

MONTHLY INSIGHT

CANADIAN STOCKS IN GREAT SHAPE

"...this bull market has more room to run because a bear market will not come until the yield curve says so."

Yield Curve Inversion	S&P TSX Peak
Sep-78	Sep-78
Nov-80	Nov-80
Jan-86	Oct-87
Oct-88	Aug-89
Jun-98	Jun-98
Aug-00	Aug-00
Sep-06	May-07

This table shows the dates of the most recent yield curve inversions in Canada which are often closely followed by a stock market peak. In 4 of the 7 instances the inversion occurred in the same month as the market peak.

Why are investors still waiting for a correction? Some investors would like to see a pullback to cool off the white hot equity markets, but they may have to wait a little longer. This is because without a yield curve inversion there will be no correction. This mantra remains as true today as it did 47 years ago. The yield curve is one of the most reliable economic indicators and one that savvy market watchers always keep on their radar. Sure this bull market may be long in the tooth, but the Canadian stock market just reached its first all-time high since 2008.

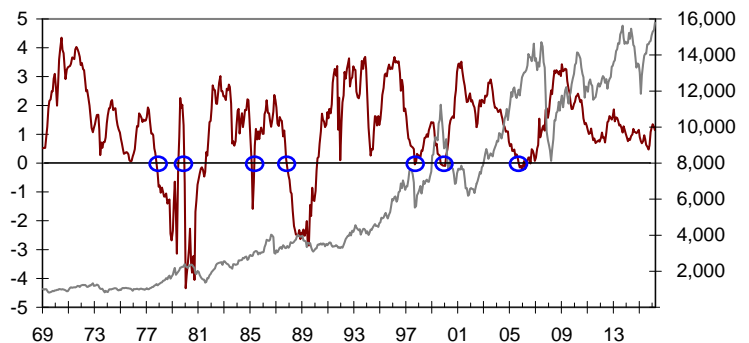
The yield curve indicates the difference between short term cash yields and long term bond yields. It is an excellent tool for predicting the direction of the economy. Typically, short term interest rates are lower than long term rates, so the yield curve slopes upwards, reflecting higher yields for longer term investments. This is referred to as a normal yield curve. When the spread between short and long term interest rates narrows, the yield curve begins to flatten. Lastly, when short term rates move above long term rates the curve becomes inverted and this is a major signal that a slowdown is likely. It is no wonder that an inverted yield curve produces so much fear.

The yield curve has an excellent track record of predicting the top of the stock market over the past 47 years and it is not signaling a bear market now. We are currently in the longest period without an inversion since 1970; while concerning for its longevity, it does not mean much since an actual inversion is the only true signal. The yield curve inversion usually takes place about 12 months before the start of a recession, but the lead time ranges from 5 to 16 months. The peak in the stock market comes around the time of the yield curve inversion, just ahead of a recession.

The chart to the right illustrates the spread between 3 month T-bills and 10 year bonds for the past 47 years and when that differential has turned negative (or inverted). The chart also compares this spread to movements in the S&P/TSX Stock index. The yield curve had been flattening until August 2016 as bond

investors started to worry about when the Bank of Canada (BOC) would begin hiking its lending rate. Since then the curve has moved upward as longer bond yields have increased while short term rates remained steady. It appears that we are still a long ways from inverting. If the BOC aggressively hikes its key policy rate and short term yields rise swiftly, they would have to increase yields by 1.1% (assuming bond yields stay the same) before the yield curve becomes inverted. This will likely not occur quickly; as the consensus remains that the next hike is a long way off.

Investors may hear cries from many circles to ignore the yield curve and that "it has lost its edge" as a leading indicator. Do not believe them; it has called each of the last 10 recessions since World War II with precision. The yield curve is an invaluable forecasting tool for predicting recessions and stock market corrections and is equally as important for what it predicts when it is not inverted: a bull market or continued strong period for equities. So based upon what the yield curve is telling investors currently, this bull market has more room to run because a bear market will not come until the yield curve says so.



The percentage spread between 3 month T-bills and 10 year bonds (left side values) is superimposed over the level of the S&P/TSX stock index (right side values) shown here in grey over the last 47 years and confirms that the spread's turning negative, as indicated by blue circles, precedes a period of weak equity performance.

MARKET DATA

28 FEBRUARY 2017

Index Total Returns (%) (C\$)

	1 Month	1 Year	5 Years
S&P TSX	0.2	23.2	7.2
S&P TSX High Dividend	1.3	27.7	7.0
S&P TSX Small Cap	-0.1	37.7	2.2
S&P TSX Preferred Shares	1.5	30.9	0.7
S&P 500	5.7	22.3	21.3
Russell 2000 (US Small Cap)	3.5	31.3	18.5
MSCI EAFE	3.1	14.0	12.6
MSCI World	4.5	19.5	17.2
MSCI Europe	2.6	6.7	8.4
MSCI Asia	3.5	15.9	7.7
MSCI Emerging Markets	4.7	24.5	3.9

Currencies:	US\$	1 Month	1 Year	5 Years
(%) (C\$)	EURO	-0.1	-4.8	1.1
	GBP	0.9	-12.8	0.8
	YEN	9.4	6.0	0.8

Bond Total Returns (%) - DEX Indices

	1 Month	1 Year	5 Years	Yield
Universe	1.0	1.9	3.4	2.06
Short Bonds	0.3	1.5	2.2	1.27
Mid Bonds	1.1	2.2	4.0	2.06
Long Bonds	1.8	2.1	4.5	3.17
Federal Bonds	0.6	-0.7	2.3	1.34
Provincial Bonds	1.3	1.9	3.9	2.44
Corporate Bonds	1.0	5.3	4.2	2.51
Real Return Bonds	0.7	1.7	1.2	0.42
91 Day T-Bills	0.0	0.5	0.8	0.49

Barclays Aggregate Bond (US\$)	0.7	1.4	2.2
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Commodities:	Index	1 Month	1 Year	5 Years
(%) (US\$)	Oil	2.3	60.0	-12.7
	Gold	3.5	1.3	-6.0
	Wheat	8.1	-15.8	-11.0

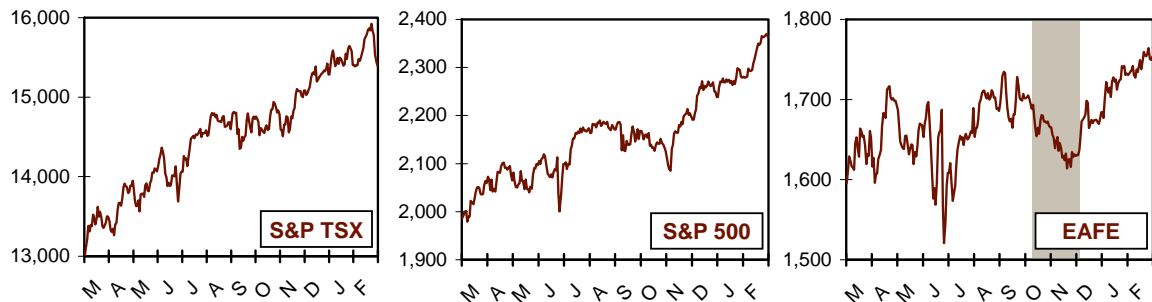
Sector Returns (%)

	S&P TSX (C\$)				S&P 500 (US\$)				MSCI EAFE (US\$)			
	1 Month	1 Year	5 Years	Weight	1 Month	1 Year	5 Years	Weight	1 Month	1 Year	5 Years	Weight
Consumer Discretionary	3.6	15.4	15.6	5.0	1.8	16.4	15.0	12.1	0.2	9.5	4.8	12.4
Consumer Staples	-0.6	-1.0	20.2	3.7	4.9	8.6	10.6	9.3	4.0	3.9	4.6	11.1
Energy	-2.5	28.2	-7.3	21.3	-2.7	22.7	-1.4	7.5	-2.4	16.9	-7.8	5.1
Financial Services	1.1	28.8	10.0	38.2	5.0	41.8	15.4	17.8	-0.3	20.1	2.8	25.1
Health Care	4.8	-29.2	2.3	0.6	6.2	13.2	15.6	13.7	4.4	1.0	6.7	10.5
Industrials	1.5	29.0	13.0	8.8	3.4	24.8	12.0	10.3	2.0	17.0	3.8	14.2
Information Technology	1.6	9.2	17.1	2.7	4.9	30.8	13.3	20.7	2.3	21.3	5.9	5.6
Materials	-3.8	26.6	-8.5	12.1	0.5	25.0	7.0	2.9	-1.2	39.6	-2.6	8.2
Telecommunication	0.4	9.1	8.4	4.8	-0.4	4.6	5.6	2.7	0.6	-3.7	2.6	4.5
Utilities	0.0	13.6	0.7	4.8	4.7	11.8	8.2	3.1	3.3	-0.8	-2.4	3.3
Growth Index	0.8	7.9	4.0		3.9	18.8	12.2		2.1	9.1	3.3	
Value Index	-0.1	22.6	4.6		3.6	24.1	10.8		0.4	0.0	1.1	

Index Charts

12 Months ending February 2017

Grey shaded areas indicate periods of stock index decline.



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