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North American bear versus bull

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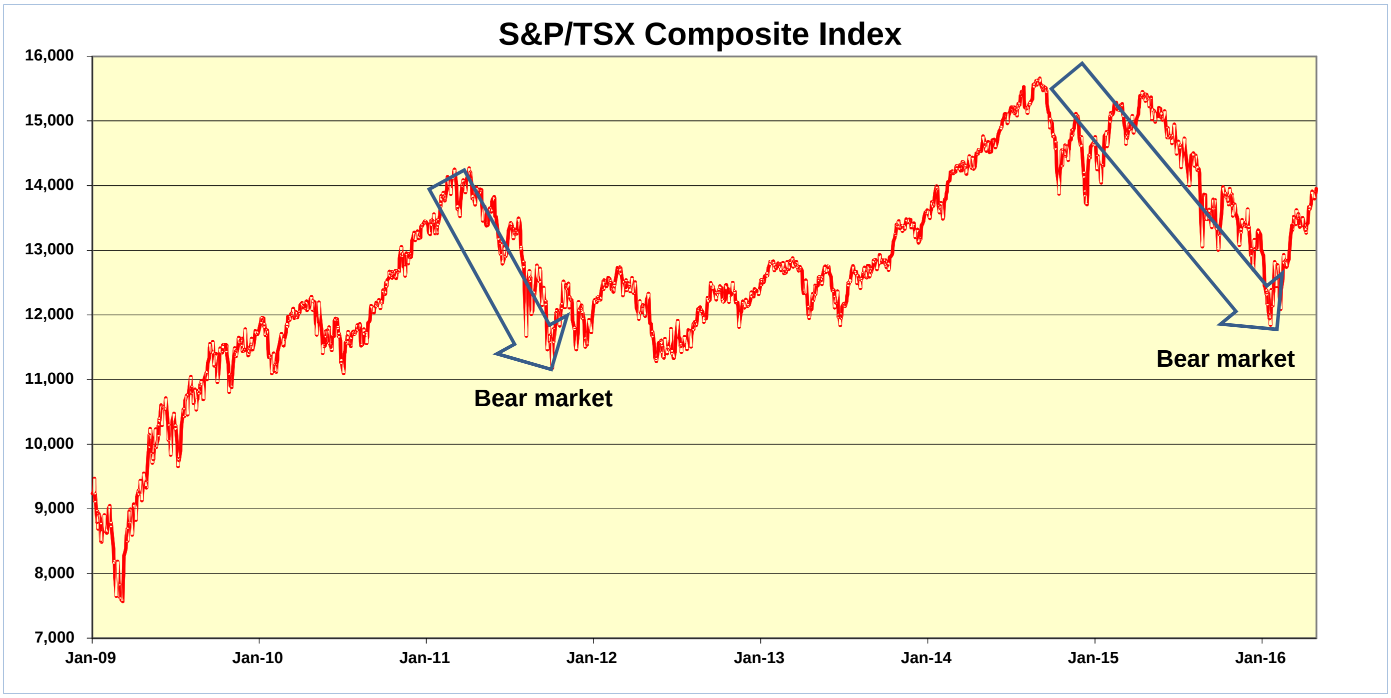
The tumultuous market meltdown of 2008-09 and the synchronized global response by major central banks and governments provided an environment where everyone appeared to be pulling in the same direction. However, the more recent performance of the two main North American stock indexes highlights the different paths travelled by the Canadian and U.S. stock markets over the past few years. The U.S. financial press continues to fret over the extended age of its bull market. There is no such preoccupation here at home as the Canadian market appears to be continuing its search for a bear market bottom. Not surprisingly, given the clear divergence of the two markets and the underlying economies, the Canada/U.S. exchange rate has also shifted dramatically, in both directions. Regular periodic investing and proper diversification are cornerstones of a well-designed portfolio. They ensure that everything is in place to take advantage of gaining markets while defending against weakening elsewhere. Making use of a professional financial advisor will ensure that a disciplined plan is in place.

Canadian bear markets



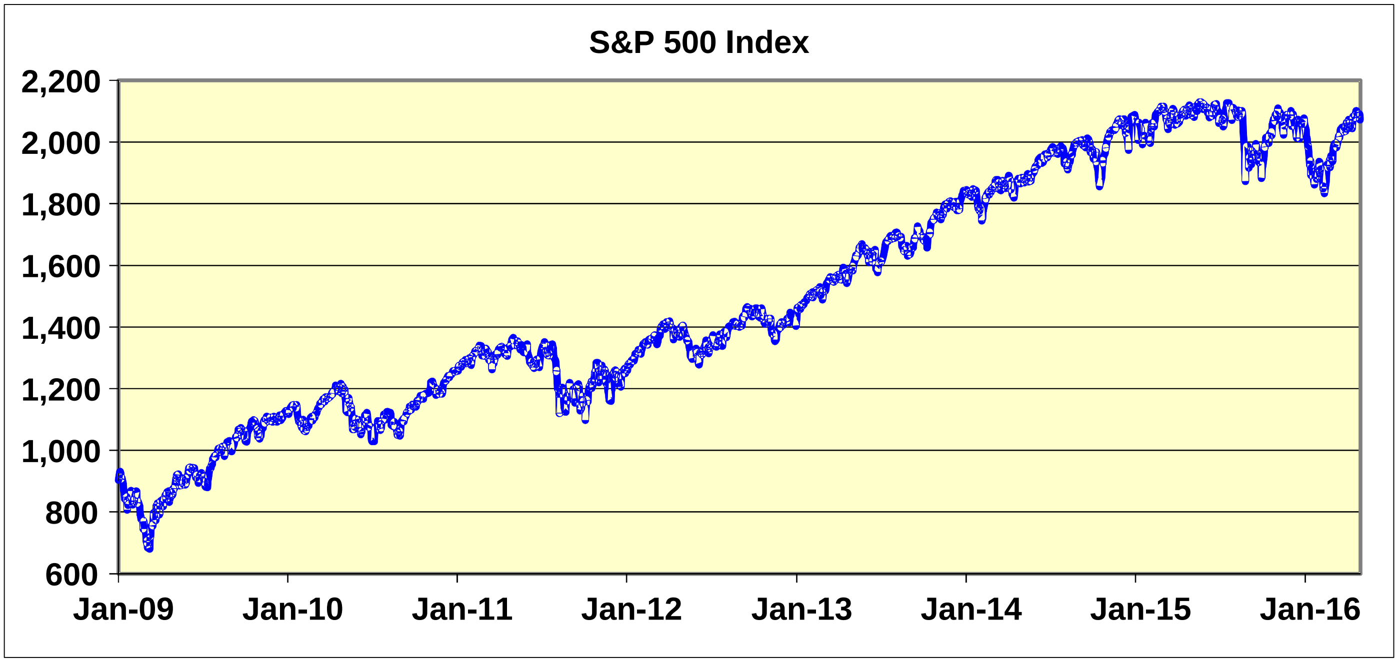
Source: Bloomberg

As can be seen in the preceding chart, the Canadian equity market has experienced two bear markets since the financial crisis in 2008-09. While there is no strictly agreed upon definition, a "bear market" is usually considered to be signalled by a 20% decline in the relevant market index. The bear market is typically considered to have ended when the same index records a subsequent 20% advance, thus ushering in a "bull market." After hitting a five-and-a-half year low on March 9, 2009, the main Canadian stock index improved significantly. Following that date, the markets advanced despite a number of pullbacks (typically signalled by a 5% decline) and corrections (typically signalled by a 10% decline). However, the market peaked at 14,270 on April 5, 2011. At the time, the S&P/TSX Composite Index stood with a cumulative 88.6% advance. Investor worries over the implications of a potential European sovereign debt crisis, focused primarily on Spain and Italy, took their toll and eventually shaved 21.7% from the index by the time the market closed on October 4, 2011. The first bear since the financial crisis had arrived.

Improving conditions followed and the market was able to stage another bull run, adding a cumulative 40.1%. This eventually allowed the index to post a new all-time high of 15,657 on September 3, 2014, albeit after several more pull-backs and corrections. However, since that date, ongoing concerns over global economic growth coupled with significant declines in commodity prices resulted in the re-emergence of a domestic bear market. Despite the fact that 18 months have now passed without a subsequent 20% improvement, it cannot be determined if the bear market has ended at the time of writing. The most recent low occurred on January 20, 2016 and represented a 24.4% drop from the peak, but lower levels may yet be revisited before an actual bull is spotted.

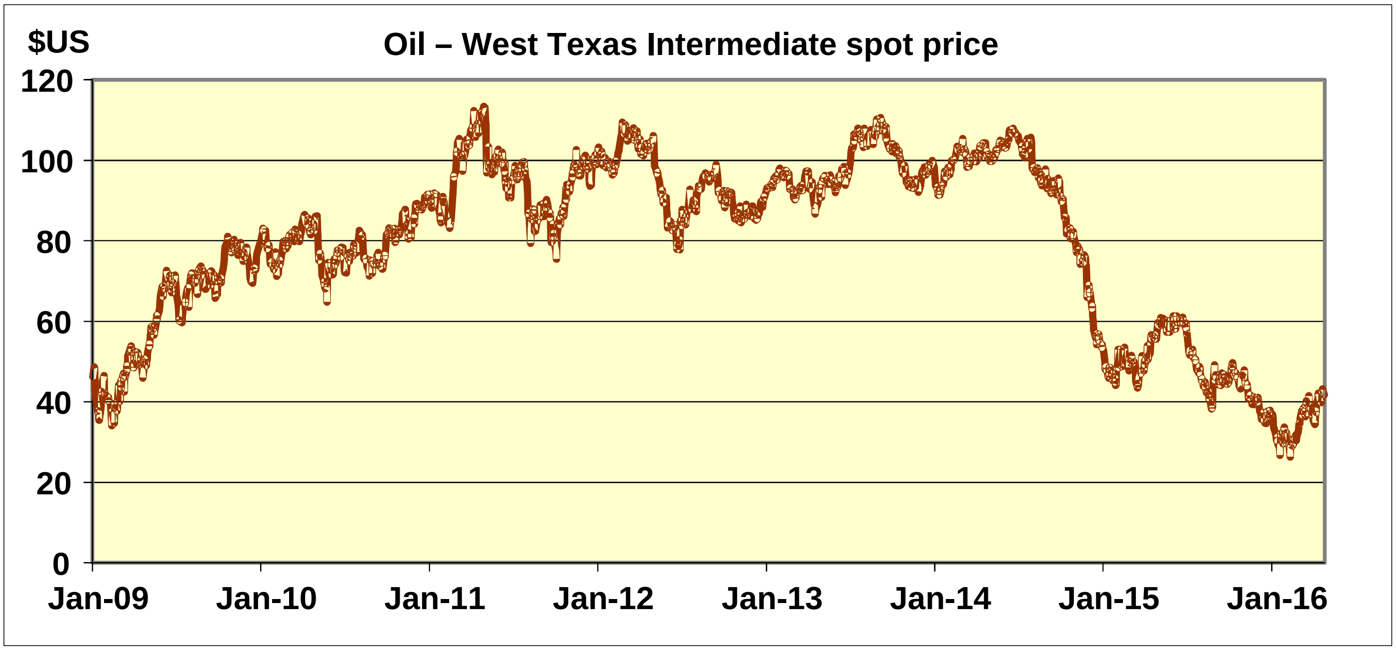
No bears in the United States – yet

The story has been different in the United States. Its market has also been confronted with a number of pullbacks and corrections. Nevertheless, since the S&P 500 Index also bottomed on March 9, 2009, the bear has remained in hibernation. There have certainly been a number of close calls. The issues surrounding European sovereign debt produced a 19.4% decline by October 2011. In addition, ongoing concerns over the strength of the global economy resulted in a 14.2% drop by February 11, 2016 from the market peak established on May 21, 2015. In the postwar, the U.S. stock market (using the S&P 500 Index and its predecessor as a proxy) has experienced 12 bull markets, including the current one. Not surprisingly, these bull runs have varied in length and extent of the gains made. The shortest lasted just over a year, from May 1947 to June 1948. It also represented the smallest gain, coming in at 24.4% – barely qualifying as a bull. At the other end of the scale, the bull market that began on October 11, 1990 lasted nine-and-a-half years, until March 24, 2000, and recorded a 417.0% cumulative gain. On average, the previous 11 bull markets have lasted 4.6 years and produced gains of 146.3%. The current bull market is considerably older than the average, having started more than seven years ago. At the time of writing, it has accumulated a 215.0% gain.



Source: Bloomberg

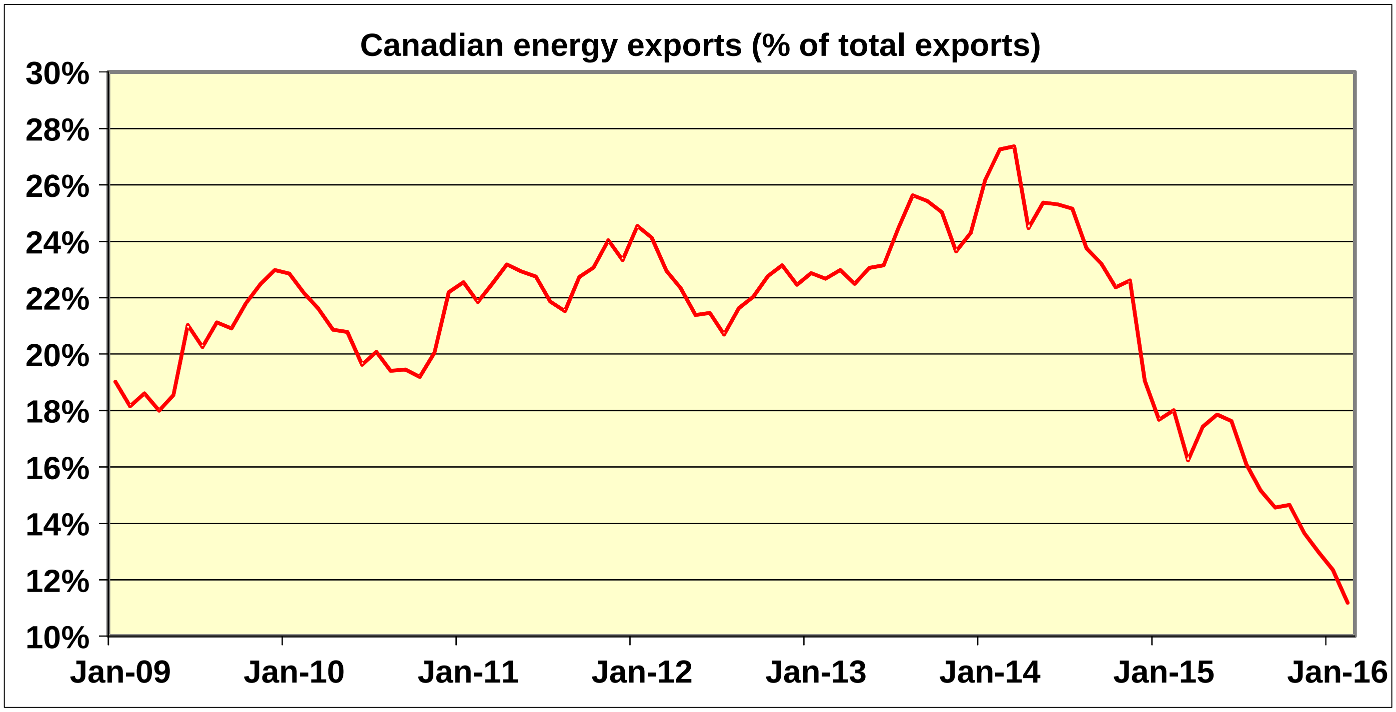
Energy



Source: U.S. Energy Information Administration

As a significant energy producer, Canada sees a considerable portion of both its international trade and broader economic activity influenced by the price of crude oil. As shown in the preceding chart, the rebound in energy demand that followed the financial crisis was sufficient to push oil prices as high as US$113.39 (per barrel, West Texas Intermediate) by April 29, 2011. This was well short of the US$147 historic peak established in July 2008. However, prices between January 2010 and October 2014 were relatively stable and Canada was a clear beneficiary. With many non-traditional sources of oil being exploited and a strong reluctance for OPEC members to sacrifice market share, prices then began a sharp drop. The move down eventually resulted in a 77% decline to US$26.19 per barrel on February 11, 2016. Surprisingly, this was lower than the low of US$30.28 reached on December 23, 2008 during the financial crisis. The near 13-year low raised many questions about the long-term viability of the more costly non-traditional oil production.

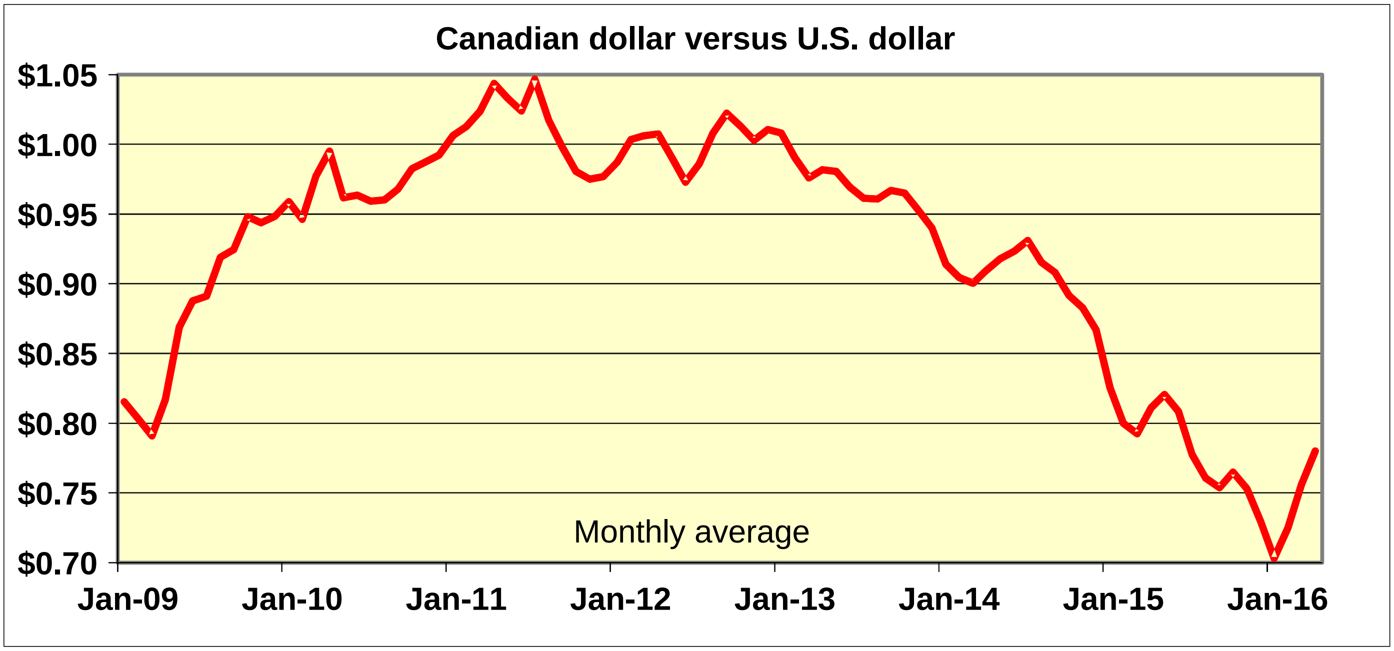
Plunging prices in energy also translated into a major shift in the makeup of Canadian exports. As can be seen in the following chart, energy exports as a percent of all exports followed the pattern established by the underlying price. By March 2014, energy exports represented 27.4% of all merchandise exports, just shy of the all-time high (this data begins in 1988) of 27.5% in June 2008 when crude oil averaged US$133.88 per barrel. Again, it was not surprising to see lower world prices for energy dampen interest in Canadian companies in that sector, thus putting additional pressure on the stock market and the Canadian dollar.



Source: Statistics Canada

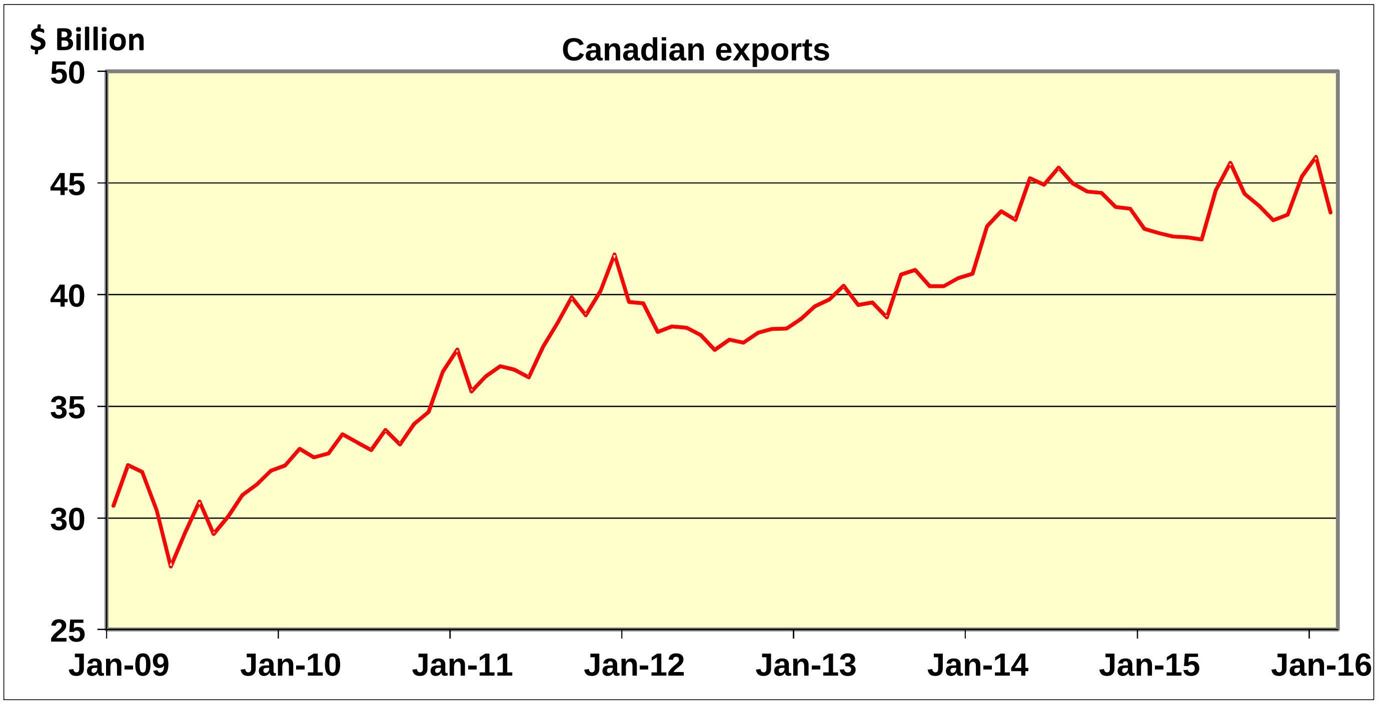
Currency

The importance of oil to Canadian trade is evident in the pricing of the Canadian dollar. Clearly, the price of oil is not the only factor influencing the value of the loonie, but the two have been closely tied for some time. The Canadian dollar is often referred to as a "petro-currency." However, a material divergence in both economic activity and monetary policy within North America has also been reflected in the recent market gyrations of the currency. The confluence of events was sufficient to drive the loonie as low as US$0.68 on January 20, 2016, its weakest point since April 9, 2003. The rebound in energy prices, coupled with some signs that the domestic economy may not be as weak as previously believed, allowed the Canadian dollar to turn sharply stronger. By the end of April 2016, it had briefly broken above US$0.80.



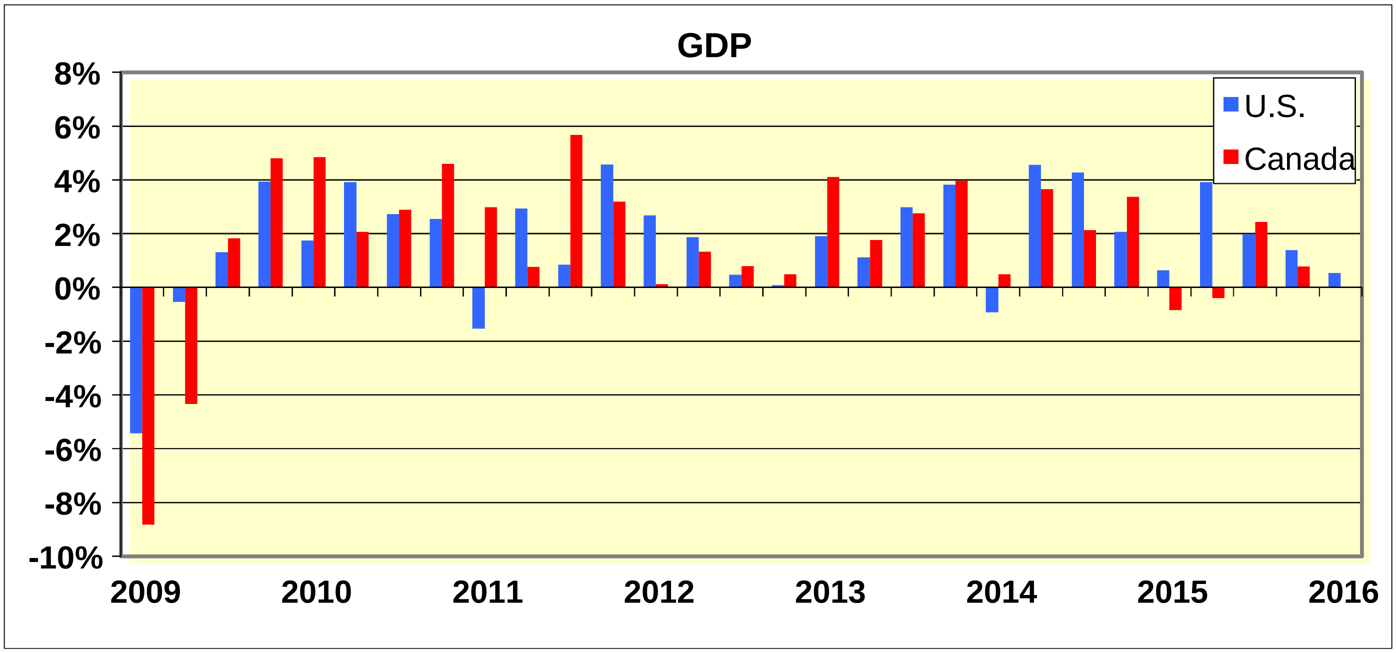
Source: Statistics Canada; Bank of Canada

As has been the case in the past, the lower value of the Canadian dollar has been instrumental in bolstering trade. As the following chart shows, merchandise exports trended higher throughout most of the post-crisis period. Domestic currency weakness gives foreign buyers greater purchasing power and Canadian goods at lower prices become more popular. The natural "shock absorber" effect of the currency and its subsequent influence on trade has helped bolster economic growth during periods when it has otherwise been relatively weak.



Source: Statistics Canada

Broader economy



Source: U.S. Bureau of Economic Analysis; Statistics Canada

Many analysts and government agencies have reduced their economic forecasts for Canada's overall GDP. Relative to the U.S., expectations have been reduced significantly. As can be seen in the preceding chart, U.S. GDP had three consecutive quarters of slowing growth. The latest estimate for the first quarter of 2016 stands at a modest 0.5% (annualized). Conversely, even though the quarterly data are not available at the time of writing, Canadian figures show that momentum carried over from the final quarter of 2015 allowed for a 0.6% GDP gain in January. A 0.1% decline in February was largely anticipated after the January advance and even a flat result for March will likely see the first quarter of 2016 back above the U.S. growth rate. However, this does not alter the fact that labour conditions and consumer activity in the U.S. appear significantly more favourable at this juncture. In either case, it appears that the economies are not operating in lock-step and it would be reasonable to expect that the U.S. and Canadian stock markets would continue to follow different paths even as they may see similar levels of volatility. As bears and bulls remain unpredictable animals, perhaps it is appropriate that they are used as analogies when describing the state of the financial market.

Conclusions

- Even though all of the world's financial markets are connected, they do not always move the same way at the same time. There are still advantages to ensuring that an investment portfolio is well diversified.
- Markets, currencies and commodities can all change direction quickly. Making regular periodic contributions to an investment plan can help ensure that an investor will avoid attempting to time the market.
- Making use of professional advice can help maintain the discipline of an investment plan and prevent emotional responses from creating a distraction.