CIBC
Asset Management

Market Spotlight

March 2016

Global Markets

Global economic sluggishness, central bank actions (and non-actions), commodity fluctuations and currency moves dominated the headlines in February. Global equity markets fell -0.49% in U.S. dollar terms and -4.46% in Canadian dollar terms, as the loonie strengthened.

Emerging markets were slightly lower but generally fared better than developed markets despite a volatile month for Chinese equities. Recent data indicates that Chinese manufacturing activity continues to decline. A stabilization and slight rebound in oil prices in the second half of the month improved the outlook for emerging market oil exporters such as Russia and Venezuela.

U.S. equity markets were close to flat overall. U.S. economic data appeared somewhat stronger, with the revised reading on fourth quarter GDP better than the initial report. That being said, the annualized U.S. growth rate of 1% is not particularly robust.

International equity markets in both Europe and Japan declined, with Japan and many European countries losing 2% or more (in USD). The possibility of further monetary action from the ECB, especially a move that could drive rates further into negative territory, had investors worried about the effect on European bank earnings. A similar situation developed in Japan, after the Bank of Japan introduced negative deposit rates in late January. Investors also digested the possibility that Great Britain may vote to exit the European Union when it holds its referendum in June.

Canadian equities again outperformed both global and U.S. markets. Canadian small caps had a particularly good month, with a gain of over 5%. This was due, in large part, to strength in smaller gold companies, as gold rallied sharply.

Current Asset Allocation*

Asset Class	Weighting
Canadian Bonds	Underweight
International Bonds	Underweight
Canadian Equities	Market Weight
U.S. Equities	Market Weight
International Equities	Overweight
Emerging Market Equities	Overweight

**For balanced portfolios, as at February 29, 2016.*

"Sound Bites"

Luc de la Durantaye

"Many market commentators are questioning the European Central Bank's (ECB) ability to further ease monetary policy. Central banks have been able to set negative interest rates to a limited degree because of the cost and inconvenience for corporations to store physical cash. But a deposit rate of -0.5% to -0.75% may prompt significant transfers of reserve balances into physical cash. The ECB definitely doesn't want to face such a scenario.

The only option left for the ECB is to stick to asset purchases for longer than initially planned and this is exactly what the ECB is doing. While this will likely help keep borrowing costs low across the eurozone, it may not be enough to further weaken the euro. All in all, 2016 is shaping up to be a more challenging year for the ECB than 2015."

Fixed Income

Bond yields moved lower for the third consecutive month. Ongoing global economic concerns and the potential for additional unconventional measures by European and Asian central banks designed to move rates lower were contributing factors. The Bank of Canada (BoC) is expected to leave its administered rate unchanged when it meets in March. The uneven growth prospects for Canada, combined with the pending stimulus spending package to be announced by the federal government, likely mean that the BoC will remain on the sidelines for now.

Canadian Equity

The Canadian equity market was up slightly (+0.47%), bringing the year-to-date return of the S&P/TSX Composite Index to -0.71%. Among the major developments in the Canadian market were U.S.-based Lowe's making a bid for Rona, Fortis' bid for Michigan-based ITC Holdings and CP Rail abandoning a proxy fight for Norfolk Southern. In addition, Republic Airways, a major client for Bombardier's CSeries, announced bankruptcy proceedings, Element Financial announced plans to restructure into two separate companies, and Valeant withdrew its earnings guidance for 2016 and announced that it is under investigation by the SEC.

"Sound Bites" *Finding Value Now*

Equity Insight

Colum McKinley, *Equities*

"The volatility of 2015 resulted in attractive valuations for many high quality businesses, especially those classified as value stocks. Value stocks meaningfully underperformed growth stocks in 2015*, in contrast to long-term trends. Only during the technology bubble (late 1990s) was the divergence more significant. But after the technology bubble burst, value stocks again generated meaningful outperformance. In 2000, the MSCI Canada Value Index rose almost 25%, compared to the over 25% decline in the MSCI Canada Growth Index. Today's volatility presents the opportunity to buy high-quality businesses when the current stock price does not truly reflect the long-term earnings potential of the company. Here are some examples.

Railroad stocks have been negatively affected by concerns over economic growth. The railroad industry has become a highly profitable oligopoly, with strong businesses generating substantial free cash flow. Companies like CN Rail have primarily used the excess free cash flow to buy back stock. The company is a highly efficient operator, leading the industry in nearly every metric. Much of the short-term volatility comes from market participants reacting to weaker economic news. Investors were concerned over recent industry data showing some slowing in freight segments (specifically coal, grain and crude oil). CN Rail has a unique North American footprint, touching both oceans and the Gulf of Mexico. This allows it to adapt to changing trade flows. CN's management team has done an incredible job of adapting by realigning costs and capacity. Despite the short-term negatives, CN's operating results recently exceeded investor expectations.

The decline in energy prices has created some interesting opportunities. In the near term, oil prices will remain quite volatile. But in the latter part of 2016 and into 2017, a number of factors will contribute to higher oil prices. First, energy companies have aggressively cut future capital expenditures. Signs of lower spending can be seen through rig activity—Baker Hughes' rig count declined from 1900 active rigs in 2014 to 502 in early 2016. Less drilling today eventually leads to lower future production. For now, with inventories high and uncertainty in the global economy, caution is still warranted. Accordingly, our energy exposure remains in high-quality businesses with strong balance sheets, such as Suncor, Cenovus and Canadian Natural Resources. These companies have already taken tangible steps to ensure their future success in an uncertain environment. Their current valuations reflect an overly pessimistic view of future energy prices. We are adding to our positions at attractive prices when the opportunity presents itself."

*MSCI Canada Value Index (-14.7%) vs. MSCI Canada Growth Index (-7.7%)