The year kicked off with an upswing in the markets driven by a return to synchronized growth in the United States and globally. Encouragingly, that trend continued in the first quarter. In the U.S, key indicators such as the unemployment level, the pace of job creation and wage and manufacturing data have been sound.

Similarly, throughout most of the developed world, purchasing manager indices (PMIs—a leading economic indicator¬—were positive. Here in Canada, the economy put on an impressive display in the first quarter, growing at an annual rate of 3.7 per cent—easily the best in the G7.

Alternative facts

Despite these positive signs, there is evidence that investor expectations have got out ahead of the fundamentals. For example, the widespread optimism that President Trump would stimulate the economy with a raft of reflationary and pro-business policies is starting to fade. The pace of implementation has been torpid, and the sustainability of the scandal-plagued Trump administration is increasingly a concern.

Across the Atlantic, the European Union dodged political calamity in May with the election of a pro-euro moderate, Emmanuel Macron, to the presidency in France. The nationalist movement remains an existential threat to EU, though public support for the movement appears to be ebbing. All eyes now are on Germany, where the next federal election will take place on September 24, 2017.

U.S. market rally

Donald Trump's rallying cry during the presidential campaign was that he would "make America great again." While he didn't win the popular vote, the majority of investors appear to have believed in him. Since the November 2016 election, U.S. equity markets have been on a tear, with the S&P 500 climbing 5.5 percent during the president's first 100 days in office.

However, just as President Trump often says one thing and means another, the long-term viability of the current bull market is questionable. Many market observers believe U.S. equities are significantly overbought and, therefore, highly susceptible to threats such as the Federal Reserve raising interest rates or the Chinese economy slowing down.

Canadian outlook

The S&P/TSX Composite returned more than 35% between the low on January 20, 2016 and the high on February 13, 2017. In Q1, it stayed in the black, but managed a gain of just 1.7%. Not surprisingly, following it's remarkable 2016 performance, the market is taking a bit of a breather. What happens next is a guessing game, but one factor to keep an eye on is business spending.

For the past several years, consumer spending—with spending on housing being a major component—has been the main driver of Canada's economic growth. This can't continue for too much longer. Debt-to-disposable income levels are already edging up to a record high of 170%. That translates to almost $1.70 in credit market debt for every dollar of adjusted household disposable income. Business spending will need to pick up soon to keep the economy's momentum on track.

Summary

Generally, equities have climbed since late 2016 on the expectation of reflation. The main drivers of this expectation have been the promise pro-business legislation in the U.S. (stimulus spending and lower taxes) and the anticipation of continued growth in the global economy. In the months ahead, two key factors that bear watching are the ability of President Trump to deliver on his economic agenda and the outcome of the German election in Q3.

Both are ticking time bombs. Perhaps neither will go off, but each has the potential on its own to create a new round of market volatility.

Getting Advice

Are you looking for additional perspective on the financial markets and how it might affect your portfolio? We encourage you to talk to us.

Speak to your Financial Advisor or contact investor services at 1 800 608 7707.