GLOBAL ECONOMY

The global economy continues to improve with world trade volume expanding at its fastest pace since 2011 so far in 2017. With trade outpacing industrial output for a third consecutive quarter, the ratio of industrial production to trade volume (a proxy for inventories) has fallen to a four-year low. That bodes well for stronger economic activity and a continued uptrend in job creation. As the chart below shows, employment in the advanced economies surged 6.6 million in the last year. With business confidence hovering at pre-recession highs, corporations should continue adding to head counts. We expect global real GDP to expand at a rate of close to 3.5% in 2017.

CANADIAN ECONOMY

Canada's real GDP grew 3.7% annualized in the first quarter of 2017. While trade was a drag on the economy courtesy of rising imports, it was more than offset by sharp gains for domestic demand. There were indeed healthy gains for consumption spending, residential investment, government expenditures and even business investment. Nominal GDP also grew a massive 8.3% annualized, a positive for public finances. We expect the Bank of Canada to alter its language in the coming months and signal the possibility of tighter monetary policy soon.

U.S. ECONOMY

The U.S. economy is bouncing back nicely after a rough start to the year. GDP is set to expand above 2% through year-end, buoyed by a rebound in business investment and healthy labour market conditions. The unemployment rate fell to a 16-year low of 4.3% in May, a development that should help strengthen the domestic economy. Encouraged by solid employment and the apparent resurgence of industrial output and consumer spending, the Federal Reserve will likely raise interest rates again in the coming months. Low inflation, however, means that monetary policy is unlikely to turn restrictive anytime soon.

CAPITAL MARKETS: PERFORMANCE AND STRATEGY

There are two important characteristics that impacted the bond market during the second quarter: the inability of the Trump administration to carry out its health reform plan. This has resulted in the postponement of the implementation of a tax reform plan that had raised the enthusiasm of the stock market in the fourth quarter of 2016. This environment was unfavourable to the bond market, which expected a stronger firm recovery in the economy and higher inflation but subsequently reversed itself in the second quarter. The second factor was the positive momentum of Canadian economic growth, with Canada experiencing the strongest G7 increase in the first quarter. At the same time, this situation caused a meaningful change in the tone from the Bank of Canada, which is now more likely to be predisposed to initiate an increase in its key interest rate during the month of July. The impact of this decision was mainly felt in the short- and medium-term maturities. These market segments generated negative returns of 0.4% and 0.1% for the quarter.

As for long-term maturities, the influence of the U.S. bond market has had a significant impact on the Canadian market, resulting in a performance of 4.1% from March to June and 6.1% for the first six months of the year. Consequently, a flattening of the yield rate curve would have been unfavourable in the second quarter due to our lack of position in long-term bonds. In addition, we witnessed a 0.35% increase in 10-year federal bond yields during June. In the U.S., moreover, it is expected that the gradual withdrawal of the Federal Reserve from its holdings of federal securities will eventually lead to upward pressure on interest rates.

On the high yield bond segment, the impact of increased credit spreads resulted in a 0% return in June but still achieved a 2.0% return for the quarter. Our result, although lower than that of its benchmark, was still 0.4% higher than that of investment grade bonds and has provided a 4.0% return year to date. In regards to the preferred shares market, the more than 0.3% increase in the 5-year Canada bond yield, against which the fixed-rate reset preferred dividend is reset, ended up being very favourable for preferred shares.

A good positioning was once again beneficial for the quarter and resulted in a return of 10% for the first six months of the year, being more than 125 basis points above the benchmark.

The Canadian stock market performance stood at a negative 1.6% for the second quarter, mainly due to the significant downturn in the energy sector (-8.3%), hit hard by a 9% decline in the price of oil during the period. Unlike in 2016, the Canadian market is clearly lagging behind the performance of other developed and emerging markets. The market was also affected by the collapse of mining stocks (-19.1%) as well as gold stocks (-6.3%). Finally, fears related to the sharp decline of mortgage lending company Home Capital, resulting from a severe flight of capital, seriously undermined the performance of the Canadian banking sector. The banking sector, also continued to be impacted by growing concerns arising from Canadian households' over indebtedness. Nevertheless, our two core managers have outperformed for the quarter and year to date.

The U.S. stock market advanced 3.1% in the second quarter, but returned only a modest gain of 0.4% in Canadian dollars, reflecting the 4.0% appreciation of the currency. As in Canada, the energy segment weighed on market performance with a 6.4% decline over the period. On the positive side, we saw a significant increase in the health care (+7.1%) and industrial (+ 4.4%) sectors. On the financial services side (+4.3%), although the first two months of the quarter were in negative territory, June witnessed a 6.4% gain largely attributable to a favourable U.S. Federal Reserve opinion regarding the solidity of banks' capitalization. Our managers maintained their positive relative contribution for the quarter and are more than 2.0% above the benchmark year to date.

The international market grew by 3.6% in Canadian dollars, supported in part by strong gains in the technology and consumer staples sectors. The continued favourable momentum of European economic growth explains this good performance, along with the positive effect of the victory of Emmanuel Macron as president of France. Similar to the first quarter, our prudent selection of stocks and sectors, and especially our near absence of positions in the energy sector, contributed to the added value generated by our managers.

Concerning the Tactical Asset Allocation following the alleviation of fears related to the possibility of an election victory of a political party with an anti-European vision in France, we increased our position in international developed countries via the ZEA exchange-traded fund. This change of position was also motivated by our belief that relative valuation of this market versus its U.S. counterpart was attractive. At the end of the quarter, we fully disposed of our short-term and long-term fixed income positions. Our motivation for the complete sale of the long-term bond segment stems from the Central Bank of Canada's more positive view of the Canadian economy, which we feel will lead to rate hikes. As such, we are changing our current barbell row stance in bonds (a mix of short-term and longer-term bonds) for a shorter-than-benchmark duration in U.S. investment grade bonds. Fully hedged, this position should generate a positive carry of 60 basis points above the Canadian index.

Attractive valuations and upside risk for oil prices favour energy stocks while the prospect of rising interest rates should also be conducive to an outperformance in financials. This change should be beneficial to Canadian equities. Therefore, we're expecting the TSX index, whose price return was slightly negative after the first six months of the year, to rebound in the second half, justifying our one-third increase in Canadian equity exposure, which now constitutes our largest overweight in the Tactical Asset Allocation positioning.