for now.

## Canada benefiting from strong U.S. economy

Historically, when the U.S. economy expands, Canada benefits by piggy-backing on the growth, and this cycle is no exception. As the fourth quarter gets underway, the strong U.S. economy continues to act as a buffer to the headwinds challenging the Canadian economy. Though the threat of U.S. auto tariffs has been taken off the table, Canada continues to face significant issues, such as high consumer debt, climbing interest rates and the discount on Canadian crude oil prices relative to global benchmarks. Canada's resource-based economy relies on stable government support, and the current political impediments to new construction of oil pipelines could place a drag on the entire economy.

Turning to equities, the S&P/TSX Composite closed out Q3 with a negative return of -1.3%. This contrasts sharply with the robust +5.9% return posted in Q2.

*(Cont..)*



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Notably, the healthcare sector, driven by cannabis stocks, had a fabulous third quarter at +33.5%. However, it represents only 2% of the index, so the overall impact was minimal. The major drag on the S&P/TSX Composite's performance came from resource-related sectors such as materials, which was down -13.2%, and energy, down -6.3%.

## U.S. Outlook

Since the beginning of 2018, the U.S. has been a leader of the global pack due to its strong performance across economic growth, earnings growth and stock-market performance. The U.S.-initiated trade war with China is clearly a risk factor for business owners and investors, but U.S. business confidence remains firm and stock prices, though volatile, have remained buoyant.

Another challenge the U.S. must contend with is rising interest rates. When the economy is strengthening, the Federal Reserve typically adjusts the interest rate upwards to keep a lid on inflation. Currently, the Fed is also using interest rate hikes as part of its normalisation of monetary policy, a multi-faceted plan to fix its balance sheet after years of quantitative easing.

On September 26, as was widely expected, the U.S. Federal Open Market Committee (FOMC) announced an increase of 25 basis points to the fed funds rate. This marks the eighth increase since the Fed began normalizing policy in December 2015, and it takes the rate to a range of 2% to 2.25%, a level last seen in April 2008.

The FOMC projects it will make one more hike before the end of the year and three in 2019. Clearly, interest rate hikes have the potential to dampen the economy. This is because they put a drag on business profits, home sales and consumer spending. However, the broad-based nature of the U.S. expansion suggests a low probability of recession in the near term.

## What's next?

The U.S. and China are key players in a highly integrated international network of trade-dependent countries, of which Canada is part. This makes the increasingly aggressive trade war between the two sparring nations all the more concerning.

As we look ahead, there are other issues that could disrupt growth in the global economy, including the Fed's rate hikes, tightening labor supply and China's industrial slowdown.

Investors will need to keep a close eye on how the financial markets react to these factors as they unfold.

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## Getting Advice

Are you looking for additional perspective on the financial markets and how they might affect your portfolio? We encourage you to talk to us. Speak to your Financial Advisor or contact investor services at **1 800 608 7707**.

*As of Sept 28, 2018

**MARKET MONITOR**

| MARKET INDICATORS | MARKET CLOSE* | 2017 RETURN | 2018 Q3 | 2018 YTD RETURN |
|---|---|---|---|---|
| S&P/TSX Composite | 16,073.14 | +6.03% | -1.3% | -0.8% |
| Dow Jones | 26,458.31 | +25.08% | +9.01% | +7.04% |
| MSCI World | 2,184.009 | +22.40 | +4.98% | +5.43 |





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