

Beyond the Headlines



Highlights

- > To the surprise of many, it is with fresh new highs that major equity indices concluded a busy first third of 2019. But headlines announcing all-time highs alongside a slowing global economy and a persistently uncertain geopolitical backdrop led a number of investors – still mindful of the painful end to 2018 – to grow increasingly pessimistic about this market.
- > Yet, a review of the last four ~20% corrections outside of a recession instead indicates that the S&P 500 rebound of 2019 is not abnormal. From this point on, lessons from the past show the upward trend typically slows but persists.
- > While this helps put things in perspective before succumbing to the old adage *sell in May and go away*, we extend our analysis by briefly updating our assessment of our four key pillars of asset allocation, namely monetary policies, economic growth, valuations and sentiment.
- > Our conclusion? It would be premature to close the books on 2019 just because we're back at an all-time high, no matter how tempting it may be. Monetary policies remain far from restrictive, green shoots are starting to appear in key economic indicators and equity valuations are nowhere near exuberant. At the same time, it wouldn't be appropriate to add risk to our tactical allocation, with sentiment quite elevated and our position in the economic cycle still calling for extra caution. In sum, we continue to believe our modest equity overweight against fixed income assets is the right mix. Stay the course.
- > The sight of new highs in the stock market seems to have marginally dampened the pessimism that has prevailed in the bond market over the last few months. Minutes from the Federal Reserve's March meeting along with a stretch of better-than-expected economic data have pushed the market to somewhat recalibrate its expectations toward what increasingly looks like a coin toss between cutting or leaving rates 'as is' to year-end. A 50/50 chance also seems to apply on our side of the border, judging by the Bank of Canada's latest policy meeting statement.
- > In short, risk management remains the motto for central bankers. Yet, if positive surprises in global growth persist and trade uncertainties ease as we anticipate, expectations for rate cuts are likely to vanish, which would undoubtedly be a headwind for fixed income securities that have greatly benefitted from such prospects thus far in 2019.
- > Equities also benefitted from the Fed's pivot. But, as long as central banks avoid arousing fears of overly restrictive monetary policy by too quickly renewing their rate hike agenda, they should outperform. We should not, however, harbour any illusions. In many ways, the excellent first third of 2019 is just a pendulum swing after a terrible end of 2018. Over the next twelve months, we must expect risk-adjusted returns closer to historical averages, i.e. a slower pace and higher volatility for stock prices.
- > For commodities, the U.S. Administration's decision to put an end to all Iran oil sanctions waivers effective May 2 is unlikely to push oil prices much higher in and of itself as other major players, most notably Saudi Arabia, have clearly stated they stand ready to fill any void. Our positive outlook – which we hold this month – is based rather on resilient global demand, though upside potential is admittedly not as compelling as it was earlier this year.

Table 1 Global Asset Allocation

Global Classes	Weights				
Cash					
Fixed Income					
Equities					
Fixed Income					
Federal					
Investment Grade					
High Yield (USD)					
Non-Traditional FI					
World Equities					
S&P/TSX					
S&P 500 (USD)					
MSCI EAFE (USD)					
MSCI EM (USD)					
Factors and Alternative Investments					
Value vs. Growth					
Small vs. Large					
Low Vol. vs. High Beta					
Canadian Dollar					
Commodities					
Energy					
Base Metals					
Gold					
Infrastructure					

Source: CIO Office

Current Allocation 
Previous Allocation 

Market Review

Fixed Income

- > April saw 10-year U.S. government bond yields rise slightly, quickly pulling the yield curve out of inversion along with it.
- > In Canada rates also rose, leading the way for relatively flat bond market returns (down a mere 0.1%), as not a single index moved in either direction by even a single digit.
- > As risk appetite grew, credit spreads fell, helping the BoAML High Yield index outperform its more risk-averse cousins, returning 1.4% over the period.

Canadian Equities

- > Last month saw the S&P/TSX set a new all time high, closing the period in line with last July's peak, and bringing year-to-date total returns to 16.9%.
- > Two sectors stood apart from the rest, as Information Technology (up 6.4%) and Consumer Discretionary (up 7.1%) both outperformed the rest of the Canadian equity market.

U.S. Equities

- > South of the border, equity markets also reached new highs with the S&P 500 closing the month 0.4% above last September's peak, bringing year-to-date total returns to an impressive 18.2%.
- > All but three sectors ended April positively, with healthcare having the most difficulty (down 2.6%) in the face of an increasingly hostile field of would-be presidential candidates, while the Telecom, Financials, and Information Technology sectors all soared to podium positions (up 6.5%, 9%, and 6.4% respectively).

Commodities

- > April was the fourth consecutive month of positive gains for oil, as the black gold climbed another 6% to 63.8\$/bbl with OPEC+ quotas and a strengthening world economy both serving to push the price upwards.
- > Meanwhile, gold and copper depreciated slightly, the former showing large fluctuations within the month to ultimately finish down just 1%.

Foreign Exchange

- > It was *Much ado about nothing* for FX markets in April, as most major currencies failed to solidify movements in any given direction.
- > The U.S. dollar index finished near where it started, while a depreciation in the Loonie – following a Bank of Canada policy statement release in which the Central Bank removed a reference to future rate hikes – eventually reversed course, keeping the currency range-bound for the month (down a meager 0.3% over the period).

Table 2 Market Total Returns

Asset classes	April	YTD	12 months
Cash (3-month T-bills)	0.1%	0.5%	1.5%
Bonds (FTSE/TMX Ovr. Univ.)	-0.1%	3.8%	6.1%
FTSE/TMX Short term	0.3%	2.0%	3.8%
FTSE/TMX Mid term	0.1%	3.9%	6.8%
FTSE/TMX Long term	-0.7%	6.2%	8.7%
FTSE/TMX Government	-0.3%	3.6%	6.2%
Federal	-0.2%	2.3%	5.1%
Provincial	-0.3%	4.9%	7.2%
Municipal	-0.1%	4.7%	6.9%
FTSE/TMX Corporate	0.3%	4.3%	5.8%
AA+	0.4%	3.0%	4.8%
A	0.1%	4.7%	5.8%
BBB	0.4%	4.9%	6.1%
BoAML High-Yield (USD)	1.4%	8.9%	6.7%
Preferred Shares	0.2%	1.3%	-6.2%
Canadian Equities (S&P/TSX)	3.2%	16.9%	9.6%
Energy	3.5%	19.7%	1.1%
Industrials	4.1%	20.0%	16.9%
Financials	5.9%	16.9%	9.2%
Materials	-2.5%	5.9%	-0.1%
Utilities	0.5%	16.7%	14.7%
Cons. Disc	7.1%	17.6%	0.5%
Cons. Staples	0.8%	11.4%	22.4%
Healthcare	2.0%	52.2%	53.4%
IT	6.4%	34.0%	34.2%
Telecom	-0.8%	9.1%	15.2%
REITs	-2.5%	14.6%	16.7%
S&P/TSX Small Cap	-0.3%	10.4%	-6.8%
US Equities (S&P500 USD)	4.0%	18.2%	13.5%
Energy	0.1%	16.5%	-7.3%
Industrials	4.1%	22.0%	10.6%
Financials	9.0%	18.3%	4.3%
Materials	3.6%	14.3%	3.0%
Utilities	0.9%	11.9%	18.0%
Cons. Disc	5.7%	22.3%	16.9%
Cons. Staples	2.5%	14.8%	18.4%
Healthcare	-2.6%	3.8%	10.5%
IT	6.4%	27.6%	22.8%
Telecom	6.5%	21.4%	15.9%
REITs	-0.5%	17.0%	21.2%
Russell 2000 (USD)	3.3%	18.0%	3.2%
World eq. (MSCI ACWI)	3.4%	16.2%	5.6%
MSCI EAFE (USD)	2.9%	13.3%	-2.7%
MSCI EM (USD)	2.1%	12.3%	-4.7%
Commodities (CRB index)	-0.8%	3.2%	-5.2%
WTI Oil (US\$/barrel)	6.0%	41.4%	-6.9%
Gold (US\$/ounce)	-1.0%	0.1%	-2.3%
Copper (US\$/tonne)	-0.9%	8.0%	-5.1%
Forex (DXY - US Dollar index)	0.2%	1.4%	6.1%
USD per EUR	-0.2%	-2.0%	-7.2%
CAD per USD	0.3%	-1.8%	4.3%

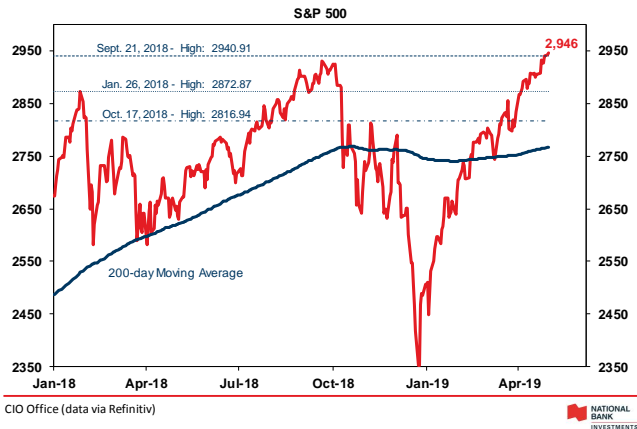
CIO Office (data via Refinitiv)

2019-04-30

Beyond the Headlines

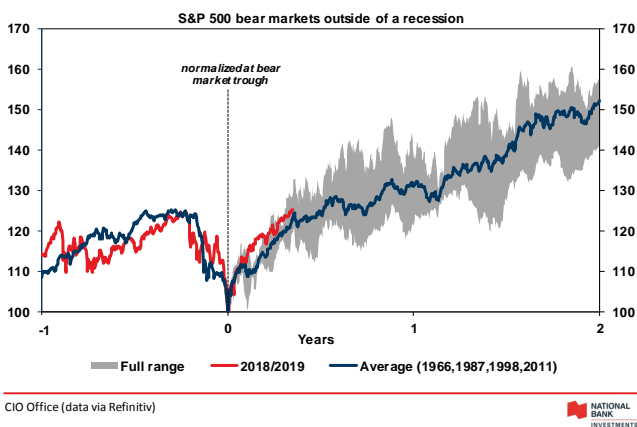
To the surprise of many, it is with fresh new highs that major equity indices concluded a busy first third of 2019, the S&P 500 slicing through key technical levels like a hot knife through butter (**Chart 1**).

1 Back to record highs for the S&P 500...



Naturally, headlines announcing all-time highs for stock indices alongside a slowing global economy and a persistently uncertain geopolitical backdrop led a number of investors – still mindful of the painful end to 2018 – to grow increasingly pessimistic about this market. Yet, that’s not what history teaches us. Instead, a review of the last four bear markets (~20% correction) outside of a recession indicates the S&P 500 rebound of 2019 is not abnormal, assuming our prospects for stabilizing global growth are accurate. From this point on, lessons from the past have shown that the upward trend typically slows but persists, although the range of possible outcomes begins to widen (**Chart 2**).

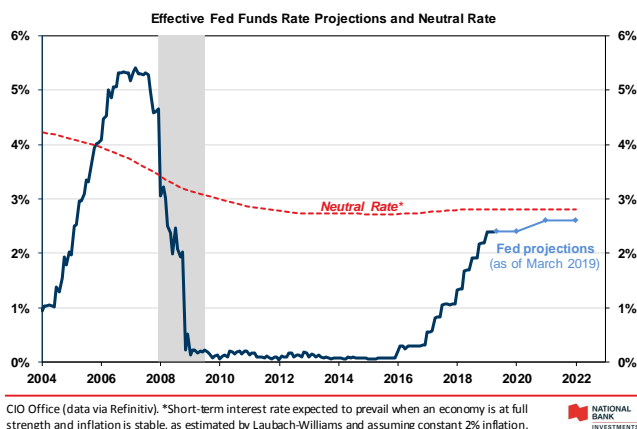
2 ... in line with the typical ex-recession rebound



While this helps put things in perspective rather than succumb to the old adage *sell in May and go away*, we must reach beyond this simple historical analysis of just these four observations (1966, 1987, 1998, 2011) which diverge widely in terms of backgrounds. To do so, let us briefly update our assessment of our four key pillars of asset allocation, namely (1) monetary policies, (2) economic growth, (3) valuations and (4) sentiment.

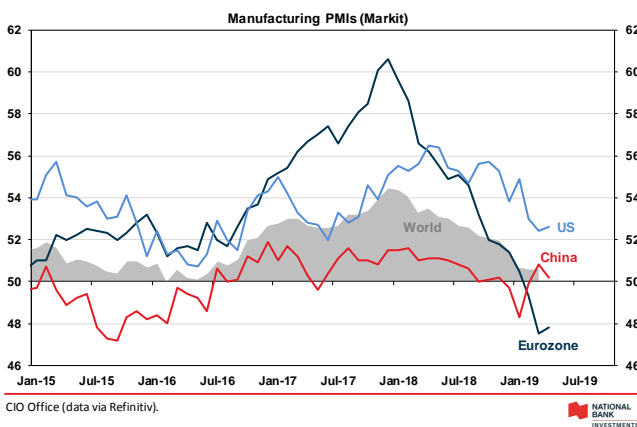
For their part, central banks pulled themselves out of the equation as much as they could in recent months, with the Federal Reserve indicating it had no intention of moving until the end of 2019, remaining comfortably just below the level deemed as neutral (**Chart 3**). A similar context exists on our side of the border, when on April 24 the Bank of Canada removed a reference to future rate hikes stating that “an accommodative policy interest rate continues to be warranted.” All in all, this remains in line with our expectation for cautious central banks outlined in our Asset Allocation report at the beginning of the year.

3 Policy rates not about to turn restrictive any time soon



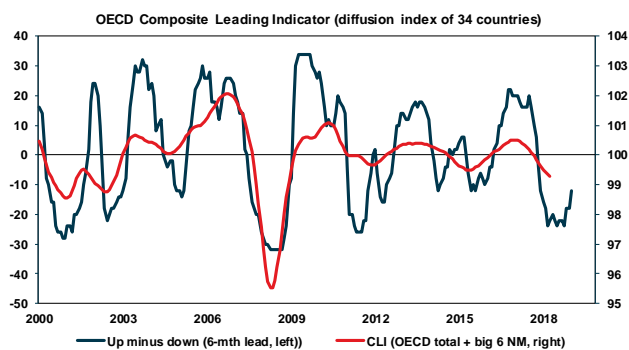
Shifting our focus to global economic growth, our expectation for stabilization seems to be increasingly becoming a reality, with the latest manufacturing PMI indices holding steady in the U.S., standing above 50 in China and rebounding from their lows in the Eurozone (**Chart 4**).

4 Manufacturing activity is stabilizing...



U.S. corporate earnings also surprised on the upside, with 77% of companies having reported Q1-2019 results showing EPS higher than analysts’ expectations who, admittedly, had set the bar quite low. It is still too early to completely rule out the risk of a worsening global slowdown, but that was certainly not the message sent by the latest economic figures (**Chart 5**, next page).

5 ... and leading economic indicators point to a rebound

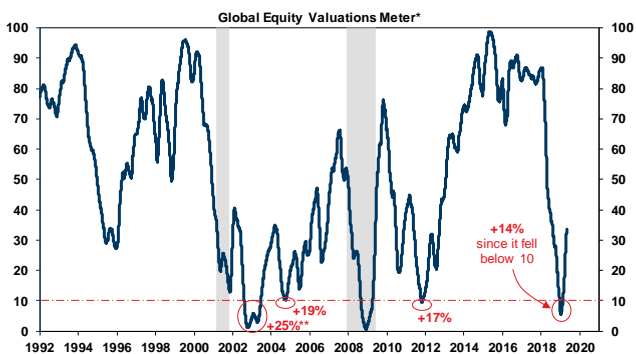


CIO Office (data via Refinitiv)



What about valuations? Aren't all-time highs in stock prices synonymous with expensive markets? Not necessarily. For instance, our global equity valuations meter – a composite measure of price/earnings ratios of key indices – isn't signalling a bargain like we argued it did late in 2018. But, it remains miles away from flagging overvaluation (Chart 6).

6 Equity valuations remain far from exuberant...



** MSCI ACWI average return over the next 12 months when Meter < 10

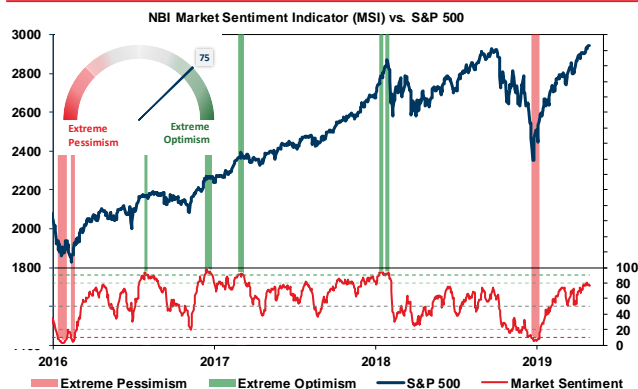
CIO Office (data via Refinitiv). *Global equity valuations meter = Average of S&P 500, MSCI EM, MSCI EAFE and S&P/TSX 12-month forward PE Ratio percentile rank over a rolling 5-year window.



On the other hand, our market sentiment indicator does begin to show elevated levels of optimism at a reading of 75, making equities increasingly vulnerable to the slightest bad news (Chart 7). We're not yet in the >90 range that is often followed by a stock market breather. But, since markets seem extremely confident that China and the U.S. will soon come to an agreement, any form of disappointment in this matter would certainly suffice.

On that point, it does indeed seem we will have an announcement from both countries in May, as the new round of negotiations that started in Beijing yesterday is set to conclude in Washington next week. Comments from government officials in both hemispheres indicate the key contentious issues left to resolve are the enforcement mechanisms to ensure compliance with the agreement and timelines for lifting tariffs, the latter being of particular importance for markets. Our view remains that there will be a deal; a positive outcome for risk assets that should, however, be limited in reach considering that rumours in

7 ... but optimism is undeniably elevated



CIO Office (data via Refinitiv, Bloomberg)



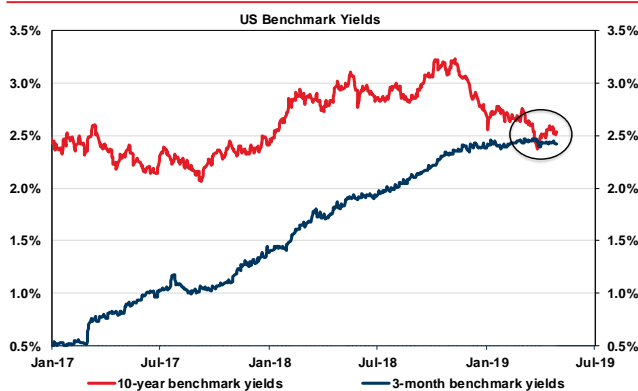
this regard have abounded in recent months. Plus, there's always the non-negligible chances of a classic buy the rumours, sell the news reaction in the short run. To be continued.

So, what's the bottom line? It would be premature to close the books on 2019 just because we're back at an all-time high, no matter how tempting that may be. Monetary policies remain far from restrictive, green shoots are starting to appear in key economic indicators and equity valuations are nowhere near exuberant. At the same time, it wouldn't be appropriate to add risk to our tactical allocation, with sentiment quite elevated and our position in the economic cycle still calling for extra caution. In sum, we continue to believe that our modest equity overweight against fixed-income assets is still the right mix. Stay the course.

Fixed Income: 50/50?

The sight of new highs in the stock market seems to have marginally dampened the pessimism which has prevailed in the bond market over the last few months, as reflected by the slight upturn in 10-year U.S. government bond yields that brought the yield curve back into positive territory (Chart 8).

8 Slight upturn away from inversion in April



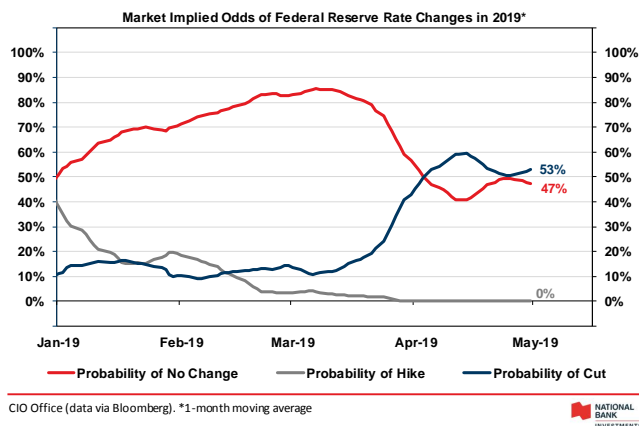
CIO Office (data via Refinitiv)



This occurred as the Minutes from the Federal Reserve's March 19-20 meeting along with a stretch of better-than-expected economic data pushed the market to somewhat recalibrate its

expectations toward what increasingly looks like a coin toss between cutting or leaving rates 'as is' to year-end (**Chart 9**).

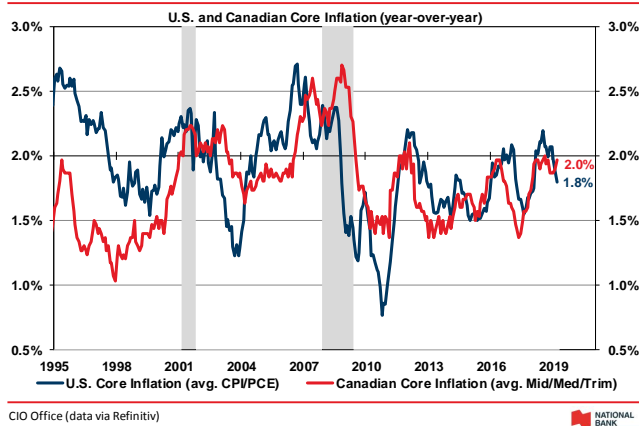
9 Heads or tails?



It appears that a 50/50 chance also applies on our side of the border, judging by the Bank of Canada's latest policy meeting statement released on April 24. Indeed, its official press release no longer contained a reference about the "timing of future rate increases," and rather emphasized that it continues to monitor economic data and global trade policies "to gauge the extent to which factors weighing on growth and the inflation outlook are dissipating." In essence, this seemingly subtle change in the wording implies that the Central Bank has opened up the possibility for rate cuts should the backdrop deteriorate, though this is not their base case.

It must be said that both Canadian and U.S. monetary policy authorities remain in good positions to show patience, with average core inflation figures near their 2% target (**Chart 10**). Where prices go from here should be closely monitored in the coming months. But, only a significant overshoot would challenge central banks' policy stances, as years of below-target inflation leave room for higher figures moving forward.

10 Inflation remains near target



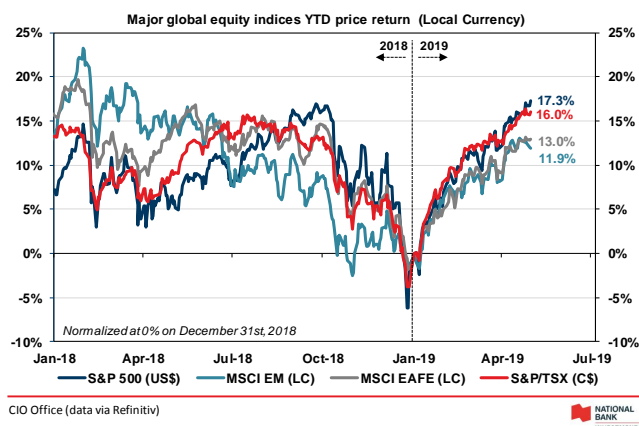
In short, risk management remains the motto for central bankers. Yet, if positive surprises in global growth persist and trade uncertainties ease as we anticipate they will, expectations for rate cuts are likely to vanish which would

undoubtedly be a headwind for fixed-income securities which have greatly benefitted from such prospects thus far in 2019.

Equities: Round Trip

North American equities completed their round trip from bear market territory, all the way back to new highs in April. After four months of 2019, the S&P 500 and S&P/TSX are higher by a whopping 17.3% and 16.0%, respectively, while international stocks are lagging despite solid double-digit returns (**Chart 11**).

11 Round trip completed in North America



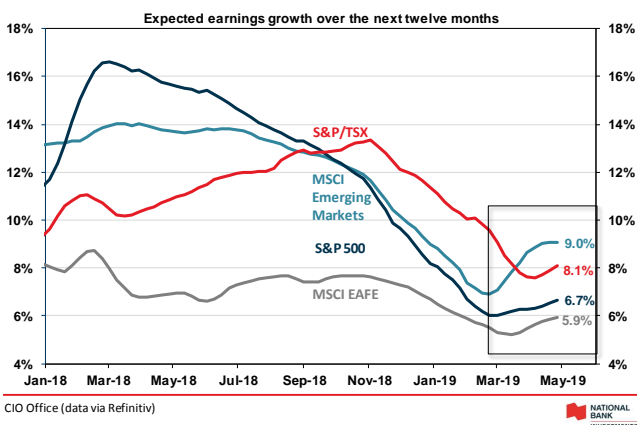
Consistent with our base case scenario, earnings from corporate America have begun to show the risk of steep growth deceleration that weighed on markets was somewhat exaggerated, with 77% of companies having reported results thus far beating expectations (**Chart 12**).

12 Q1 earnings are coming out better-than-expected...

	Earnings Summary - S&P 500				Q1/2019 YoY%
	% Reported	% Beat	% Met	% Missed	
S&P 500	59%	77%	6%	17%	0.5%
Financials	78%	71%	10%	19%	6.8%
Industrials	77%	74%	6%	20%	7.2%
Energy	62%	72%	6%	22%	-28.1%
Real Estate	59%	68%	16%	16%	4.6%
Health Care	58%	81%	6%	14%	9.2%
Materials	58%	80%	0%	20%	-14.6%
Staples	58%	84%	0%	16%	-0.8%
Technology	54%	86%	5%	8%	-2.3%
Discretionary	45%	79%	7%	14%	6.8%
Comm. Sev.	42%	82%	9%	9%	-11.0%
Utilities	32%	50%	0%	50%	-1.2%

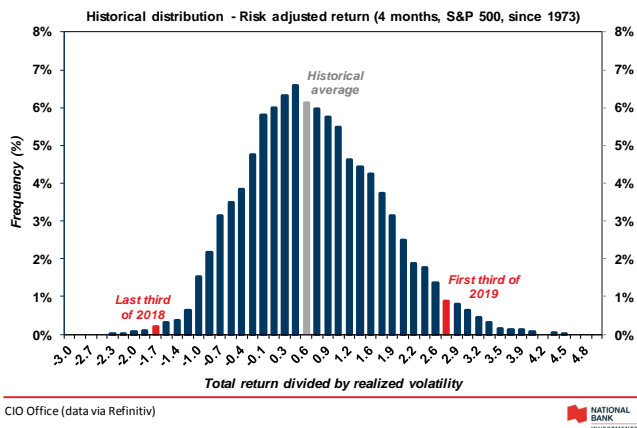
It may seem surprising to see markets positively welcome an earnings season on track to deliver near zero growth compared to Q1 of last year. However, let us recall that what matters most for markets isn't so much the level of growth, but rather the deviation from what was expected, and what that implies for the future. At 0.5%, year-over-year growth in the S&P 500 EPS is better than the -2.4% equity analysts surveyed by Thomson Reuters expected three weeks ago, hence why we're seeing growth expectations for the next twelve months rebounding globally along with stock prices (**Chart 13**, next page).

13 ... and forward expectations are turning the corner



Under these circumstances and as mentioned in the introduction, we continue to believe equities offer the best alternative at this point. We should not, however, harbour any illusions. In many ways, the excellent first third of 2019 is just a pendulum swing after the terrible end of 2018. Going forward, we must expect risk-adjusted returns closer to historical averages, i.e. a slower pace and higher volatility for stock prices (Chart 14).

14 A return to "normality" for the coming months?

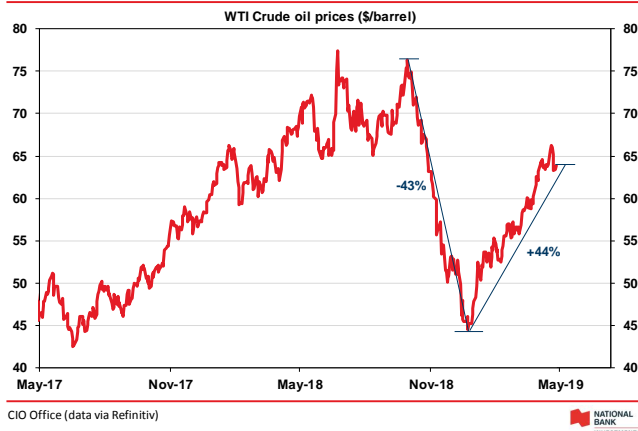


Commodities: V for Vendetta

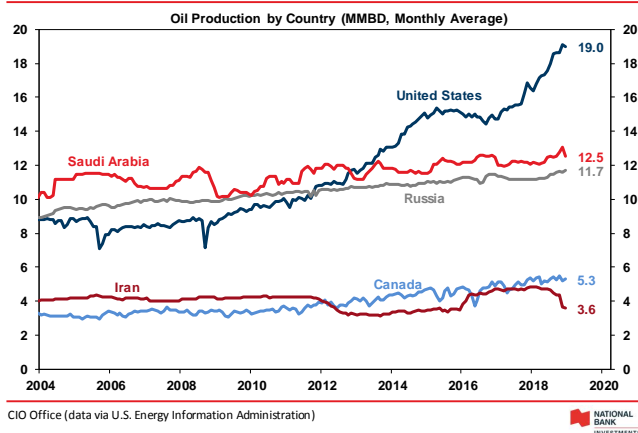
The V-shaped recovery in crude prices continued in April, with WTI oil now up 41% year-to-date (44% from its December lows), making it the best-performing major asset over the period (Chart 15).

The latest factor to hit the headlines in oil's favour has been the U.S. Administration's decision to put an end to all Iran oil sanctions waivers effective May 2, thereby stepping up its vendetta against the Middle Eastern country. However, the potential withdrawal of another fraction of Iranian crude oil from world markets – estimated at 1.3mb/d – is unlikely to push prices much higher in and of itself, as this move was largely expected to come at some point. And other major players, most notably Saudi Arabia, have clearly stated they stand ready to fill any void (Chart 16).

15 V-shaped recovery in crude prices continued in April



16 Supply should remain sufficient despite Iran sanctions



Our positive outlook for energy prices – which we hold this month – is based rather on resilient global demand, though upside potential is admittedly not as compelling as it was earlier this year.

CIO Office

CIO-Office@bnc.ca

Martin LefebvreCIO and Strategist
martin.lefebvre@bnc.ca**Simon-Carl Dunberry**Chief Analyst
simon-carl.dunberry@bnc.ca**Louis Lajoie**Principal Analyst
louis.lajoie@bnc.ca**Nicolas Charlton**Analyst
nicolas.charlton@bnc.ca**General**

The present document was prepared by National Bank Investments Inc. (NBI), a wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on the Toronto Stock Exchange (NA: TSX).

The information and the data supplied in the present document, including those supplied by third parties, are considered accurate at the time of their printing and were obtained from sources which we considered reliable. We reserve the right to modify them without advance notice. This information and data are supplied as informative content only. No representation or guarantee, explicit or implicit, is made as for the exactness, the quality and the complete character of this information and these data. The opinions expressed are not to be construed as solicitation or offer to buy or sell shares mentioned herein and should not be considered as recommendations. The opinions are not intended as investment advice nor are they provided to promote any particular investments and should in no way form the basis for your investment decisions. National Bank Investments Inc. has taken the necessary measures to ensure the quality and accuracy of the information contained herein at the time of publication. It does not, however, guarantee that the information is accurate or complete, and this communication creates no legal or contractual obligation on the part of National Bank Investments Inc.

NBI or its affiliates often act as financial advisor, agent or underwriter for certain issuers mentioned herein and may receive remuneration for its services. As well NBI and its affiliates and/or their officers, directors, representatives, associates, may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time in the open market or otherwise.

This document is for distribution only under such circumstances in Canada and to residents of Canada as may be permitted by applicable law. This document is not directed at you if NBI or any affiliate distributing this document is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that NBI is permitted to provide this document to you under relevant legislation and regulations.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments (the "Funds"). Please read the prospectus of the Funds before investing. The Funds' securities are not insured by the Canada Deposit Insurance Corporation or by any other government deposit insurer. The Funds are not guaranteed, their values change frequently and past performance may not be repeated.

© 2019 National Bank Investments Inc. All rights reserved. Any reproduction, in whole or in part, is strictly prohibited without the prior written consent of National Bank Investments Inc.

® NATIONAL BANK INVESTMENTS is a registered trademark of National Bank of Canada, used under license by National Bank Investments Inc.