LOM OFFSHORE FINANCIAL SERVICES

Monthly Global Market Commentary
December 4, 2018

Approaching Neutral – 12/03/18
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Markets rebounded sharply last week with the MSCI World Index gaining 3.40% while the S&P500 rose 4.91%. The bond markets were mainly flat on the week.

The Federal Reserve

The Federal Reserves' role is to balance unemployment with inflation. It achieves that goal by controlling the cost at which banks can borrow money and by buying companies stocks and bonds in the open market (known as quantitative easing). By lowering interest rates and buying up shares of companies in the open market, they prop up the economy. When they believe the economy is overheating (e.g., almost everyone that wants a job has one and prices of goods are rising), they try to cool things down by raising the interest rates and reducing their balance sheet. The latter is important because an overheated economy would be more likely to engage in risk-taking behaviors and unchecked inflation can erode our ability to save and plan over the long-term.

The new Fed Chair, Jerome Powell, inherited an environment with historically low interest rates and a strong economy. He has been on record expressing concern that the low rates were creating a bond market bubble (declining interest rates increase the price of existing bonds). At the beginning of the year, the aggressive schedule of four rate hikes appeared unlikely. As the impact of the tax cuts appeared to stimulate the economy while the effects of an uncertain quantity of tariffs were yet to be felt, the Fed felt comfortable enough to raise rates.

Markets got spooked in October, when Mr. Powell implied that we were "a long way" from neutral, a rate level that would neither heat up or cool down the economy. That uncertainty, along with other risks like a trade war escalation and a potential hard Brexit, weighed down markets.

In a televised meeting at the Economic Club of New York on Wednesday, Powell was quoted as saying we are now "just below neutral." I believe this implies the band would be 3-7% (since the historical average is close to 5%). Markets took this as good news, rallying sharply into the second half of the week.

Group of 20

Nations of the G20 met over the weekend. Positive news came out of the conference as the US and China managed to agree to some concessions. The US postponed the escalation in tariffs for 90 days and China pledged to "substantially increase" purchases of US goods. The G20 also agreed to cut their pledge to "fight protectionism" and "unfair trade practices" from their joint statement. At the end of the conference, President Trump was caught on an open mic saying "get me out of here" after leaving the stage. Markets rallied on the news of delayed tariffs.

Conclusion

Monday saw reporting of the first yield curve inversion, with the 3-year rates trading at higher values than the 5 year. You may hear some news about inversions being tied to market corrections. While it's true that we monitor those statistics, the inversion of the 2-year and 10-year rates is 100% correlated with a correction in 24 months. We haven't seen that yet.

The market rally was based on a lot of positive economic news so we can be a bit more confident that it was justified. It is worth noting that both the Fed interest rate and the tariff news are likely negatively correlated (if one goes well, the other should go poorly). That is because a de-escalation of the trade war would stimulate the economy, causing the Fed to have more reason to raise interest rates to avoid an overheated mania.

Don't panic. We are late cycle so things are going to be a bit bumpy but you should still benefit from being in the market. Our fixed income portfolios have benefited from floating rate notes in a rising interest rate environment. As rate hikes become less certain in the coming year (the Fed is currently split evenly between 2-, 3- and 4-rate hikes), we will be considering reducing our exposure.

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Stock Market Performance

	12/4/18	W-o-W	M-o-M	Y-o-Y
DJIA	25,826	4.4%	2.2%	6.3%
S&P 500	2,790	4.0%	2.5%	5.7%
MSCI World	2,067	3.3%	1.5%	-0.2%
S&P/TSX	15,275	2.2%	1.0%	-4.3%
BSX	2,364	1.8%	3.2%	4.3%
FTSE100	7,009	-0.1%	-1.2%	-4.5%
DAX	11,393	0.7%	-1.1%	-12.8%
CAC	5,028	0.9%	-1.4%	-6.7%
Nikkei	22,036	0.4%	-0.9%	-3.0%
Hang Seng	27,260	3.5%	2.9%	-6.4%
Shanghai	2,666	3.5%	-0.4%	-19.4%

Key Rates and Prices

Currencies	12/4/18	Month ago	Year ago
EUR	$1.14	$1.14	$1.19
GBP	$1.28	$1.30	$1.35
JPY	¥112.78	¥113.20	¥112.41
CAD	$0.76	$0.76	$0.79
CHF	$1.01	$1.00	$1.02
AUD	$0.74	$0.72	$0.76
Fixed Income			
3M LIBOR	2.74	2.59	1.51
3M Treasury Bill	2.41	2.32	1.27
2Yr Treasury Note	2.83	2.91	1.81
10Yr Treasury Note	2.97	3.21	2.37
Fed Funds Rate	2.25	2.25	1.25
Commodities			
Gold/oz.	1,240.81	1,232.95	1,276.11
Silver/oz.	14.58	14.75	16.32
Copper/lb.	2.86	2.85	3.10
Oil	53.93	63.14	57.47

Global Economic Calendar (December 4th — December 7th)

Tues: General Services PMI (CN); PMI Composite (JP); Redbook (US); Motor Vehicle Sales (US)
Wed: Bank Reserve Settlement (US); Retail Sales (EZ); MBA Mortgage Applications (US); Bank of Canada Announcement (CN)
Thurs: Jobless Claims (US); Challenger Job-Cut Report (US); International Trade (US); EIA Petroleum Status Report (US); Money Supply (US)
Fri: Baker-Huges Rig Count (US); Employment Situation (US); Labour Force Survey (CA)