

Fed and the Bull: Don't Stop It Now

A Publication of BMO Capital Markets Economic Research · Douglas Porter, CFA, Chief Economist, BMO Financial Group

Equity markets were mixed this week, with the Federal Reserve all but locking in a July rate cut, while the Bank of Canada stood firmly on the sidelines. The S&P 500 rose 0.8%, punching above the 3,000 level for the first time. Last week, we described what looked like a clear technical breakout above the range that was set in early-2018—that was reinforced this week. Meantime, the TSX dipped 0.3%, and has retaken its usual position in the back seat to the U.S. indices.

The Fed is all but locked into a rate hike later this month, with market pricing going even further to reflect about a chance of a 50 bp move (we're not in that camp, for the record). Fed Chair Powell, in his testimony to Congress, said that *"since then [June 19 meeting], based on incoming data and other developments, it appears that uncertainties around trade tensions and concerns about the strength of the global economy continue to weigh on the U.S. economic outlook. Inflation pressures remain muted."*

In other words, don't be confused by the fact that payrolls rebounded a chunky 224k in June, and core CPI matched its biggest month-over-month gain of the cycle—Jay wants you to know that the Fed is cutting rates.

Meantime, the Bank of Canada's policy statement (rates left unchanged), updated Monetary Policy Report and a rollicking June housing starts figure all reinforced our view that the BoC will sit back and watch the Fed move. Fundamentally, Canadian rates are already more stimulative (negative in real terms and below the presumed neutral range), inflation is firmer and the housing market is best left undisturbed at this point. Indeed, the Bank reiterated that *"the degree of accommodation being provided by the current policy interest rate remains appropriate"*.

So, what does this all imply. First, for those that automatically assume this policy combination means a surge in the loonie, think again. The currency has perked up, but remains tucked below 77 US cents, and the market is already pricing much more action from the Fed than the BoC. Back in the equity market, rate-sensitive sectors have been winners alongside Fed easing expectations and the drop in longer-term rates (e.g., utilities have outperformed on both sides of the border over the past three months). Banks, not so much, with rate cuts and a still-flat yield curve weighing. Arguably the biggest winners have been technology and other cyclicals like consumer discretionary. If the Fed cuts rates against a backdrop of full employment yet subdued inflation, that's a pretty winning combination—just need those pesky trade tensions to go away.

ECONOMIC RESEARCH
1-800-613-0205
economics.bmo.com

Robert Kavcic, Senior Economist
+1 (416) 359-8329
robert.kavcic@bmo.com

Table 1 - Market Performance

| July 12, 2019 | | Performance (percent) | | | | | |
|---------------|---------------|-----------------------|-------|-------|--------|-------|-------|
| | Current Price | 1 Week | 1 Mo. | 3 Mo. | 1 Year | Y-T-D | 2018 |
| Dow Jones | 27,332 | 1.5 | 5.1 | 3.5 | 9.7 | 17.2 | -5.6 |
| NASDAQ | 8,244 | 1.0 | 5.8 | 3.3 | 5.4 | 24.2 | -3.9 |
| S&P 500 | 3,014 | 0.8 | 4.7 | 3.7 | 7.7 | 20.2 | -6.2 |
| NIKKEI 225 | 21,686 | -0.3 | 2.6 | -0.8 | -2.3 | 8.3 | -12.1 |
| S&P/TSX | 16,488 | -0.3 | 1.6 | 0.0 | -0.5 | 15.1 | -11.6 |
| CAC 40 | 5,573 | -0.4 | 3.7 | 1.3 | 3.1 | 17.8 | -11.0 |
| FTSE 100 | 7,506 | -0.6 | 1.9 | 0.9 | -1.9 | 11.6 | -12.5 |
| DAX | 12,323 | -2.0 | 1.7 | 2.7 | -1.4 | 16.7 | -18.3 |
| China CSI 300 | 3,809 | -2.2 | 3.2 | -4.5 | 9.4 | 26.5 | -25.3 |

Source: BMO Economics, Bloomberg

Chart of the Week

The loonie has kept the C\$-adjusted S&P 500 off a record high, but U.S. stocks are still outperforming for unhedged Canadian investors.

S&P 500 in C\$ (Jan 1, 2018 = 100)
 TSX (Jan 1, 2018 = 100)
 S&P 500 (Jan 1, 2018 = 100)



North American Sector Performances

(% change over period)

Table 2 - S&P 500 Sector Performance

| July 12, 2019 | | | | | | |
|--------------------|------------|------------|------------|------------|-------------|-------------|
| S&P 500 Sectors | 1 Wk | 1 Mo. | 3 Mo. | 1 Year | Y-T-D | 2018 |
| Energy | 2.2 | 7.1 | -4.5 | -15.0 | 12.5 | -20.5 |
| Cons Discretionary | 2.1 | 6.5 | 5.3 | 10.2 | 26.1 | -0.5 |
| Info Technology | 1.5 | 6.4 | 5.7 | 11.6 | 30.9 | -1.6 |
| Industrials | 1.2 | 4.5 | 1.4 | 7.2 | 21.8 | -15.0 |
| Telecom Services | 1.2 | 7.5 | 3.6 | 13.8 | 23.0 | -16.4 |
| Cons Staples | 0.9 | 2.3 | 6.2 | 14.4 | 18.0 | -11.2 |
| Banks | 0.5 | 5.2 | 2.3 | -0.6 | 18.1 | -18.4 |
| Financials | 0.5 | 4.8 | 4.3 | 4.5 | 18.7 | -14.7 |
| Utilities | -0.1 | 1.7 | 4.1 | 15.5 | 14.5 | 0.5 |
| Materials | -0.8 | 1.5 | 0.6 | -0.3 | 15.6 | -16.4 |
| Health Care | -1.4 | 1.2 | 2.9 | 6.0 | 6.8 | 4.7 |
| S&P 100 Large Cap | 0.9 | 4.9 | 4.0 | 7.9 | 19.6 | -5.9 |
| S&P 400 Mid Cap | -0.3 | 3.1 | -0.3 | -1.8 | 17.9 | -12.5 |
| S&P 600 Small Cap | -1.5 | 2.4 | -2.6 | -9.8 | 11.8 | -9.8 |
| S&P 500 | 0.8 | 4.7 | 3.7 | 7.7 | 20.2 | -6.2 |

Source: BMO Economics, Bloomberg

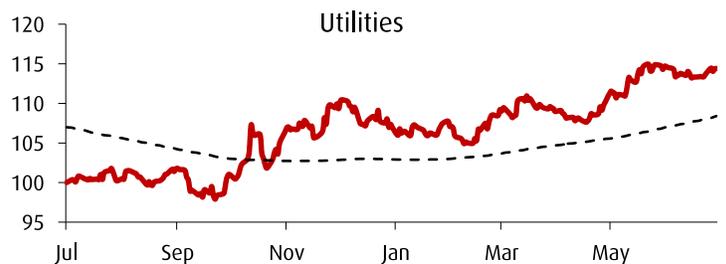
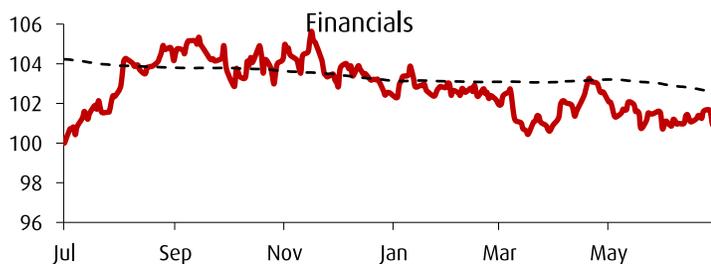
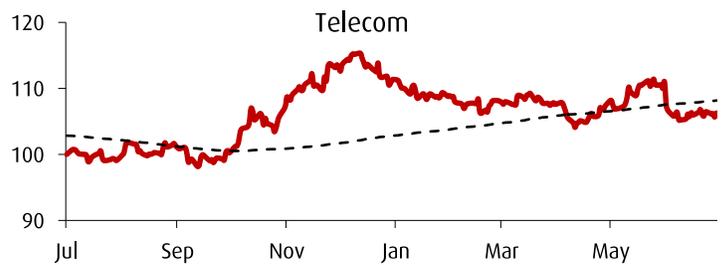
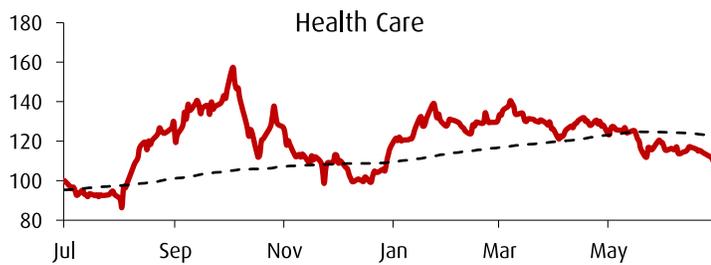
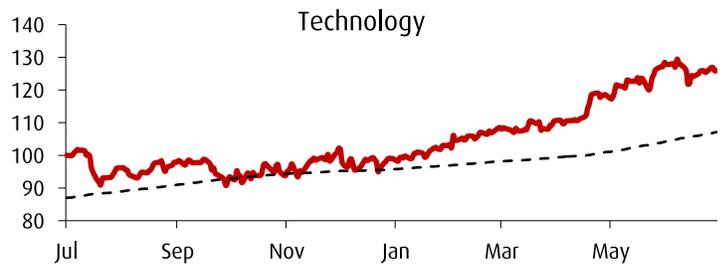
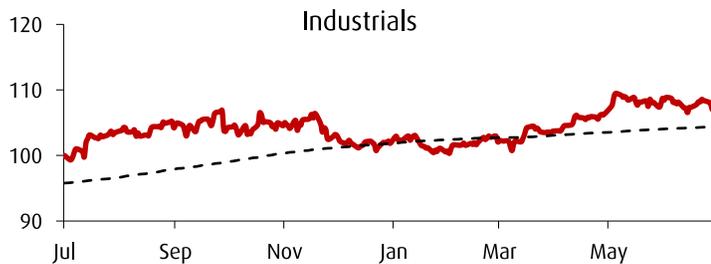
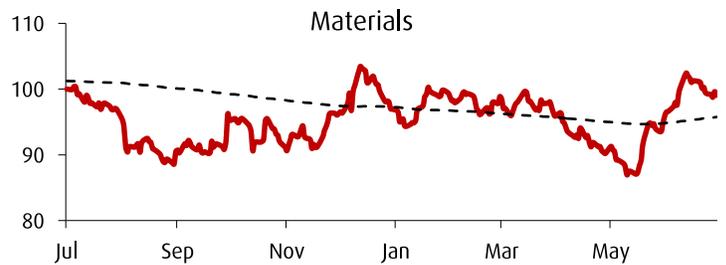
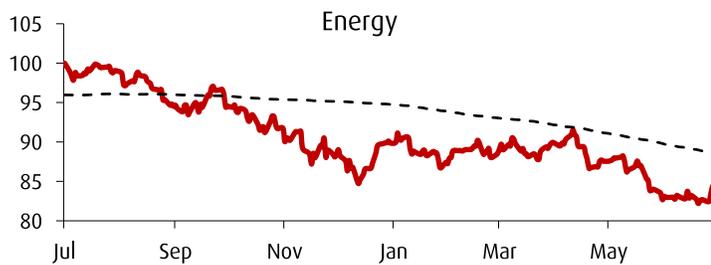
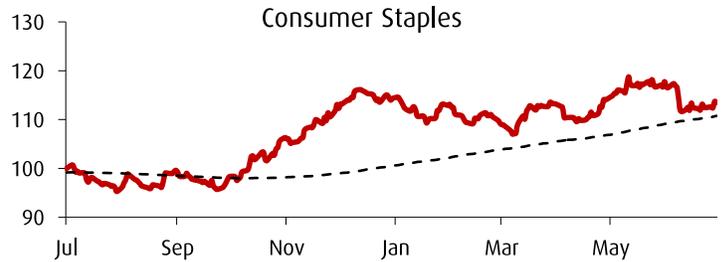
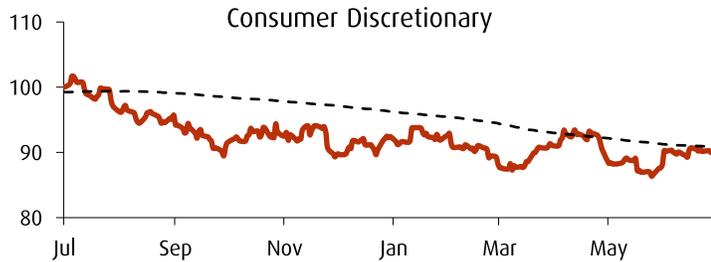
Table 3 - TSX Sector Performance

| July 12, 2019 | | | | | | |
|--------------------|-------------|------------|------------|-------------|-------------|--------------|
| TSX Sectors | 1 Wk | 1 Mo. | 3 Mo. | 1 Year | Y-T-D | 2018 |
| Energy | 1.8 | 3.7 | -6.1 | -15.6 | 12.2 | -21.5 |
| Cons Discretionary | 1.1 | 5.5 | 0.6 | -9.1 | 15.5 | -17.7 |
| Cons Staples | 0.3 | -2.4 | -0.1 | 13.0 | 13.1 | 0.6 |
| Materials | -0.1 | 5.6 | 4.0 | -1.2 | 12.5 | -10.6 |
| Utilities | -0.5 | 0.6 | 4.2 | 12.8 | 20.6 | -13.4 |
| Telecom Services | -0.6 | -2.8 | -1.2 | 5.8 | 8.3 | -5.3 |
| Info Technology | -0.6 | -1.1 | 13.1 | 24.0 | 44.9 | 12.5 |
| Industrials | -0.7 | 0.9 | 4.1 | 7.6 | 21.7 | -3.9 |
| Financials | -1.0 | 1.8 | 0.1 | 0.4 | 12.6 | -12.6 |
| Banks | -1.2 | 1.4 | -0.6 | -2.0 | 9.6 | -11.4 |
| Health Care | -9.8 | -12.0 | -18.2 | 0.4 | 19.9 | -16.6 |
| S&P/TSX Mid Cap | -0.1 | 2.5 | -0.3 | -2.8 | 16.3 | -15.2 |
| S&P/TSX Sml Cap | -0.3 | 2.5 | -2.1 | -10.7 | 9.4 | -20.1 |
| S&P/TSX 60 Lrg Cap | -0.4 | 1.3 | 0.1 | 0.3 | 14.7 | -10.5 |
| TSX | -0.3 | 1.6 | 0.0 | -0.5 | 15.1 | -11.6 |

Source: BMO Economics, Bloomberg

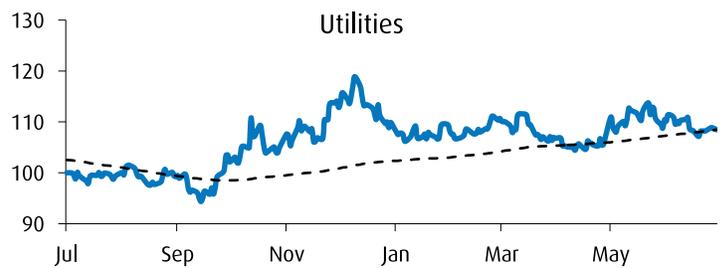
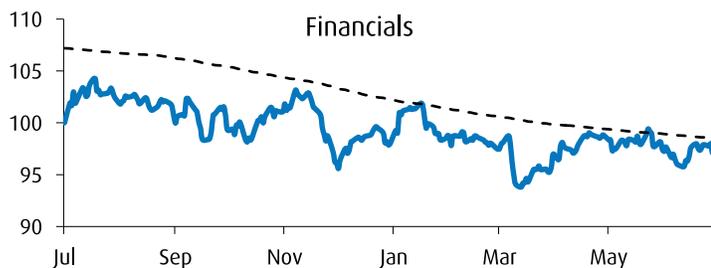
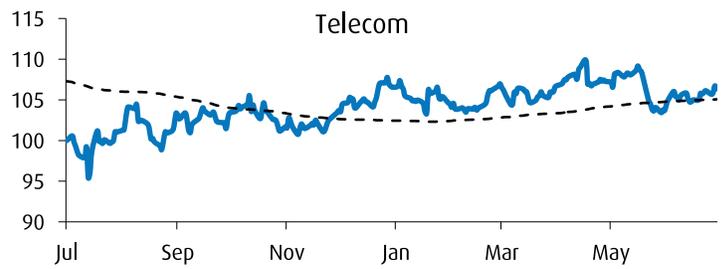
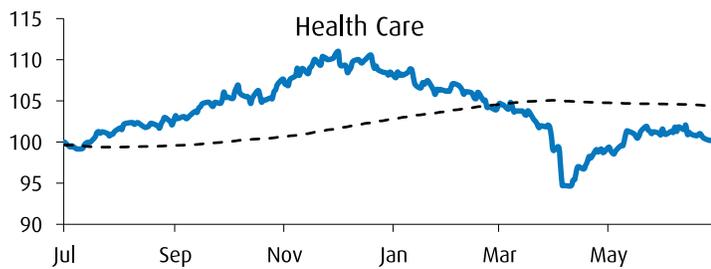
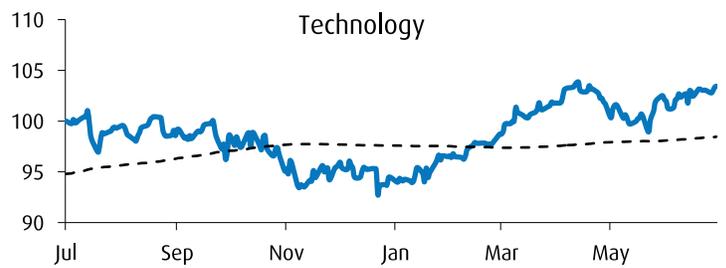
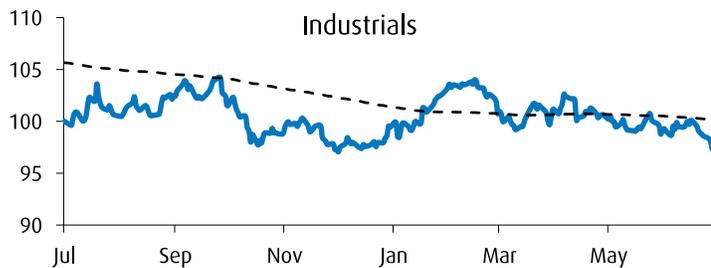
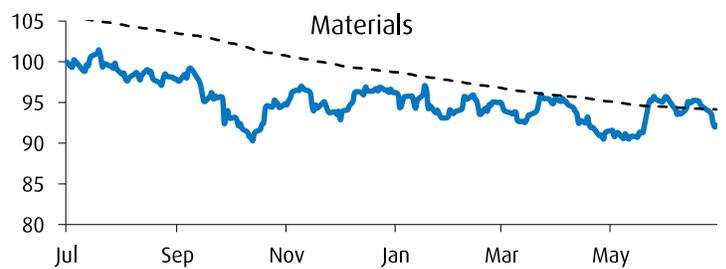
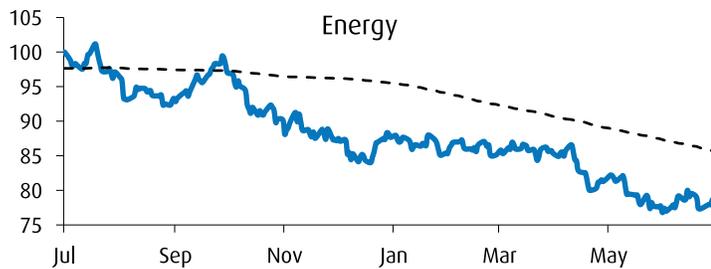
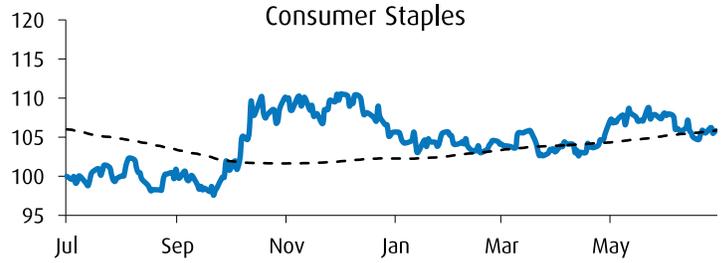
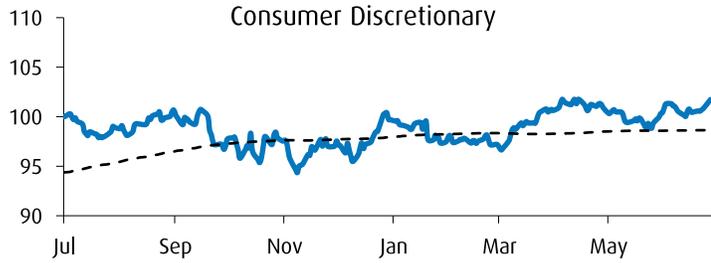
TSX Sector Performance

(relative to the index, year-ago = 100; dashed line = 200-day m.a.)



S&P 500 Sector Performance

(relative to the index, year-ago = 100; dashed line = 200-day m.a.)



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