"Germane Thoughts"

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A line from the 1970's Stealers Wheel hit "Stuck in the Middle with You" comes to mind when looking back at investor sentiment for the month of May, "Clowns to the left of me, jokers to the right, here I am, stuck in the middle with you". With the American Association of Individual Investors, better known as the AAII, sentiment survey hitting a historically high neutral rating in the month of May, we believe this sets the market up well for another leg up as economic numbers bounce back from a weak first four months of 2015 and sentiment remains tepid.

Global equity markets posted a wide range of returns in May with the Nikkei 225 Index in Japan leading the way, rising for 11 consecutive days to end the month, up 5.3%. Chinese markets continued their parabolic ascent, up another 3.8% in May and up 42.5% so far in 2015, even as the economy in China continues to slow. Unfortunately back home here, the TSX Composite was at the other end of the spectrum, down 1.0% as valuations remain elevated, while south of the border, the S&P 500 Index rose 1% in May, putting the YTD return at 2.4%.

In Canada, the Health Care sector continued its run, tacking on another 11.4% in May and leading all other sectors by a country mile so far in 2015, up 66.3%. Most of this can be attributed to Valeant Pharmaceuticals Inc., which rose 13.3% in May and is up 78.2% YTD.

Meanwhile, the Energy sector essentially gave back all of the 7% return generated in April, declining 6.3% in May, even as WTI oil prices stabilized in the US$60 per barrel range. The weakness in energy spilled over into the Railway sector as Canadian National and Canadian Pacific Railway declined 5.3% and 10.9% respectively, pricing in lower crude by rail volumes on a go-forward basis.

The Healthcare sector also led the U.S. market in May as it rose another 4.3%, on the back of attractive valuations and more potential M&A in the sector. Similar to Canada, the Energy sector also lagged in the U.S. in May, down 5.2% during the month.

Currency and interest rate volatility remained elevated in May as the Canadian dollar gave back some of its strong April return, declining 3% vs. the U.S. dollar. A similar story for the Euro, Australian dollar and Japanese Yen which fell 2.1%, 3.3% and 3.8% respectively vs the U.S. dollar. Meanwhile, German 10-year bunds rose from a low of 7 basis points in mid-April to a high of 72 basis points in mid-May, to end the month just under 50 basis points. With stronger economic data out of Europe so far in 2015, and some expectations (*not us!*) that the ECB could begin its own taper tantrum, we would expect currency and interest rate volatility to remain high for the foreseeable future.

Economic statistics reported in May continue to suggest the soft patch for the U.S. economy in the first four months of 2015 was transitory due to the harsh winter weather. U.S. vehicle sales surged to a nine-year high in May with a seasonally adjusted annual rate (SAAR) for light vehicle sales of 17.7 million. Also, the change in Nonfarm Payrolls in May came in well above expectations with a print of 280,000 jobs created, although the Unemployment Rate rose slightly to 5.5% from 5.4% in April, as the Labour Force Participation Rate rose. In our view this is a positive indicator as it signals people that have been out of the workforce for some time have started to look for jobs again.

The jobs number in Canada also surprised to the upside in May, with 58,900 jobs created suggesting the economy is holding up better than expected against the oil price shock. Even the details looked good with a fairly even split between full-time and part-time positions and manufacturing churning out an impressive 21,500 jobs.

We remain cautious on Canadian employment numbers as we believe the lagged effect from the oil price shock still has room to works its way through the system, especially in energy dependent provinces such as Alberta and Saskatchewan.

Forward Looking Information and Disclaimer

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