Toronto Student Investment Council

Market Update for the Weeks of June 17, 2018 & June 24, 2018

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Commentary

- The Federal Reserve has increased its benchmark rate from 175bps to 200bps as it begins to implement quantitative tightening – the reverse of quantitative easing in which the Fed will slow its acquisition of treasuries and allow assets on its balance sheet to expire.
  - This move will likely increase exert upwards pressure across the yield curve making certain fixed-income assets viable investments again (as real return is now positive).
  - Expect volatility in equity markets as investors re-allocate capital away from equity investments into fixed income and alternative assets.
- The US-China trade war is escalating and many suspect the Trump administration will restrict US companies from selling key components such as semiconductors to Chinese firms, greatly disrupting the supply chain for China's tech giants. China would likely retaliate.
  - China has eased monetary policy again in an attempt to signal to the US it has tools at its disposal to remain competitive by cutting its reserve requirement ratio (therefore increasing money supply).
  - A trade war would force China to re-evaluate its monetary policies to stay competitive, a difficult process to do as China attempts to deleverage. Many economists believe deleveraging will be achieved by sacrificing growth which would adversely affect the global trade infrastructure designed to fuel China's rapidly growing economy, especially in emerging markets.
- US-Canada trade relations continue to degrade as the potential of US tariffs on key Canadian steel exports and automobiles would harm the Canadian economy.
  - Tariffs would increase the cost of inputs for large-scale infrastructure projects and would slow Canadian growth.
  - On July 1, Canada introduced counter-tariffs despite industrials within Canada urging Ottawa not to retaliate as retaliatory measures would further cripple the sector.
- Companies all around the world are notching strong earnings, largely led by the US, and CAPEX is increasing as free cash flow becomes abundant.
  - A Deloitte survey finds that CAPEX is expected to grow at its fastest pace since 2012 in the next 12 months, largely driven by strong earnings, business confidence, and favorable US fiscal policy (tax cuts).
  - Whether this new CAPEX regime will persist remains to be seen, however.
- Most experts believe we have entered into the final stages of our late-cycle – the economic environment that has characterized the last two-to-three years.
  - Unlike 2008's late-cycle which resulted in the great financial crisis due to highly leveraged investors and structural issues in the housing market, many believe this cycle's end will be characterized by high inflation and a contracting credit environment.

M&A Activity

- AT&T's takeover of Time Warner closed on June 15th without any conditions following a federal judge's ruling that the merger would not harm competition in the TV industry.
- This has prompted optimism in the M&A industry for more vertical deals like AT&T's to take place, especially in the health care sector.
- Deals to watch include CVS/Aetna, Cigna/Express Scripts as their proposed acquisitions seem a lot more realistic now than before the deal.
- Regarding private equity M&A, while there have been few blockbuster deals so far in 2018, general consensus is that the latter half of 2018 will see private equity firms finally begin to deploy their $1.1tn in "dry powder".

Key Indices Performance

Index	Close	Week	YTD
TSX	16,278	-1.0%	0.4%
S&P 500	2,718	-1.3%	1.7%
MSCI EAFE	1,959	-1.1%	-4.5%
10-yr GoC Yield	2.17%	0.04%	0.13%
Oil ($/bbl)	$74.30	8.3%	23.0%
Canadian Dollar	US $0.76	1.0%	-4.3%

Events Calendar

July 10 – U.K. Manufacturing & Trade (May), U.S. NFIB Business Optimism Index, U.S. JOLT Job Openings (May), Canada Housing Starts (June)/Building Permits (May)
July 11 – MBA Mortgage Applications, Producer Price Index (June), Bank of Canada Rate Statement/Monetary Policy Report, Bank of England Governor Carney Speech
July 12 – U.S. Jobless Claims (June), Consumer Price Index (June), Canada Housing Price Index (May)
July 13 – U.S. Export/Import Price Index, U.S. Fed Monetary Policy Report, U.S. Baker Oil Rig Count

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