Weekly Trends

PRIVATE CLIENT SOLUTIONS

Jason Castelli, CFA

March 22, 2019

Cementing the Pivot

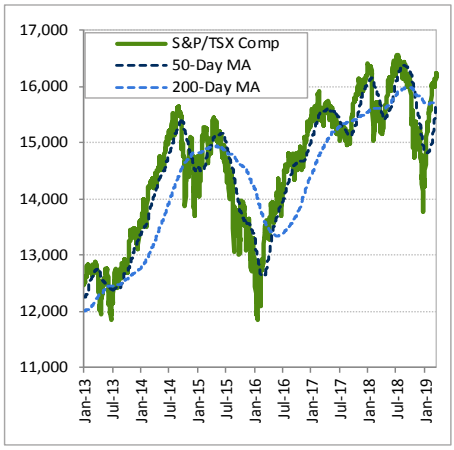
Canadian and US markets are poised to close out Q1 with one of the strongest starts in over 70 years, as the S&P/TSX and S&P 500 have gains of over 13% YTD. As we wrote in our monthly *Insights & Strategies: The Power of a Pivot,* central banks have played a big part in rescuing the market off its December lows. The global shift from a tightening bias to more accommodative monetary policy provided a significant tailwind for equity markets that were deeply oversold at the time.

- The Federal Reserve reiterated that interest rate and balance sheet decisions would be data-dependent and kept policy rates on hold in January. However, this week's FOMC meeting cemented its dovish pivot by indicating they will not hike the fed funds rate any further this year; and based on the Dot plot there is only one more projected hike left in this cycle.
- As for the European Central Bank, the monetary authority underscored the rising risks to growth in the euro area and highlighted that it was ready to deploy all policy tools as necessary. Meanwhile in Asia, the People's Bank of China has injected significant liquidity into the banking system and introduced new policy tools in an effort to stimulate the slowing economy.
- The accommodative monetary policy and looser financial conditions should be signalling to the bond market that economic growth will reaccelerate in the coming months, stoking inflation and thus pushing bond yields higher. However, this has not been the case. The bond market is quite literally not "buying it", but rather telegraphing further economic weakness ahead.

Equity Market YTD Returns (%)

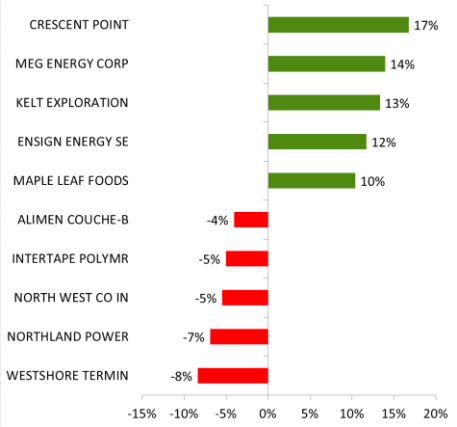
Canadian Sectors	Weight	Recommendation
Consumer Discretionary	4.0	Underweight
Consumer Staples	3.7	Overweight
Energy	18.5	Underweight
Financials	32.0	Market weight
Health Care	2.3	Underweight
Industrials	10.7	Market weight
Technology	4.4	Market weight
Materials	11.2	Market weight
Communications	5.7	Overweight
Utilities	4.1	Market weight
Real Estate	3.4	Overweight

Technical Considerations	Level	Target
S&P/TSX Composite	16,245	15,600



Source: Bloomberg, Raymond James Ltd.
Sectors are based on Bloomberg classifications

S&P/TSX Top 5 Gainers/Laggards*



S&P/TSX Market Internals

Weekly Advance	150	60%
Weekly Decline	92	37%
Advance-Decline	58	
New 52 wk high	24	10%
New 52 wk low	0	0%
No. Stocks Above 50-d	171	68%
No. Stocks Above 200-d	137	55%
Arms Weekly Index	0.51	Neutral
RSI (14-day)	67.4	Neutral
50-DMA	15,720	Uptrend
200-DMA	15,711	Uptrend

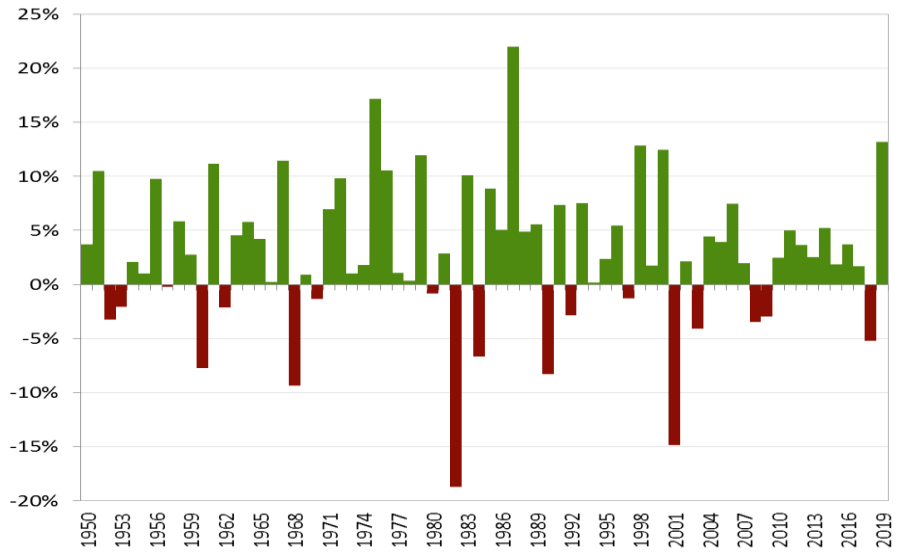
*Source: Bloomberg, Raymond James Ltd; * 5-day price return*

Please read domestic and foreign disclosure/risk information beginning on page 5

Raymond James Ltd. 5300-40 King St W. | Toronto ON Canada M5H 3Y2.
2200-925 West Georgia Street | Vancouver BC Canada V6C 3L2.

Canadian and US markets are poised to close out Q1 with one of the strongest starts in over 70 years, as the S&P/TSX and S&P 500 have gains of over 13% YTD. As we wrote in our monthly *Insights & Strategies: The Power of a Pivot,* central banks have played a big part in rescuing the market off its December lows. The global shift from a tightening bias to more accommodative monetary policy provided a significant tailwind for equity markets that were deeply oversold at the time.

S&P/TSX Quarterly Returns; Q1/19 Strong Start to the Year



Source: Bloomberg, Raymond James Ltd.

The Federal Reserve reiterated that interest rate and balance sheet decisions would be data-dependent and kept policy rates on hold in January. However, this week's FOMC meeting cemented its dovish pivot by indicating they will not hike the fed funds rate any further this year; and based on the Dot plot there is only one more projected hike left in this cycle. Further, they confirmed the balance sheet run-off will conclude by September. Leading up to the decision, market participants were concerned the Fed would not be dovish enough, but the Fed over-delivered as it's hard to see how they could have been any more accommodative. Post the FOMC meeting, the implied probability of a rate cut in 2019 jumped to 40%, while the 2020 probability rose to 50%.

As for the European Central Bank, the monetary authority underscored the rising risks to growth in the euro area and highlighted that it was ready to deploy all policy tools as necessary. Meanwhile in Asia, the People's Bank of China has injected significant liquidity into the banking system and introduced new policy tools in an effort to stimulate the slowing economy.

While risk assets have responded in kind as highlighted above by the stellar start to the year, what we find fascinating is that bonds are not behaving as one would have anticipated. The accommodative monetary policy and looser financial conditions should be signalling to the bond market that economic growth will reaccelerate in the coming months, stoking inflation and thus pushing bond yields higher.

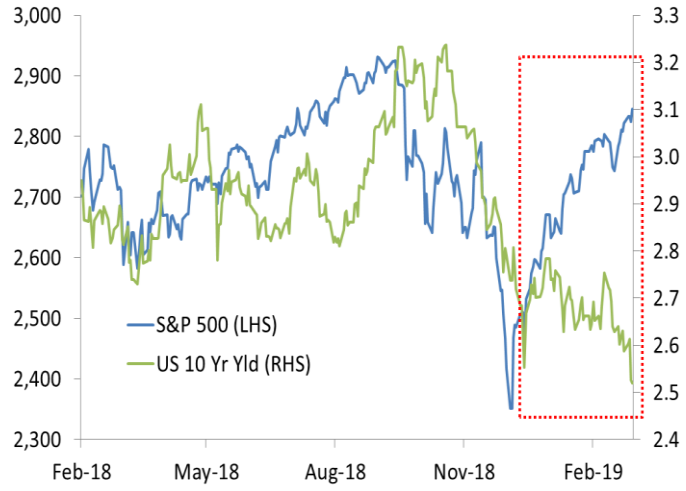
However, this has not been the case. The bond market is quite literally not "buying it", but rather telegraphing further economic weakness ahead. The US 10 year

treasury yield dipped below 2.5% this week and the 2s10s curve continues to flatten now just 11 bps from inversion.

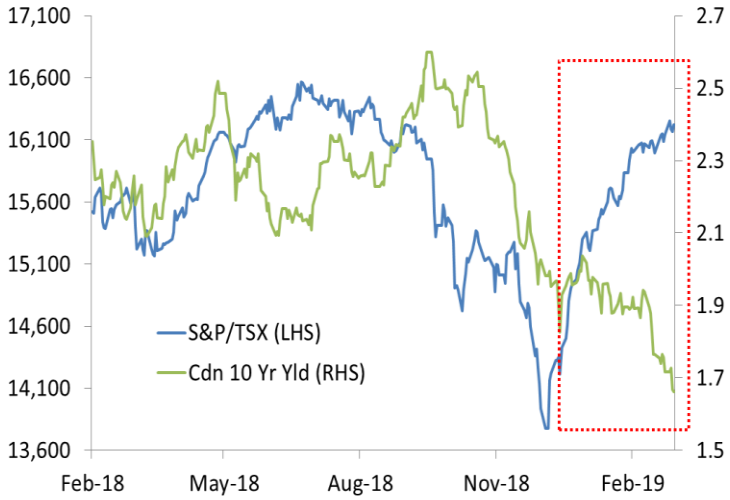
Similarly in Canada, investors have pushed the Canadian 10 year yield to 1.66% which is currently below the Bank of Canada's (BoC) overnight rate of 1.75% as the market becomes increasingly convinced the BoC will cut interest rates this year amid weakening economic data. So either bond markets have it wrong or equities do. Similar divergences between equities and bonds have occurred in the past and the historical track record has shown bonds typically end up being correct in the long- to medium-term.

With the market and economy providing mixed signals over the past few months this reinforces our asset allocation positioning to be neutral equities.

S&P 500 & US 10 Year Yield: Who's Got It Right…



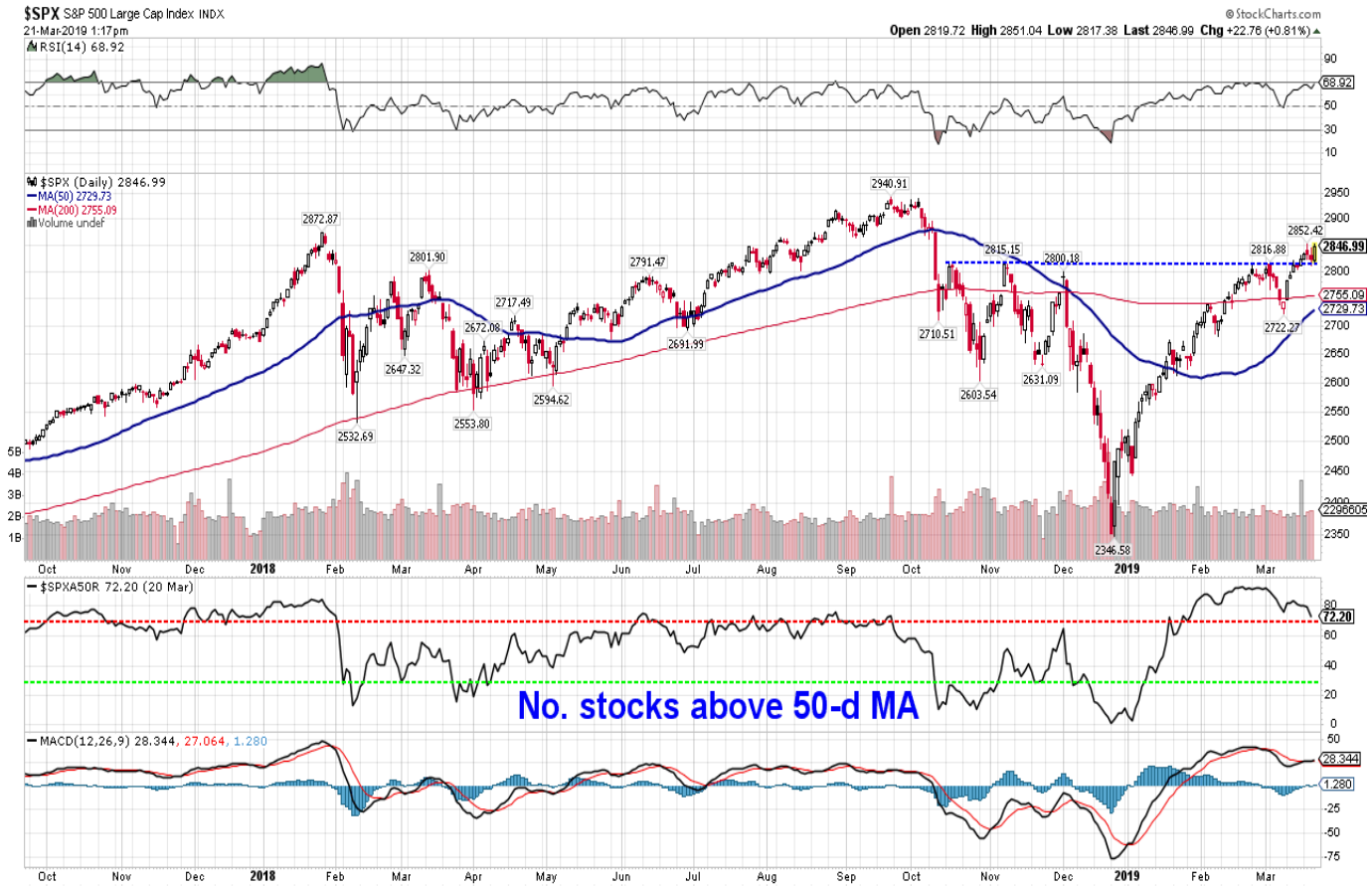
…Same Story for the S&P/TSX & Cdn Bond Market



Source: Bloomberg, Raymond James Ltd.

Nonetheless, the near-term path of least resistance appears to be higher with the S&P 500 clearing a technical resistance level around 2,816. A factor that could help sustain the recent rally is the current positioning of institutional money managers. According to BofA Merrill Lynch's March Global Fund Manager Survey, money managers' cash levels remain elevated averaging 4.6% while allocations to equities sits at their lowest levels since September 2016. Within equities, positioning is defensive with managers' long defensives and rate sensitive plays while short cyclicals. As economic conditions respond to the accommodative monetary policy, cash levels may return to more normalized levels, providing a cash injection into the market. Additionally, corporate earnings will play an important role in supporting future equity gains. As of March 15th, the S&P 500 is forecast to record its first year-over-year earnings decline since 2016 with Q1/19 estimated EPS being marked down to negative 3.6%, compared to an estimated 2.8% at the beginning of the quarter. However, given US corporations have been big buyers of their own stock through Q1/19, buyback activity will be one component that will support EPS growth (earnings/share will appear higher due to fewer shares outstanding). This could help the S&P 500 avoid the current projected earnings decline.

S&P 500 Takes Out Overhead Resistance: Path of Least Resistance Appears Higher



Source: stockcharts.com

Important Investor Disclosures

Complete disclosures for companies covered by Raymond James can be viewed at: https://www.rjcapitalmarkets.com/Disclosures/Index.

This newsletter is prepared by the Private Client Services team (PCS) of Raymond James Ltd. (RJL) for distribution to RJL's retail clients. It is not a product of the Research Department of RJL.

All opinions and recommendations reflect the judgement of the author at this date and are subject to change. The author's recommendations may be based on technical analysis and may or may not take into account information contained in fundamental research reports published by RJL or its affiliates. Information is from sources believed to be reliable but accuracy cannot be guaranteed. It is for informational purposes only. It is not meant to provide legal or tax advice; as each situation is different, individuals should seek advice based on their circumstances. Nor is it an offer to sell or the solicitation of an offer to buy any securities. It is intended for distribution only in those jurisdictions where RJL is registered. RJL, its officers, directors, agents, employees and families may from time to time hold long or short positions in the securities mentioned herein and may engage in transactions contrary to the conclusions in this newsletter. RJL may perform investment banking or other services for, or solicit investment banking business from, any company mentioned in this newsletter. Securities offered through Raymond James Ltd., Member-Canadian Investor Protection Fund. Financial planning and insurance offered through Raymond James Financial Planning Ltd., not a Member-Canadian Investor Protection Fund.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual funds. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. The results presented should not and cannot be viewed as an indicator of future performance. Individual results will vary and transaction costs relating to investing in these stocks will affect overall performance.

Information regarding High, Medium, and Low risk securities is available from your Financial Advisor.