National Association of Federal Retirees

Association nationale des retraités fédéraux

Winds of Change 2016 - 2017

The Canadian Pension Landscape

Teaser : Introduction and International Economic Landscape

this is an excerpt of the full document

Introduction

In Winds of Change 2015-2016, we suggested that the past year had been one of status quo - that, while there were some political changes, things were relatively stable. That was not the case in 2016-2017. It has been a very busy year for public markets, private pension plan agreements and pension plan legislation.

Markets crashed and rushed back up and crashed again (over and over). The British exit from the EU sent markets tumbling while an unpredictable U.S. presidential election lead to an even more unpredictable president whose late-night comments on Twitter can send stocks soaring or plummeting. OPEC considered cutting production, leading the price of oil to dip and rise. In response, pension plans had large losses, then large gains and in some cases large losses again.

As market uncertainty increased, corporations continued to push for more certainty on their bottom lines. Defined contribution plans (DCs) continued to take the place of defined benefit plans (DBs). The big three automakers convinced their employees to move to a DC plan, and Canada Post almost locked out their employees to try do the same, unsuccessfully. This environment is also making target benefit plans attractive.

For its part, the Canadian government rolled out two pieces of legislation that made waves in the pension world: they would expand the Canada Pension Plan (Bill C-26) and would provide the framework to enable the creation of target benefit plans (and the “surrender” of accrued defined benefits) for Crown corporations and federally-regulated employers (Bill C-27).

The following pages will dive into these changes, enabling you to gain an understanding of where we’ve been over the past year, and the changes likely to come over the next.

Economic Landscape

International Markets

Last year was a tumultuous for international markets—high anxiety and uncertainty were the name of the game. Stock markets had their worst start to a year – ever. January was disastrous; stock markets lost more than $4 trillion (U.S.) in value, and bond markets were unstable because central banks sold reserves to support their currencies while investors rushed in for safety. The Shanghai Composite Index was one of the worst hit on January 26, 2016. Amid fears of China's economic slowdown, it reached its lowest level since December 2014 – the largest one-day loss in 8 years.

Japan delivered one of the biggest shocks to the market when it announced a negative interest rate policy[1] on January 29, 2016. Yields on Japanese government 10-year bond yields hit zero in February, then hit -0.05% by the end of the month. Investors dumped shares of banks and Japanese investors fled to U.K./U.S. debt. Germany then followed suit in June 2016, with the 10-year bond yield being sold at a negative. Switzerland's bond market briefly traded below zero as well. Altogether market interest rates tumbled. Global negative yielding debt grew to $13.4-trillion (U.S.).

Great Britain voted to leave the European Union on June 23, 2016 – 51.89% voted in favor of Brexit. The pound sterling immediately took a sharp decline, dropping from nearly US$1.50 to under US$1.30 in a matter of days (an 11% drop the night of the referendum itself). (Wall Street Journal, 2016) $3-trillion was lost in global stocks in the two days following the vote. 10-year yield gilts (UK government bonds) dropped from just under 2% in January to below 1%. As of January 2017, the pound has yet to recover, hovering between $1.20 USD and $1.26 USD.

[1] Central banks pay banks interest on the funds they park with the central body. With negative interest rates, banks are required to pay the central bank to hold their deposits. While these measures can impact bank profitability (which can trickle down to the consumer level), the strategy is supposed to make it more expensive for banks to sit on their cash and instead encourages them lend or invest, thereby stimulating the economy.

From the end of June 2016, the S&P 500, which had also been hit by the Brexit news, recovered significantly, hitting a series of record of highs. Some improvements in U.S. economic data helped Wall Street – until the U.S. election really hit its stride. By August markets would swing wildly until a significant drop the night Donald Trump was elected president.

Then markets shifted – again. Investors seemed to like the idea of a Republican-controlled Congress that would implement fiscal stimulus and tax cuts, and would roll back regulations on U.S. business. The Dow Jones Industrial Average Index inched over 20,000 points for the first time ever. Bond yields in the U.S. and Canada shot up (though not as significantly in Canada). Financial analysts began talking about "Trumpflation", speculation that President Trump would spur on inflation in the U.S. dollar, adding $6-trillion in deficits in the coming decade.

Throughout all of this, while uncertainty was high, volatility[2] was at historic lows. The CBOE Market Volatility Index (VIX) measures fear in the market, and it has been at an extremely subdued level for months.[3] That being said, January 2017 saw an uptick in the VIX as protectionist trade policies and restrictions on travel into the U.S. have dominated President Trump's early days. (Moore, 2017) If this is the case, and uncertainty and volatility increase, pension plans should expect a decrease in returns. Denise Kehler of Willis Towers Watson said, "[…] the strength we've been seeing for a very long time is coming to a close. […] Overall, we think this is the most unstable that we've seen the economy for some time."

[2] Volatility refers to the amount of uncertainty or risk about the size of changes in securities' values. High volatility means the price of the stock changes dramatically over a short time.

[3] This has led to some confusion, but uncertainty or instability don't always necessarily translate into volatility. The VIX is more of a coincident indicator than a leading indicator; in other words, VIX is more like a picture of the market, than a predictive measure.

Works Cited

Moore, E. (2017, January 31). *Investors cool on Trumpflation after US travel ban*. Retrieved from Financial Times: https://www.ft.com/content/b6fc266e-e710-11e6-967b-c88452263daf

Wall Street Journal. (2016). Retrieved from http://www.vis-am.ch/uploads/allegati/The_big_events_that_shook_financial_markets_in_2016.pdf