Economic Commentary

Second Quarter 2019

U.S./China Trade War Dominates Headlines

The ongoing trade war between the U.S. and China continues to provide a high degree of uncertainty for global financial markets. Potential outcomes could have a dramatic impact on future growth prospects for the global economy, both positive and negative. This has had an impact on business investment as well as future hiring plans by many companies, both in the U.S. and abroad. Increased tariffs by the U.S. applied on Chinese goods pose a persistent threat to China if progress is not made by both sides towards coming to a resolution that President Trump feels is a win for the U.S. As expected, China would counter any increase in tariffs with additional retaliatory measures on the U.S., further derailing the global economy.

U.S. Fed Shifts Closer to Cutting

The U.S. Federal Reserve has shifted fairly abruptly from its original path of embarking on a tighter monetary policy to now preparing markets for the possibility of an interest rate cut. Market expectations are calling for a rate cut to occur as early as the July meeting of the FOMC. The Federal Reserve would like to see some sort of resolution or at least substantive progress being made with regard to the U.S./China trade discussions. This is a key global issue that will dramatically impact the course of the economy over the next few years. The Fed may not want to act pre-emptively if a trade deal is imminent.

Economic data remains mixed as the U.S. consumer has rebounded while businesses are becoming more concerned about the impact of a potential trade war on industrial production.

Bank of Canada Diverging from the Pack

Expectations are for the Bank of Canada to maintain its neutral stance with regard to its interest rate policy. The BOC could remain on hold into 2020. The Canadian economy bounced back nicely with two solid months of GDP growth, following a soft patch earlier in the year. Job growth continues to be strong, providing further support to the Canadian economy.

The Canadian dollar has been a recent beneficiary of the divergent path of the interest rate policies of the Federal Reserve and the BOC. The Canadian dollar exhibited strength going into the end of the quarter as market expectations ramped up for a potential cut in U.S. interest rates. .

Equity and Bond Market Divergence Continues

The disconnect between equity markets and the bond market continues. Interest rate levels in the bond market are foreshadowing global economic concerns as interest rates have declined dramatically so far in 2019. Equity markets, on the other hand, remain at elevated levels and seem to be buoyed by the prospect for potential interest rate cuts by the U.S. Federal Reserve rather than being concerned about the underlying reasons why the Fed would be needing to cut rates. At some point relative market levels between equity and bond market valuations will need to revert back to a more normal relationship.

Key Metrics

Indicator	Value	Chg Q1	Chg 1Y
S&P/TSX Composite	16,382.20	2.6%	3.9%
S&P 500 (USD)	2,941.76	4.3%	10.4%
MSCI EAFE (USD)	1,922.30	3.9%	1.7%
USD/CAD	$ 0.76	1.9%	0.3%
WTI Crude ($/bl))	$ 58.47	-2.8%	-21.1%
GoC 10Y Bond	1.47%	-15.1	-70.2
GoC Deposit Rate	1.75%	0 bps	50 bps
Cdn CPI YoY	2.4%	0.5%	-0.1%
US 10Y Treasury	2.01%	-40.0 bps	-85.5 bps
Fed Funds Rate	2.50%	0 bps	50 bps
USD CPI YoY	1.8%	-0.1%	-1.1%

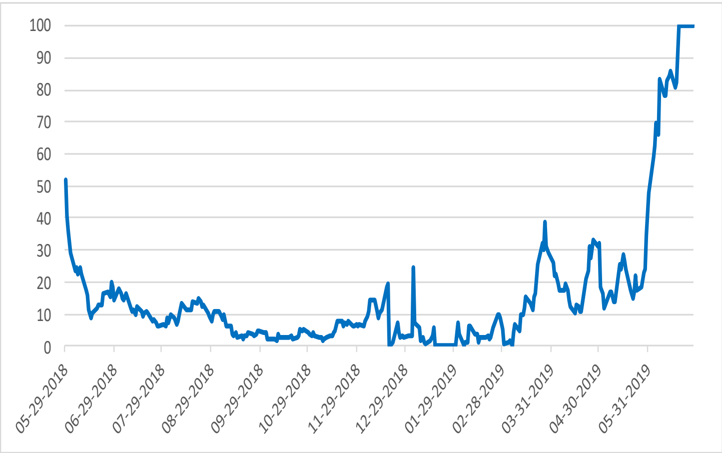
Top Themes

U.S./China trade uncertainty continue to disrupt markets

U.S. Fed moves closer to interest rate cuts

Bank of Canada expected to remain on the sideline

Top Chart: Market Implied Probability of Fed Rate Cut*



Source: Bloomberg, Lincluden

*Occurring at Fed Meeting July31, 2019