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This is what it sounds like when doves cry

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Markets roared back in January from December's steep sell-off. The S&P/TSX Composite Index was up 8.7% – it's best month in a decade. In the U.S., the S&P 500 Index had its best January performance in over 30 years. International equities also surged and the "risk-on" sentiment echoed across other asset classes, such as corporate bonds. This is hardly the outcome one would expect to go along with mixed corporate earnings and growing evidence of a slowdown in global economies. If underlying fundamentals haven't changed, then what gives? The answer is, once again, a dovish pivot by the U.S. Federal Reserve (Fed). The Fed's recent statement has effectively put a floor on asset prices by implying that if things get more challenging, it will provide a bailout by lowering interest rates and adding money supply, a "Fed put," so to speak.

It came as no surprise that the Fed chose to hold rates steady, but officials went a few steps further. The January statement removed the reference to further gradual increases in the Fed funds rate. Instead, policymakers are now maintaining that they will be patient in assessing the need for future adjustments and are agnostic about the direction of potential moves. Perhaps even more surprisingly, the notes on policy implementation state that officials are now prepared to adjust the plans for completing the balance sheet normalization process (quantitative tightening, QT). The central bank is reconsidering how far it must let its bond holdings unwind, and it is leaning toward ending that so-called QT sooner than it thought. Keep in mind, the Fed balance sheet is still US$3 trillion larger than when it started. We would imagine the Fed is closer to the start of the unwind than to the end. While the Fed funds rate influences shorter-term yields, QT impacts longer term rates the most.

The shift in tone can be compared with December 2018, when the Fed indicated a bias to tighten further and referred to its balance sheet reduction (QT) as being on autopilot. Both equity and fixed-income markets liked the Fed's surprisingly dovish stance on rates. Bonds had good returns due to compressing yields. A pause in rates was also good news for stocks, which rallied on price/earnings expansion. In a press conference, Fed Chairman Jerome Powell also said that the current policy was in a neutral range, another change from the Chairman's view last year. We will leave the discussion on neutral rates for another edition of Portfolio Construction.

The latest communications from the Bank of Canada (BoC) also suggest that it has a somewhat more sanguine view of the world. Overall, it appears that while the BoC adopted a more dovish tone recently, it is still expecting that the next rate move will be a hike. Regardless, the BoC will likely not raise rates materially if the Fed remains on hold. The Canadian dollar had already increased by 3.8% during January.

We tactically position our portfolios based on short-term elements in the markets. The recent changes in central banks' policy are an important catalyst. There is no denying the risk of persistent drawdown is low in the near term given central banks' propensity to react to any downturn. This is a significant shift from a year ago when the BoC and Fed were keen on hiking rates back to normal. We were concerned the hikes would eventually cause recession (like they did in previous cycles) and positioned our portfolios defensively for most of 2018. There is no doubt global economies are now in the late cycle and investors should exercise normal caution. However, central banks are trying hard to prolong this cycle and with this strong backing, we believe equity should perform well. The U.S. dollar may have to give, as a result of lower interest rate expectations. We have made a few changes in the portfolios to capture more upside:

1. We have removed the long put option program as it will be redundant with the Fed put
2. We are adding equity exposure via the income allocation and equity allocation mandates
3. We are adding exposure to emerging markets which should benefit from a weaker U.S. dollar.

Combined top 15 equity holdings as of January 31, 2019 of a representative balanced Private Client Managed Portfolio with alpha-style equity exposure:*

1. Atco	6. AT&T	11. HeidelbergCement
2. Canadian Utilities	7. E-L Financial	12. Suncor Energy
3. Loblaw Companies	8. Power Financial	13. Bank of Nova Scotia
4. Enbridge	9. AltaGas	14. ASM International
5. IA Financial Group	10. CIBC	15. Canadian Natural Resources

Combined top 15 equity holdings as of January 31, 2019 of a representative balanced Private Client Managed Portfolio with value-style equity exposure:*

1. Alimentation Couche-Tard	6. Bank of Nova Scotia	11. Parker Hannifin
2. Toronto-Dominion Bank	7. S&P Global	12. Gilead Sciences
3. Royal Bank of Canada	8. Brookfield Property Partners	13. TMX Group
4. Dollarama	9. Apple	14. Chubb
5. Brookfield Asset Management	10. Magna International	15. CGI Group

Combined top 15 equity holdings as of January 31, 2019 of a representative balanced Private Client Managed Portfolio with growth-style equity exposure:*

1. CSX	6. Canadian Pacific Railway	11. Finning Tractor & Equipment
2. Keyera	7. Linde	12. Gilead Sciences
3. Tourmaline Oil	8. Emera	13. Anthem
4. George Weston	9. Athene Holding	14. Activision Blizzard
5. Jacobs Engineering Group	10. Magna International	15. Franco-Nevada

*Approximately 33% fixed-income, 10% enhanced income, 49% equities, and 7% global real estate.

To see the top 15 holdings of the individual pools or the equity alpha mandates, please contact your Stonegate advisor.