Industrial Alliance
Investment Management Inc.
Economic and Financial Bulletin

May 31, 2015

Risky to bet against the Fed?

There's no denying that the start of the year was disappointing as far as economic indicators were concerned. Following the vigorous upswing in the U.S. job market in 2014, it was only natural to expect households to be driving growth early in the year. What is surprising, though, is that households are being cautious and choosing to bank the savings they have seen from the drop in prices at the pump and the stronger job market. Pundits have therefore been quick to revise their predictions as to an initial increase in interest rates by the U.S. Federal Reserve. However, we are of the opinion that it may be risky to wager against a potential hike from the Fed in the fall. On the bond market, inflationary expectations have clearly been setting in since the beginning of the quarter, and it would only take a handful of figures above and beyond the expected—as we saw this month with the impressive surge in construction starts—for investors to flock in droves to revise their expectations and send the market into a disorderly unwinding. We remain of the opinion that the initial increase is likely to occur in September, but the possibility of this being brought forward to July is not zero.

Canada: higher unemployment in April

The Canadian economy experienced negative growth during the first quarter to the tune of -0.6%, which was not helped by the downturn in oil sector investments and a more cautious approach by consumers. Recent information is pointing to a slight rally in the second quarter, but we remain cautious about this given the rapid build-up in inventory since the end of 2014.

Canada lost 19,700 jobs in April, whereas market expectations were closer to 5,000. Construction and retail were the most hard-hit sectors, losing 20,500 and 28,400 jobs, respectively. The decline in oil and natural gas companies' infrastructure projects, together with the closures of retailers Target Corp. and some stores for Best Buy Canada were strong contributors to these losses.

The annualized rate of inflation for April was 0.8%, compared to 1.2% the month before. The Bank of Canada (BoC) predicted in March that inflation would remain within its target range of 1%–3% during the first quarter, due in part to the recent fall in oil prices. Moreover, BoC Governor Stephen Poloz confirmed in a recent statement that a return to the target inflation rate of 2% may be as far ahead as late 2016.

United States: rate hike in June highly unlikely

The minutes of the Federal Open Market Committee (FOMC) meeting on April 28–29 were hotly awaited by investors keen for clues as to when the Federal Reserve would raise its rates. However, the Fed chose to perpetuate the uncertainty, with the Committee hinting that a rate increase was highly unlikely, although not impossible. Although we are of the opinion that if positive surprises occur in the consumer and employment markets, the Fed may be spurred into action sooner rather than later, our most probable scenario remains that of an initial increase as of September.

Things are gradually looking up on the job front. 223,000 jobs were gained in April, falling slightly short of expectations but up significantly from the 85,000 jobs created in March (number revised for previous month). The unemployment rate is now 5.4%, close to what the Fed defines as full employment.

Retail sales were up slightly by 0.1% in April, consumers apparently more inclined to bank than to spend the savings resulting from lower gas prices. While consumers are proving exceedingly cautious in their everyday spending, observations suggest that the savings trickling down from lower prices at the pump are being channeled into the real estate market, which has seen a strong start to the year.

Construction starts in April skyrocketed to the highest level since 2007, 1.14 million, surprising many. Although the residential construction sector only accounts for less than 4% of the economy, this surge in activity bodes well for an acceleration in growth over the coming quarters.

Europe: the economy is still gaining momentum

A positive sign in the euro zone, the economy grew 0.4% over the first quarter—the fastest in nearly two years (see graph). France, in particular, exceeded expectations by moving up 0.6%. Italy and Spain also performed well with gains of 0.3% and 0.9%, respectively. Germany, the most powerful country in the euro zone, saw its economy decline by 0.3%, however. Notably, the European region profited from the marked drop in oil prices, a weak currency and a surge in confidence around the expected benefits of the quantitative easing program launched by the European Central Bank (ECB), which could last until the end of September 2016. Moreover, the ECB announced that it would be bringing forward its asset purchases in anticipation of low market liquidity over the summer, a move that has had a negative impact on the relative value of the euro.

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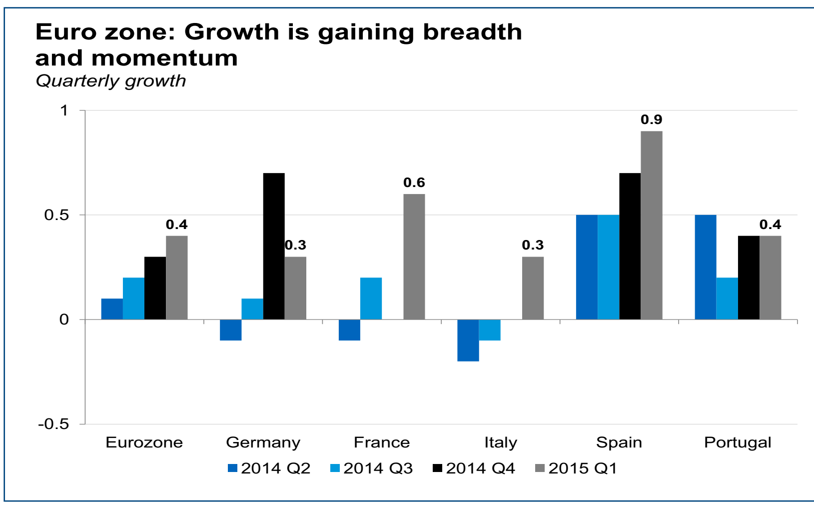
Economic and Financial Statistics

	As at 2015-05-31[1]	As at 2014-12-31
Canada - Unemployment rate	6.8%	6.6%
Canada - CPI (year/year variation)	0.8%	2.0%
Canada - GDP (year/year variation)	1.5%	2.3%
U.S. - Unemployment rate	5.5%	5.8%
U.S. - CPI (year/year variation)	-0.2%	1.3%
U.S. - GDP (year/year variation)	2.7%	2.7%
2-year Canada Bonds	0.57%	1.01%
10-year Canada Bonds	1.62%	1.79%
Oil (West Texas) ($US)	60.1	53.8
Gold ($US)	1,190.0	1,186.3
CRB Commodities Index ($US)	223.2	230.0
Exchange rate $CA/$US	1.2448	1.1621

Source: IAIM

[1] Most recent data available at such date



Source: IAIM

INDUSTRIAL ALLIANCE
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Reference indexes[1] - Returns as at May 31, 2015

	Simple returns[2]			Compound annual returns			
	1 month %	3 months %	YTD %	1 year %	3 years %	5 years %	10 years %
INDEXES RELATED TO INCOME FUNDS							
FTSE TMX Canada 91 Day T-Bill Index	0.1	0.1	0.3	0.9	1.0	0.9	1.9
FTSE TMX Canada Short Term Bond Index	0.4	(0.1)	1.9	3.2	2.6	3.2	3.8
FTSE TMX Canada Universe Bond Index	0.2	(1.5)	2.9	7.1	4.0	5.6	5.2
S&P/TSX Capped Income Trusts (Total Return)	(4.1)	(5.0)	4.6	9.5	8.3	15.1	10.9
SB - World Government Bonds (Can. $)	0.4	(2.7)	3.4	5.5	3.9	5.1	3.0
INDEXES RELATED TO CANADIAN EQUITY FUNDS							
S&P/TSX 60	(1.2)	(1.0)	3.6	7.7	13.4	7.9	7.8
S&P/TSX Completion Index	(1.4)	0.1	4.5	0.7	10.2	8.7	7.2
S&P/TSX Composite Index	(1.2)	(0.7)	3.8	5.8	12.6	8.1	7.5
S&P/TSX Capped Composite Index	(1.2)	(0.7)	3.8	5.8	12.6	8.1	7.5
S&P/TSX SmallCap Index	0.3	1.0	4.8	(7.2)	4.6	3.4	3.0
INDEXES RELATED TO U.S. & INTERNATIONAL EQUITY FUNDS							
S&P 500 (Can. $)	4.2	0.3	10.9	28.2	27.3	20.7	8.1
S&P 500 (Can. $) (Reuters)	4.4	0.6	11.3	28.5	27.4	20.7	8.1
MSCI - World (Can. $)	3.2	0.7	12.9	21.2	24.6	16.9	6.7
MSCI - EAFE (Can. $)	2.3	1.6	16.7	14.2	23.0	13.9	5.5
MSCI - EAFE (Can. $) (Reuters)	2.5	1.9	17.0	14.4	23.1	13.8	5.5
MSCI - Europe (Can. $)	2.2	0.8	15.6	9.7	24.6	15.2	6.1
INDEXES RELATED TO SPECIALTY FUNDS							
MSCI - AC Asian Pacific Free (Can. $)	1.8	4.0	19.1	25.7	20.7	12.7	7.1
MSCI - Emerging Markets (Can. $)	(1.2)	1.6	13.7	15.1	13.1	8.1	9.1
MSCI - World Health Care (Can. $)	5.5	3.1	18.6	37.3	33.1	23.3	8.2
NASDAQ 100 (Can. $)	5.0	1.2	14.3	38.4	29.1	23.7	11.3
S&P/TSX Capped REIT Index	(5.2)	(5.3)	3.6	5.0	5.0	12.8	9.4

	Variation			Compound annual variation			
	1 month %	3 months %	YTD %	1 year %	3 years %	5 years %	10 years %
EXCHANGE RATE (Can. $ / US $) As at May 31, 2015: 1.2465	2.9	(0.3)	7.4	14.7	6.4	3.6	0.0
EXCHANGE RATE (US $ / Can. $) As at May 31, 2015: 0.8022	(2.8)	0.3	(6.9)	(12.8)	(6.0)	(3.4)	0.0

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Global: China wants to open up more

China has announced guidelines for capital markets reform. Part of its plan involves a liberalization of the financial markets as well as international recognition of its currency, the yuan. This plan comes in addition to the expansionary measures undertaken by the People's Bank of China (PBoC) to stimulate the economy, which has bolstered the strong growth seen in the Shanghai Composite Index since last year. The index has advanced by nearly 12% in the last month and some analysts are even fearful the stock market bubble there may burst.

Financial markets: the loonie slides again

- The S&P/TSX Composite Index dipped into the red in May. The Canadian index declined 1.2% over the month, despite a gain of 1.1% drop in U.S. crude prices, although overall performance remains negative since the beginning of the quarter (-0.7%) and positive in 2015 in general (3.8%).
- The U.S. S&P 500 Index is still in the green, posting a total return of 1.3% (+4.2% in Canadian dollars). The loonie's depreciation—2.9% in May alone—is in fact working to Canadian investors' benefit in 2015, boosting the total U.S market yield of 3.2% in local currency to 10.9% in Canadian dollars.
- The global MSCI - EAFE and MSCI - World indexes climbed respectively 1.6% and 1.3% (2.3% and 3.2% in Canadian dollars). Emerging markets, measured by the MSCI - Emerging Markets Index, slipped 2.5% (-1.2% in Canadian dollars). Since the beginning of the year, total returns for the MSCI - EAFE, MSCI - World and MSCI - Emerging Markets indexes are, respectively, 13.9%, 7.3% and 8.2% (16.7%, 12.9% and 13.7% in Canadian dollars).
- The Canadian bond market, measured by the FTSE TMX Canada Universe Bond Index, gained 0.2% in May. The overall return since the beginning of the year remains positive at 2.9%.

[1] Indexes presented in this document are total return index.
[2] The rates for the period are non-annualized.