ETERNA
FINANCIAL GROUP

MARKET REVIEW MAY 2018

STATISTICS on 2018-05-31

CANADA		
Unemployment (April)	5.80%	
C.P.I. (April)	2.20%	↓
3 months treasury bills CDA	1.27%	↑
Bonds CDA 5 years	2.11%	↓
Bonds CDA 10 years	2.24%	↓
S&P/TSX	16062	↑

UNITED STATES		
Unemployment	3.80%	↓
C.P.I. (April)	2.50%	↑
3 months treasury bills US	1.89%	↑
Bonds US 5 years	2.70%	↓
Bonds US 10 years	2.86%	↓
Dow Jones - Industrial	24416	↑
S&P 500	2705	↑

CURRENCY		
$ US / $ CAN	0.7717	↑
$ US / € Euro	1.1693	↑
¥ Yen / $ USA.	108.82	↑

The arrow indicates the trend since the publication of the last monthly data or end of the month.

The Canadian stock market did well in May, generating a total return of 3.1%, allowing the S&P/TSX Index to move out of the red from the end of December. In May, nine of the eleven sectors posted gains, with health, technology, industry and materials as the best performers. We also note strong performances from securities such as CN Rail and CP Rail, Nutrien, CAE, Bombardier and Magna. Overall, North American markets did better. Emerging markets suffered as safe-haven stocks prevailed, while trade tensions resurfaced and the U.S. dollar appreciated. Thus, he S&P 500 American index generated a return of 2.4%, which, combined with the depreciation of the loonie, generated a total return of 3.5% for the Canadian investor. U.S. growth seems to have more recent momentum relative to the rest of the world. Although expansion is well in place, vigour appears somewhat weaker. Markets evolved in two stages in May: the sharp rise in markets at the beginning of the month gave way to selling pressure when oil prices fell. This occurred in response to OPEC's hint of a possible upturn in its production and also because of trade tensions that rose a few notches on the eve of tariff increases announced by the Trump administration. Added to this is the Italian drama, against the backdrop of the inability to form a government that is not Eurosceptic and fiscally irresponsible. In short, the last few days of May saw volatility rise and interest rates on government bonds fall. The month-end bond rally reversed the trend of previous weeks and allowed rates on 10-year Canadian federal bond to close at 2.25%, lower than at the end of April. The FTSE/TMX Canadian Bond Index returned 0.8%, with the longest maturities providing the best performance. Provincial securities did particularly well. The maturity curve flattened as shorter-term rates remained unchanged. The U.S. Federal Reserve's decision to leave rates unchanged was followed by the Bank of Canada in May. However, the analysis is divergent, with the U.S. Bank sounding rather accommodating, while the Bank of Canada appeared to be cautious about the future. Still, it is the economic statistics of the coming months that will dictate the actions of central banks. Overall inflation is reassuring at the moment, but labour costs are rising on the continent. Several uncertainties persist, particularly related to global trade and collaboration between states in America, Europe and Asia. The coming weeks will be marked by developments following the G7 meeting, the formation of new governments in Italy and Spain and the possible summit with North Korea. Closer to home, Ontarians will go to the polls on June 7. As the months go by, we will also be able to better see the effects of the U.S. tax reform on growth. In short, despite ambient noise and temporary distractions, the fundamentals will take over.

PERFORMANCE as of 2018-05-31

	1 month	3 months	12 months
Bonds			
FSTE/TMX - 91 Day Tbill	0.10%	0.29%	0.84%
FSTE/TMX - Short Term	0.15%	0.25%	-0.84%
FSTE/TMX - Mid Term	0.42%	0.26%	-3.02%
Stock Market Indices			
CANADA - S&P/TSX	3.12%	4.83%	7.75%
USA - S&P 500	3.45%	1.32%	9.66%
MSCI - E.A.F.E.	-1.25%	-0.71%	3.51%
$ CAN versus $ US	-0.90%	-0.99%	4.02%

SOURCES: Bloomberg, TSX Group - Total Return, $ CAN

WHO DECIDES ON INTEREST RATES IN THE UNITED STATES?

We are often asked how interest rates are determined and who decides the 5-year or 10-year bond rates. In short, it is market players - different market participants - who are able to buy and sell bonds, because government, municipal and corporate bonds are traded in the market at any time. These are investors who, according to their offers and demands, will accept a price, and thus an interest rate, for their security. Demand for a security yielding 3% should be higher than for another trading at 2%. If you think the security is riskier because it has a longer maturity, or because the issuer's situation is bad, or you think inflation will be higher in the future, you will want to hold a bond if it offers a higher rate of return. Transactions are ongoing, as is the case for equities.

However, one group has a greater influence: central banks. Although the situation differs from one country to another, they have a predetermined legislative role conferring on them responsibilities regarding monetary policy, the currency and financial system. In the United States, the Federal Reserve Bank (FRB) is the main regulator. Completely independent of the government, although its governors are confirmed by the Senate, the FRB is at the top of a group of twelve regional banks covering the different regions of the United States (e.g. San Francisco, Chicago or St. Louis reserves, etc.). These regional reserves supervise the banks and financial system operating within their territory. You will find on an American bank note the acronym of the regional reserve that issued it. The FRB, however, is responsible for overseeing the entire system. Located in Washington, D.C., its mandate includes conducting monetary policy to maximize employment, maintain price stability (inflation), and moderate long-term interest rates. This monetary policy is implemented by a monetary policy committee called the Federal Open Market Committee (FOMC). The FOMC is composed of seven members of the board of governors of the FRB as well as the twelve presidents of the regional reserves, five of whom have voting rights at a given time according to a pre-established rotation. It is through their vote that members indicate the policy to follow. The FOMC meetings are therefore highly anticipated and their minutes are published a few weeks later. The interest rates that can influence the FOMC are the discount rate, but especially the Fed Funds (FF) rate, the latter being the rate at which banks and savings institutions can trade their liquidity on a daily basis. The FF is therefore the daily rate targeted by the FOMC. The committee ordered the New York Reserve, the largest of the twelve and the one covering New York's financial centre, to conduct the necessary day-to-day market operations in order to reach the FF target. As of May 31, 2018, the target is 1.75%. Given the current economic growth and conditions, stakeholders expect the target to be raised to 2% by the next meeting on June 13. Rates on other maturities are traded on the market according to the target provided by the FOMC.