Industrial Alliance
Investment Management Inc.
Economic and Financial Bulletin

July 31, 2015

Sébastien Mc Mahon, M.E.Sc., PRM, CFA
Frédéric Gagnon
economics@ia.ca or ia.ca/economy

The wind is rising in China…

Uncertainty persists regarding the economic situation in China. Although the National Bureau of Statistics announced 7% growth in the country's real gross domestic product (GDP) for the second quarter year-over-year, the perception in the financial markets is pointing more toward a sharp downturn. Import volume has declined since the start of the year, while some indicators strongly correlated with GDP growth in China are signaling much slimmer growth than announced (see graph). Moreover, manufacturing activity and earnings in the industrial sector are showing clear signs of fragility, weighing heavily on the demand for raw materials. One will recall that China is one of the world's biggest consumers of natural resources, such as iron ore, copper and oil. The prices of these commodities have in fact been declining sharply for the past year, plummeting 42%, 27% and 52% respectively. Potential difficulties in the second world power could also affect other major economies, such as Japan, where 50% of exports are currently exposed to Chinese activities.

Canada: key interest rate cut to 0.5%

On July 15, the Bank of Canada announced its second interest rate cut of the year, bringing its key policy rate down from 0.75% to 0.50%, with a goal to stimulating economic activity. The country is still feeling the effects of the oil price collapse that began at the end of 2014, primarily through the weakness of investments in the energy sector. In the months of April and May, the economy slowed 0.1% and 0.2% respectively. In addition, according to Bank of Canada estimates, the economy contracted 0.5% in the second quarter, thus adding to the 0.6% decline of the first quarter. In purely technical terms, two consecutive quarters of contraction in real GDP would signal that Canada is heading into a recession. However, the situation is somewhat atypical because this downturn is essentially concentrated in one sector (energy) and in western Canada (Alberta).

Although the GDP numbers presented above show a weakness in production, Canada still created 96,000 jobs in the first six months of the year, mostly full-time, compared to 41,000 jobs during the same period in 2014. Moreover, as can be read in its recent monetary policy report, the Bank of Canada remains optimistic about a recovery in external demand in the manufacturing sector, which would foster employment in the provinces of Quebec and Ontario in particular.

United States: more encouraging growth in second quarter

According to a first reading of GDP in the second quarter, U.S. economic growth accelerated at an annualized pace of 2.3%. This result supports the idea that first-quarter weaknesses were primarily the result of transitory factors, including harsh weather and problems in some of the country's western ports. However, there are still some risk factors that could curtail growth, such as the lowered forecasts for world growth, the strength of the U.S. dollar, and the rather hesitant increase in wages.

The job market continues to improve in the U.S., with more than 1.2 million jobs now added in the first six months of the year and an unemployment rate at its lowest level since April 2008. Although the U.S. Federal Reserve (the Fed) recognizes the recent progress in the job market, it deems that the situation is not representative of a maximum level of unemployment, mentioning for example that wage growth remains modest. For that matter, in its July 29 press release, the Fed did not give any indication as to whether it would begin its process of raising the key policy rate after the next meeting of the Federal Open Market Committee (FOMC) on September 17, 2015.

The U.S. real estate market remains strong as existing home sales, construction housing starts and building permits were all higher than expected in June. Recent improvements in employment, low borrowing costs and a higher rate of household formation are all factors helping to stimulate demand in this sector.

Europe: tight budget restrictions in Greece

Much ink has been spilled over the Greek crisis in the last few months, until the conclusion of an agreement on July 13. This agreement entails the implementation of a new program of budget restrictions that will enable Greece to have access to financial assistance from the European Union, totaling some 86 billion euros over the next three years. In addition to the budget cuts, Greece will have to privatize some of its airports and infrastructures in order to transfer 50 billion euros of assets into an independent fund that will be used to recapitalize the country's banks and to reduce the debt. These measures are of course generating considerable political tension within the country.

Continued on last page

Economic and Financial Statistics

	As at 2015-07-31[1]	As at 2014-12-31
Canada - Unemployment rate	6.8%	6.6%
Canada - CPI (year/year variation)	1.0%	2.0%
Canada - GDP (year/year variation)	0.5%	2.3%
U.S. - Unemployment rate	5.3%	5.8%
U.S. - CPI (year/year variation)	0.1%	1.3%
U.S. - GDP (year/year variation)	2.3%	2.7%
2-year Canada Bonds	0.41%	1.01%
10-year Canada Bonds	1.44%	1.79%
Oil (West Texas) ($US)	48.5	53.8
Gold ($US)	1,094.3	1,186.3
CRB Commodities Index ($US)	202.6	230.0
Exchange rate $CA/$US	1.3089	1.1621

Source: IAIM

[1] Most recent data available at such date

Reference indexes[1] - Returns as at July 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	0.2	0.5	0.9	1.0	0.9	1.8
FTSE TMX Canada Short Term Bond Index	0.4	1.0	2.5	3.7	2.7	3.0	3.8
FTSE TMX Canada Universe Bond Index	1.4	1.1	3.8	7.1	4.0	5.3	5.2
S&P/TSX Capped Income Trusts (Total Return)	0.0	(5.3)	3.3	6.9	5.7	14.3	9.4
SB - World Government Bonds (Can. $)	5.1	5.3	8.5	10.6	6.4	5.3	3.9
INDEXES RELATED TO CANADIAN EQUITY FUNDS							
S&P/TSX 60	1.0	(3.0)	1.6	(0.6)	12.0	7.6	6.6
S&P/TSX Completion Index	(4.2)	(8.1)	(2.5)	(9.2)	7.1	6.8	5.6
S&P/TSX Composite Index	(0.3)	(4.3)	0.6	(2.9)	10.7	7.4	6.3
S&P/TSX Capped Composite Index	(0.3)	(4.3)	0.6	(2.9)	10.7	7.4	6.3
S&P/TSX SmallCap Index	(6.4)	(9.5)	(5.5)	(19.7)	1.0	1.0	1.4
INDEXES RELATED TO U.S. & INTERNATIONAL EQUITY FUNDS							
S&P 500 (Can. $)	6.8	9.2	16.2	33.2	28.4	21.9	8.4
S&P 500 (Can. $) (Reuters)	6.4	8.9	16.1	32.9	28.3	21.8	8.4
MSCI - World (Can. $)	6.5	7.4	17.5	25.7	25.0	17.2	6.9
MSCI - EAFE (Can. $)	6.8	6.2	21.1	19.5	22.7	13.3	5.7
MSCI - EAFE (Can. $) (Reuters)	6.4	6.0	21.0	19.2	22.5	13.2	5.6
MSCI - Europe (Can. $)	7.9	7.0	21.0	19.2	24.2	14.2	6.3
INDEXES RELATED TO SPECIALTY FUNDS							
MSCI - AC Asian Pacific Free (Can. $)	1.7	0.5	17.6	17.4	19.1	11.7	6.8
MSCI - Emerging Markets (Can. $)	(2.6)	(6.2)	8.0	4.2	10.3	5.8	7.6
MSCI - World Health Care (Can. $)	9.0	13.7	27.8	45.5	34.3	25.3	9.1
NASDAQ 100 (Can. $)	9.2	11.9	21.8	41.2	31.3	25.6	11.8
S&P/TSX Capped REIT Index	0.3	(5.9)	2.9	3.4	2.7	10.7	8.5

	Variation			Compound annual variation			
	1 month %	3 months %	YTD %	1 year %	3 years %	5 years %	10 years %
EXCHANGE RATE (Can. $ / US $) As at July 31, 2015: 1.3047	4.6	7.7	12.5	19.8	9.2	4.9	0.6
EXCHANGE RATE (US $ / Can. $) As at July 31, 2015: 0.7665	(4.4)	(7.1)	(11.1)	(16.5)	(8.4)	(4.6)	(0.6)

Continued from first page

World: Chinese stock market collapse continues

In July, the Chinese stock market recorded its weakest monthly performance in six years, with the Shanghai Composite Index down 14%. The index has now plunged roughly 30% since its June peak. Moreover, the government is not being shy about intervening to try to control the damage. Recent measures have including allowing hundreds of companies to suspend their stock market activities, prohibiting major company shareholders from selling their shares, and setting up a state-run fund of more than US$480 billion to bolster the market. These efforts, however, are appearing to be less effective than anticipated.

Financial markets

- Performance of the S&P/TSX Composite Index remained weak in July. The Canadian index declined 0.3% during the month, largely influenced by the materials and energy sectors, which lost 14.5% and 6.5% respectively. The total return for the Canadian market since the start of the year is 0.6%.
- The U.S. S&P 500 Index was up for the month, with a total return of 2.1% (6.8% in Canadian dollars). The sector that did the best was utilities, growing 6.0%. Given the 12.5% depreciation of the loonie against the greenback in 2015, the 3.4% total year-to-date return for the U.S. market translates into more than 16% in Canadian dollars.
- World indices MSCI - EAFE and MSCI - World were up 3.5% and 2.5% respectively (6.8% and 6.5% in Canadian dollars). Meanwhile the emerging markets, measured by the MSCI - Emerging Markets Index, were down 4.3% (-2.6% in Canadian dollars). For the year to date, total returns for the MSCI - EAFE, MSCI - World and MSCI - Emerging Markets are respectively, in local currency, 12.6%, 6.7% and 1.3% (21.1%, 17.5% and 8.0% in Canadian dollars).
- The Canadian bond market, measured by the FTSE TMX Canada Universe Bond Index, shed 1.4% in July. The return for the year to date is 3.8%.

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