Weekly Commentary – December 18, 2017

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Best of the season and a happy new year to all of our readers. Our next edition will be dated January 8, 2018.

Economic Calendar

Date	Release	Period	Consensus	Previous
U.S.				
December 18	NAHB Housing Market Index	December 17	64.29	70.00
December 21	GDP Growth Rate Q/Q Final	Q3 17	3.3%	3.1%
December 21	Corporate Profits Q/Q Final	Q3 17	5.8%	0.1%
December 22	Durable Goods Orders	November 17	0.27%	-1.20%
Canada				
December 18	Foreign Securities Purchases	October 17	$15.90B	$16.81B
December 21	Inflation Rate Y/Y	November 17	1.7%	1.4%

Key Earnings:
December 18: Acorn International Inc., Barnwell Industries Inc., HEICO Corp., Lennar Corp.
December 19: China HGS Real Estate Inc., FedEx Corp., Micron Technology Inc., ReneSola Ltd.
December 20: Bioanalytical Systems Inc., Cintas Corp., General Mills Inc., WSI Industries Inc.
December 21: Accenture PLC, Carmax Inc., Hovnanian Enterprises Inc., Nike Inc., Paychex Inc.

Source: Trading Economics, Yahoo Finance

Market Focus

Loonie sees selling pressure

While it came as no surprise to the financial markets, the move by the U.S. Federal Reserve to hike interest rates refocused attention on the widening divide between U.S. and Canadian monetary policy. The addition of 25 basis points (a basis point is 1/100th of one per cent) to the federal funds rate at the December meeting brings the total to 125 since the end of the global financial crisis in 2008-09. Conversely, over the same period, the Bank of Canada raised rates three times in 2010, cut rates twice in 2015 and tightened twice in 2017. The net effect has been 75 basis points of tightening. Not surprisingly, as the bank has stated that its approach going forward will be cautious, the Canadian dollar has come under selling pressure. The loonie, which traded as high as US$0.825 in early September, has fallen nearly five cents to break below US$0.776 on December 12. With the U.S. forecast to outperform the domestic economy and a greater tightening bias stateside, a material strengthening of the Canadian dollar appears unlikely at this juncture.

U.S. Federal Reserve hikes rates again

For the third time in 2017 and for a fifth time since the end of the financial crisis, the U.S. Federal Reserve Board raised administered interest rates at the conclusion of its two-day policy meeting. The mid-point range for federal funds now stands at 1.375%. While this is the highest rate since October 28, 2008, it remains well below the previous cyclical peak of 5.25%. Coinciding with the announcement, the Fed released its updated economic forecast. Projections for U.S. economic growth have been revised higher with GDP growth expected to be 2.5% for 2017, 2.5% in 2018, 2.1% in 2019 and 2% in 2020. 2018 saw the largest upward revision (+0.4%) while other years were +0.1% or 0.2%. More importantly for the financial markets, the Fed is projecting three further interest rate hikes in 2018.

U.K. inflation ticks higher

The U.K. Office for National Statistics announced that the consumer price index rose 3.1% year-over-year in November, up from the 3% level seen in October and is the fastest inflation pace since March 2012. Most of the gain was attributed to rising prices of transport, leisure activities, and restaurants and hotels. Governor of the Bank of England Mark Carney will have to write a letter to Philip Hammond, Chancellor of the Exchequer, explaining how the bank intends to bring inflation back to its 2% target. Current policy dictates that the governor write a letter to the chancellor if inflation is above 3% or below 1%. The last time this occurred was in December 2016, after inflation fell to 0.9% (October data). Even though the bank hiked administered interest rates in November, it decided to hold off at the December meeting. Still, the bank did state that higher rates would be needed over the next few years, in order to return inflation to its target.

Longer View

Following several years of a general expansion in the price-earnings ratio of equities, we believe returns from this asset class will moderate somewhat and become more closely tied to the rate of growth in company earnings. With equity market volatility increasing to at least the normal range, it's important to keep in mind that equities are best suited for long-term investing, and that the allocation in your portfolio should reflect your investment horizon and risk tolerance. Fixed-income investments, while generally providing limited income in today's low interest rate world, are an effective diversifier in a portfolio. When there is extreme pessimism in the equity market, fixed-income tends to outperform. There is no one asset class that looks better than others, in our view, as their current valuations accurately reflect their potential and risk. Talk to your professional advisor to ensure your portfolio is optimized and continues to meet your needs.

Weekly Summary

December 12

▲ The U.K. Office for National Statistics announced that the consumer price index rose 3.1% year-over-year in November. This is up from the 3% level seen in October and is the fastest inflation pace since March 2012. Most of the gain was attributed to rising prices of transport, leisure activities, and restaurants and hotels. These results were above expectations for there was no change in the annual rate. These figures pose a heightened dilemma for the Bank of England as the nation faces increased inflationary pressures at a time when economic growth appears to be relatively soft.

▲ The U.S. Bureau of Labor Statistics reported that its Producer Price Index – Final Demand (PPI-FD) increased 0.4% (seasonally adjusted) in November. The index increased 3.1% for the 12 months ended November 2017, the largest year-over-year advance since an identical 3.1% rise in January 2012. These figures are above consensus expectations. The PPI data are closely watched as they indicate relative inflationary pressures at the industry level.

December 13

▲ The U.S. Bureau of Labor Statistics announced that the consumer price index rose 0.4% (seasonally adjusted basis) in November. Over the last 12 months, the index increased 2.2%. During the month, the energy sub-index rose 3.9%, driven by a 7.3% jump in gasoline prices. The gain in energy accounted for about three-fourths of the all-items increase. The overall results matched consensus estimates. These figures are consistent with the U.S. Federal Reserve's expectations of somewhat greater inflationary pressures since mid-year.

▲ The U.S. Federal Reserve raised interest rates following its latest two-day policy meeting, with the target range for the federal funds rate now set at 1.25% to 1.5%. The statement highlighted continued strength in the labour market and broader economy despite "hurricane-related fluctuations." The text of the release continued to contain the phrase "economic conditions will evolve in a manner that will warrant gradual increases in the federal funds rate." The policy shift was widely anticipated and is in line with expectations. Monetary policy, as decided by the Fed, has a significant influence on both the U.S. and global economy. Its lead is often followed by policymakers in other countries.

December 14

■ The Bank of England kept its benchmark bank rate at 0.5% following its latest policy announcement window. This follows the 25-basis point hike at the previous meeting. Policymakers reiterated that further modest increases in interest rates are likely to be needed over the next few years in order to return inflation to their target. The bank also announced that it was maintaining the stock of U.K. government bond purchases at £435 billion. These monetary policy results were widely anticipated.

▼ The U.S. Department of Labor announced that initial jobless claims totalled 225,000 (seasonally adjusted) in the week ending December 9, a decrease of 11,000 from the previous week's unrevised level of 236,000. The four-week moving average was 234,750, a decrease of 6,750 from the previous week's unrevised average of 241,500. These results are stronger than consensus estimates.

▲ The U.S. Census Bureau announced that retail and food services sales were up 0.8% (seasonally adjusted) in November and were 5.8% above November 2016 levels. In addition, the sales gain for October was revised higher to 0.5% from 0.2%. Excluding autos, sales were up 1% during November and up 5.7% on a year-over-year basis. These figures are considerably stronger than expected. Since consumer spending accounts for roughly two-thirds of U.S. economic activity, it is critical to overall GDP results.

▲ Statistics Canada announced that its New Housing Price Index (NHPI) rose 0.1% in October, following a 0.2% increase in September. On a year-over-year basis, the index is up 3.5%. Once again, considerable regional disparity was seen in the underlying data. However, the overall results are in line with consensus expectations and suggest continued modest improvements in net worth for homeowners.

▲ The U.S. Census Bureau announced that business sales rose 0.6% in October and were up 6.5% from October 2016 levels. At the same time, inventories slipped 0.1% but were up 3.5% on a year-over-year basis. As a result, the total business inventories/sales ratio at the end of October was 1.35. The October 2016 ratio was 1.39. These results matched consensus expectations. Strong business sales suggest stable economic growth while diminishing inventories/sales ratios suggest a business need to replenish dwindling stockpiles.