April 2017 – Trump's first 100 days (or 500 tweets)

US equity markets rallied in the last two weeks of April but failed to reclaim record levels achieved in the prior month, as investors took on a more favourable view of international equities. Canadian bonds were the top performing asset class in our universe (+1.3%), beating international equities (+0.85%), US equities (0.80%) and Canadian equities (0.22%), which fell behind on energy and bank sector performance.

While it was a relatively quiet month for markets, the same can't be said for Washington given Trump's 100th day in office (and 500th tweet!) landed in April. And perhaps Trump's tweets explain why investors have become increasingly impervious to the noise coming out of Washington, by and large ignoring Trump's failures to gain traction on tax and trade. To be sure, investors remain confident in corporate America (for the most part), but conviction in Trump has eroded which explains the rotation we've seen out of cyclicals into defensives. Even Trump's conviction seems to have wavered as he admits getting things done hasn't been "so easy". While this may have come as a surprise to Trump, it doesn't appear to have surprised the S&P 500 which remains at a record level (currently 2,400). So what will become of Trump's campaign promises? Generally speaking, our view of politics and investing is that they don't mix. The market has had a terrible track record at calling political outcomes which was clearly demonstrated by both Brexit and the US election. While we don't ignore the political environment, given the disproportionate impact policy can have on an economy, we generally prefer to focus on fundamentals and valuations to guide our long-term investment decisions.

Looking at the current state of fundamentals, US equities appear to be healthy. With the first quarter earnings season wrapping up, revenue and profit growth are handily beating analyst expectations across the majority of sectors. This confirms what we've been seeing in the macro economic data we follow, which includes a healthy labour market, stable housing prices, improved manufacturing conditions and a confident consumer. Overall, revenue growth for the quarter on a blended basis so far is 8.8% year-over-year, driven largely by energy stocks. This should come as no surprise given the significant recovery in oil over the past year. As well, earnings growth is hitting six year highs at a blended rate of 15.4% year over year. In terms of profit composition, economically sensitive sectors including energy, materials, financials and technology have been the top performers. While fundamentals remain solid, valuations offer a more fragile view of the market. P/E ratios remain in elevated territory at 18.5 times forward earnings, and therefore return generation going forward could be challenged. Compared to historically low bond yields however, equities look better. For example, constructing a like P/E ratio for 10-year US Treasury notes reveals government bonds are about twice as expensive as US equities and perhaps offers some explanation surrounding the duration of the current bull market. The trouble with valuations is they don't offer much insight into timing, and can in fact be quite misleading in the short term. That is, what is currently expensive, could become even more expensive in the coming months, thereby leaving profit potential on the table. While P/E ratios may not be a great timing tool, they do offer an idea of return potential over the next several years, which is always factored into our long-term view of the market.

In terms of positioning within the Active Balanced portfolios, we have taken a slight overweight in equities relative to our cash position and prefer the US and European markets as they appear to offer the best risk reward profile within our investable universe. Our long term strategic view on Canada remains neutral given the higher exposure to the energy sector offers greater risk, which accounts for about 50% of S&P/TSX profit growth.

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