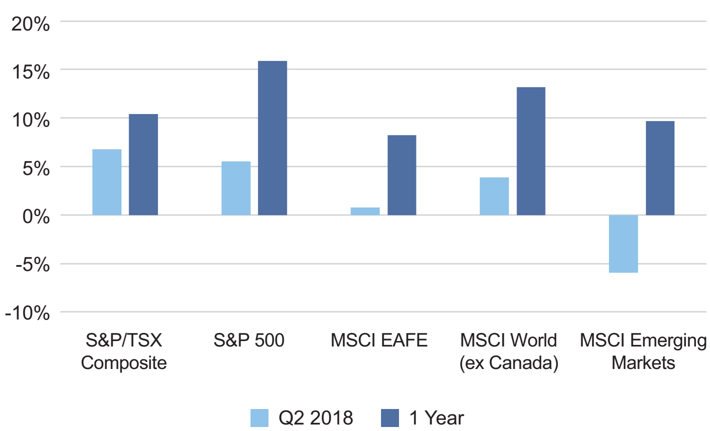
Overall world economic growth in the quarter appears to have slowly decelerated after two consecutive quarters of 3.5% annualized growth. This deceleration seems to have bypassed the U.S. economy, which was bolstered by tax cuts, increased fiscal spending, and a tightening labour market. U.S. President Donald Trump's current and forthcoming trade tariffs have significantly added further downside risks to global growth.

Global equity markets have moved trade wars to the top of their analytical agendas. Canada and Mexico are threatened by the slow progress of North American Free Trade Agreement (NAFTA) negotiations and by Mr. Trump's recent statement that he will delay a decision on NAFTA until after the November 2018 U.S. mid-term elections. Further clouding the issue is the uncertainty of the NAFTA stance of Mexico's new government, due to be elected on July 1, 2018.

No country wins a trade war, so hopefully some semblance of reason will come into play and at the very least produce some softening in Mr. Trump's ill-advised draconian trade policies. Interestingly, Mr. Trump may be using trade as an election weapon just as George W. Bush did in his first presidential term when he reversed his tariff policy after the mid-term elections.

Equity Index Performance (CAD)
at June 30, 2018



Source: TD Securities, MSCI

Global bond markets endured bouts of volatility in the quarter due to a number of factors: accelerating U.S. growth and the slowing of economic expansion elsewhere; increasing trade war threats, especially between U.S. and China; and a populist coalition government in Italy. However, overall inflation expectations are the longer-term valuation metric for bond yields and prices. These expectations are seen as rising slowly over time.

From a monetarist's perspective, the past massive quantitative easing (QE) of world central banks should eventually put upward pressure on inflation. Sustained trade wars can also be a contributing factor to inflation. Nevertheless, prices for commodities other than oil have recently flattened, and long-term bond yields have decreased, factors which generally do not point to large increases in inflation expectations.

Given the rise in oil prices due to the reimposition of U.S. sanctions on Iran and production problems in Libya, Venezuela, and elsewhere, higher oil prices can reduce consumption, which in turn reduces upward pressure on inflation. In addition, longer-term debt deflation will continue to act as a depressant to the overall inflation picture despite near term inflation risks.

Canada

After a slowdown in the first quarter of 2018 due to slower consumer spending and the impact of the new mortgage lending rules on housing investment, the Canadian economy showed some resilience in the second quarter. Consumer spending increased despite higher consumer loan interest rates as tighter labour markets and rising wages acted as an offset. Headline inflation remained above 2% and is expected to rise slowly.

Increased government spending and stronger oil and gas exports should lend a helping hand in sustaining real Canadian GDP growth of slightly over 2%. Risks to this forecast continue as NAFTA negotiations face delays and as the housing market remains fragile despite some price stabilization. The U.S.'s imposition of steel and aluminium tariffs on Canadian imports and Canada's retaliation, despite its trivial dollar value, could be a possible signal that the U.S. intends to put additional tariffs on Canadian automotive and agricultural exports.

U.S.

Unlike many other developed economies, the U.S. economic expansion did not slow in the quarter. However, continuing positive economic data was balanced by moves from the Trump administration to escalate trade war fears, especially against China. Despite signing a somewhat superfluous and mistrusted nuclear disarmament document with North Korea, President Trump withdrew from the Iran nuclear accord. This withdrawal was one factor causing the oil price increases during the quarter. Given the relative strength of the U.S. economy and some pick-up in inflation, the U.S. Federal Reserve (the Fed) is expected to continue with its rate increases, potentially making another three moves in 2018. These actions are weighing on longer-term growth expectations.

Europe

Europe is plagued with political crises in Italy and Spain, and continued disunity concerning migration policies on top of a potentially escalating trade war with the U.S. Additionally, the European Central Bank's (ECB) plan to end its QE program fogs the economic outlook.

In the U.K., Brexit negotiations continue to have a dampening effect on business and consumer confidence, inhibiting planned investment spending. The U.K. economy has picked up a modicum of momentum after a weak first quarter, but future economic growth prospects are subject to debate. Relatively accommodative monetary and fiscal policy may provide a partial offset to the Brexit angst.

Japan

Japan continues to suffer from weak economic growth and a lack of overall inflation despite continued QE by the Bank of Japan and massive government spending for the 2020 Tokyo Olympics. Consumer confidence remains depressed due to the lack of real wage growth. U.S. tariffs on Japanese steel and aluminium, and the potential for a peak in the technology cycle, pose a threat to Japan's external trade sector. Japan's plans to achieve a primary budget balance by 2020 were pushed back to 2025, further impacting the country's internal debt imbalance.

Emerging Markets

Emerging market economies and stock markets also faced the headwinds of global liquidity tightening, trade tensions, escalating interest rates, and a strengthening U.S. dollar, which adds to the problem of servicing dollar-denominated external debt. Many emerging market economies appear to be in an earlier stage of their economic cycles than developed economies, so several central banks have not yet tightened liquidity. These counter-trend monetary policies should, from a longer-term perspective, offer attractive emerging market investment opportunities.