THE MONTHLY MORTGAGE COMMENTARY

Debt & Structured Finance | Canada Research

JUNE 2019

CLASHING SIGNALS

For the fourth time in less than two years, the S&P 500 index surged and recorded another record high. While traditionally viewed as a positive indicator for the economy, this latest stock market rally occurred in an environment where investors are near peak levels of pessimism and the bond market is flashing dire warnings of the future. There is a fundamental dichotomy between the current signals from the equity and bond markets, meaning a continued rally in both assets is unsustainable in the long run as only one can ultimately be correct, to the detriment of the other.

In the bond market, long-term yields continue to compress as investors seek safe harbour amid escalating global trade tensions. At the same time, an inverted yield curve stokes recession fears and dovish central banks corroborate low inflation and slow growth expectations. The U.S. 10-Year Treasury yield, in particular, sank below 2.0% for the first time since November 2016, a stark reversal from just seven months ago when those yields were as high as 3.2%.

Meanwhile, equity investors are adamant that a recession has been avoided given expectations for an interest rate cut that would alleviate inversion concerns and extend this record-long expansion. In fact, some investment strategists are insisting that fears of a looming recession are exaggerated and cite metrics such as healthy market breadth, safe earnings growth and acceptable spreads for junk-rated bonds that support a continued bull run.

No matter which camp emerges victorious, volatility can be expected as the opposing side corrects. In the near term, pivotal events include the outcome of U.S.-China trade talks to take place at the upcoming G20 summit as well as central bank interest rate movements. Investors are currently pricing in a 25 bps cut by the Federal Reserve next month with as many as two more before the end of the year. For the Bank of Canada, investors expect the central bank to follow suit with an interest rate cut in late 2019 or early 2020.

For investors looking to navigate financial market volatility in a low yield environment, commercial real estate remains an attractive alternative. Canadian industrial and residential assets recorded respective annual total returns of 14.9% and 11.8% according to MSCI Realpac's latest Canada Property Index results. In the office market, Vancouver ranked among the top ten worldwide for the highest prime rent growth for two years running. The recent drop in long-term bond yields also buoys real estate returns. At some point, however, interest rate floors or rising spreads may creep into effect given declining overall yields for lenders.

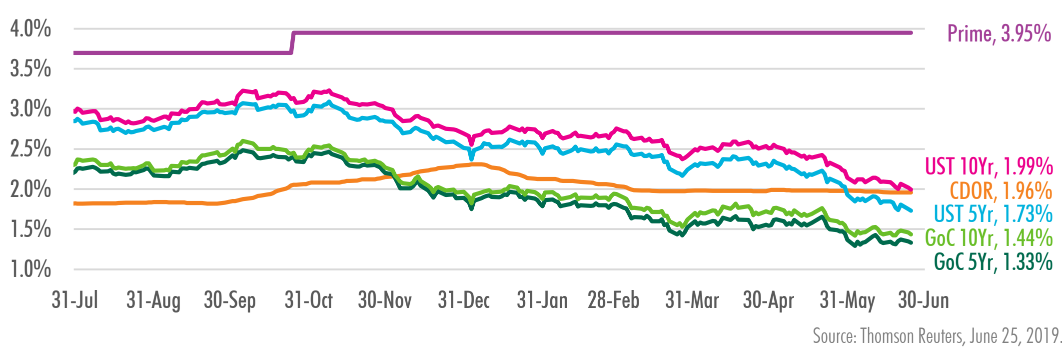
Key Indicator	Current	30 Days
5Yr Mortgage Spread	1.55-2.10%	
10Yr Mortgage Spread	1.70-2.30%	
5Yr CMB Spread	31 bps	-3 bps
10Yr CMB Spread	41 bps	-2 bps
USD/CAD	$0.7594	2.07%
WTI Crude	US$57.83	-1.36%
S&P/TSX REIT Index	187.65	0.14%

Source: Thomson Reuters, June 25, 2019.

Economic Highlights:

- Employment grew by 27,700 new jobs in May 2019 and drove the unemployment rate to a new record low of 5.4%.
- Retail sales increased by 0.1% in April 2019, marking the third consecutive month of growth.
- Inflation rose to 2.4% in May 2019, the highest level in seven months.

Benchmark Yields



Source: Thomson Reuters, June 25, 2019.

ViewPoints:

- Fed Loses Its Patience And Almost Everything You Can Trade Goes Nuts
- Strategists Say You're Overthinking Threats To The Bull Market
- Vancouver Office Cost Escalation Among World's Highest: CBRE
- China's Treasuries Holdings Drop As Trade War Heightens Focus

Contact

MARC MEEHAN
Director, Canada Research
+1 647 943 4205
marc.meehan@cbre.com

EVAN LEE
Research Manager, Canada Research
+1 647 943 3654
evan.lee@cbre.com

To learn more about CBRE Research, or to access additional research reports, visit the Global Research Gateway at *www.cbre.com/research-and-reports*