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Spring 2018 Market Update

April 23, 2018

Spring has finally sprung. It is hard to believe we are already heading into the month of May. Please read on for our Spring 2018 Market Update.

In contrast to the relative market calm of 2017, volatility returned to equity markets in the first quarter of this year. Most global markets dropped sharply in early February, with some falling into correction territory (a decline of 10% or more). The initial decline was apparently due to market participants' concern about rising inflation based on strong U.S. economic data.

Though they recovered somewhat over the ensuing weeks, equity indexes remained choppy through February and March, and many finished the period with negative returns in local currency terms. The S&P 500 Index, a broad measure of U.S. stocks, lost 0.8%, the MSCI World Index fell about 1.2% and developed markets in Europe also declined. Markets in Asia were mixed. Canada's S&P/TSX Composite Index underperformed its global counterparts, losing 4.5% during the three-month period. The Canadian benchmark is heavily weighted toward sectors that exhibited weak performance for the quarter, such as energy and materials. It also has modest representation in information technology, which outperformed.

The Canadian dollar fell 2.7% relative to the U.S. dollar over the first quarter. As a result, many foreign markets were positive when expressed in Canadian dollars. Including dividends, the S&P 500 Index gained 2.0% and the MSCI World Index was up 1.6% in Canadian dollar terms.

After raising rates in January, the Bank of Canada announced it was maintaining the target for its key overnight interest rate at 1.25% at its meeting on March 7. The central bank raised concerns about the heightened uncertainties surrounding international trade. The U.S. Federal Reserve under new Chairman Jerome Powell raised its target range for the federal funds rate by a quarter point to 1.5-1.75% during its March 2018 meeting. This was in line with market expectations, based on a stronger U.S. economic outlook.

U.S. 10-year Treasury yields rose in the quarter, reflecting the market's expectations for continued growth and higher interest rates, while Canadian government bond yields were up slightly. Rising yields are generally negative for the prices of bonds and other income securities, and as a result, the FTSE TMX Canada Universe Bond Index, which reflects a wide range of Canadian government and corporate bonds, had a gain of just 0.1% for the quarter.

The re-emergence of equity volatility in the first quarter may have surprised some investors, but it represented a return to normal. In fact, 2017, was unusual for its relative stability. During the month of February 2018, the S&P/TSX Composite Index had three trading days in which losses were greater than 1.50%, *while 2017 only had two trading days during the entire year in which losses were greater than 1.50%*[i].

It's important to remember that market declines are a natural part of investing. Such market movements often present experienced portfolio managers with their best investment opportunities, while passive strategies will remain exposed to the fluctuations of the entire market. It's also worth noting that this bout of volatility was not driven by a change to company fundamentals. Overall, business prospects remain solid, with continued economic growth, strong confidence levels and favourable U.S. tax reforms.

The developments in the first quarter remind us that markets are highly complex, interconnected, dynamic entities. Given that short-term pullbacks are an expected part of investing, we continue to recommend a long-term, diversified strategy tailored to your individual financial goals. If you have any questions about your portfolio, please do not hesitate to contact either one of us.

Sincerely,

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[i] For February 2018, the days are February 2 (-1.61%), February 5 (-1.74%) and February 8 (-1.73%). For 2017, the days are May 17 (-1.73%) and February 24 (-1.53%). There were only 5 days with losses greater than 1% in 2017; for the first quarter of 2018 in total there were 11 days with losses of greater than 1%.