Weekly Commentary – November 20, 2017

Alfred Lam, MBA, CFA
Senior Vice-President & Chief Investment Officer

Richard J. Wylie, MA, CFA
Vice-President, Investment Strategy

Economic Calendar

Date	Release	Period	Consensus	Previous
U.S.				
November 21	Existing Home Sales	October 17	5.36 M	5.39 M
November 22	Durable Goods Orders	October 17	-0.22%	2.20%
November 24	Markit Manufacturing PMI Flash	November 17	53.5	54.6
November 24	Markit Services PMI Flash	November 17	54.5	55.3
Canada				
November 23	Retail Sales Y/Y	September 17	6.3%	6.9%

Key Earnings:
November 20: Digital Power Corp., Micronet Enertec Technologies Inc.
November 21: Campbell Soup Co., Lowe's Companies Inc., Salesforce.com Inc.
November 22: Deere & Co., Ship Finance International Ltd.
November 23: North Atlantic Drilling Ltd., Seadrill Ltd.
November 24: AllianceBerstein Global High Income Fund Inc.

Source: Trading Economics, Yahoo Finance

Market Focus

Canadian manufacturing challenges remain

Statistics Canada announced that manufacturing sales advanced 0.5% in September, led by a dramatic 10.3% jump in petroleum and coal products. The broader monthly gain follows a downwardly revised 1.4% improvement in August. However, despite the back-to-back gains, the third quarter as a whole revealed an 8.1% (annualized) decline in manufacturing output, the weakest since the first quarter of 2015. Still, recent jobs data have been encouraging, with manufacturing employment up 3% (year-over-year) in October. Yet despite these gains, overall manufacturing employment continues to run 25.3% below the pre-recession peak recorded in September 2002. At that time, manufacturing employment represented 15.1% of all Canadian jobs. In the October data, that figure was down to 9.4%. The U.S. displays a similar pattern with manufacturing employment slipping from 11.6% to 8.5% of total employment over the same period.

U.S. consumer spending follows through

Updated figures from the U.S. Census Bureau revealed a 0.2% gain in retail and food services sales during October. The increase came in the wake of an upwardly revised 1.9% advance (originally reported as 1.6%) in September. The September surge, reflecting the purchase of replacement vehicles and rebuilding efforts in the wake of the hurricanes, was not expected to continue into the fourth quarter. Core retail sales (excludes automobiles, gasoline, building materials and food services) rose 0.3% in October after gaining 0.5% in September. Going forward, the continued strength of the U.S. labour market is expected to fuel more stable monthly growth in consumer spending.

Japanese economy gains ground

Japan's statistics bureau reported that real GDP expanded 1.4% (annualized) in the third quarter. This was down from the 2.6% rate recorded in the second quarter, but did extend the current expansion to seven consecutive quarters. This is the longest stretch since an eight-quarter run from April-June 1999 to January-March 2001. The economy expanded despite a 0.5% (quarter-over-quarter) dip in consumer spending, as trade provided an offsetting boost amounting to a 0.5% contribution to total growth.

Despite the steady growth, the Bank of Japan is not expected to alter policy as core inflation remains subdued at a 0.7% year-over-year rate.

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

November 14

▲ Germany's federal statistical office announced that real GDP grew 0.8% (quarter-over-quarter) in the third quarter of 2017. This is the "flash estimate" prepared with preliminary data and is often subject to substantial revision. In the second quarter, real GDP increased 0.6% on the same basis. Personal consumption and government expenditure remained relatively stable. However, fixed capital formation and international trade showed signs of strengthening. These results are stronger than expected as the market was looking for third quarter growth to match the second quarter pace. GDP is the broadest measure of aggregate economic activity and encompasses every sector of the economy.

▲ The U.S. Bureau of Labor Statistics reported that its Producer Price Index – Final Demand (PPI-FD) increased 0.4% (seasonally adjusted) in October. The index increased 2.8% for the 12 months ended October 2017, the largest rise since a matching advance of 2.8% for the 12 months ended February 2012. These figures are above consensus expectations. The PPI data are closely watched as they indicate relative inflationary pressures at the industry level.

November 15

▼ The U.K. Office for National Statistics announced that 14,000 jobs were lost in the three-month period that ended in September, and the unemployment rate remained steady at 4.3%, its lowest level since 1975. Employment was up 279,000 on a year-over-year basis, while the unemployment rate was down from 4.8% on the same basis. These results are in line with market consensus. The employment data reflects the strength of the broader economy and individual sectors. As well, it is indicative of consumer spending trends.

▲ Japan's statistics bureau reported that real GDP expanded 1.4% (annualized) in the third quarter, down from the 2.6% rate recorded in the second quarter. However, this did extend the current expansion to seven consecutive quarters, the longest stretch since an eight-quarter run from April-June 1999 to January-March 2001. The economy expanded despite a dip in consumer spending, as trade provided an offsetting boost. These results are somewhat stronger than market expectations. GDP is the broadest measure of aggregate economic activity and encompasses every sector of the economy.

▲ The U.S. Census Bureau announced that retail and food services sales were up 0.2% (seasonally adjusted) for the month of October and were 4.5% above October 2016 levels. Excluding autos, sales were up 0.1% during the month and up 4.3% on a year-over-year basis. These figures are marginally stronger than expected. Since consumer spending accounts for roughly two-thirds of U.S. economic activity, it is critical to overall GDP results.

▲ The U.S. Bureau of Labor Statistics reported that the consumer price index increased 0.1% (seasonally adjusted basis) in October. Over the last 12 months, the index increased 2%. These results matched market expectations. These figures are consistent with the U.S. Federal Reserve's expectations of neutral inflationary pressures.

▲ The U.S. Census Bureau announced that business sales rose 1.4% in September and were up 6.4% from September 2016 levels. At the same time, inventories were largely unchanged during the month, but were up 3.5% on a year-over-year basis. As a result, the total business inventories/sales ratio at the end of September was 1.36. The September 2016 ratio was 1.40. These results were slightly stronger than consensus expectations. Strong business sales suggest stable economic growth, while diminishing inventories/sales ratios suggest a business need to replenish dwindling stockpiles.

November 16

▲ The U.K.'s national statistics office reported that retail sales rebounded in October, rising 0.3% following September's downwardly revised 0.7% decline (originally reported as -0.6%). However, on a year-over-year basis sales growth turned negative dropping 0.3%, the first decline on this basis since March 2013. Despite the annual decline, these results are above consensus estimates.

▲ The U.S. Department of Labor announced that initial jobless claims totalled 249,000 (seasonally adjusted) in the week ending November 11, an increase of 10,000 from the previous week's unrevised level of 239,000. The four-week moving average was 237,750, an increase of 6,500 from the previous week's unrevised average of 231,250. These results are weaker than consensus estimates.

▲ The Federal Reserve Bank of Philadelphia reported that manufacturing activity in the region continued to grow in November, but at a less robust pace. The Philly Fed general business conditions index eased to 22.7 from 27.9 in October. These results are below market expectations. This data release is followed as an indicator of broader manufacturing sector trends.

▲ Statistics Canada reported that manufacturing sales rose 0.5% to $53.7 billion in September. The gain was mainly attributed to higher sales in the petroleum and coal product industries. On a year-over-year basis, manufacturing sales rose 4.6%. These results are stronger than market consensus. This data is closely watched as it can create high-value employment and remains one of the slowest to recover from the 2008-09 recession.

▲ Statistics Canada announced that foreign investors acquired $16.8 billion of Canadian securities in September, following the acquisition of $9.8 billion in the previous month. Canadian investors increased their holdings of foreign securities by $2.4 billion in September, following $12.1 billion in August. The foreign acquisition of Canadian securities was well above expectations. Foreign investment flows can significantly influence the relative strength of the Canadian dollar.

▲ The U.S. Federal Reserve announced that industrial production expanded 0.9% in October after gaining an upwardly revised 0.4% (originally reported as 0.3%) in September. On a year-over-year basis, industrial production was reported to have gained 2.9%. Capacity utilization for total industry rose to 77% from 76.4% in September and 75.7% a year earlier. These results are considerably stronger than expected. The improvement in production should be reflected as a gain in real economic output in the quarterly GDP figures.

November 17

▲ The U.S. Census Bureau announced that housing starts in October were at a seasonally adjusted annual rate of 1,290,000. This is 13.7% above the revised September estimate of 1,135,000, but is 2.9% below the October 2016 rate of 1,328,000. At the same time, the number of building permits issued in October was at a seasonally adjusted annual rate of 1,297,000. This is 5.9% above the revised September rate of 1,225,000 and is 0.9% above the October 2016 figure of 1,285,000. These figures are stronger than market expectations.

▲ Statistics Canada reported that consumer prices rose 0.2% (seasonally adjusted, monthly basis) in October, matching the gain in September. On a year-over-year basis, the Consumer Price Index (CPI) was up 1.4%, down from 1.6% in September. During the month, price changes were mixed with six major components increasing and two declining. The Bank of Canada's three measures of core inflation were also mixed, but continued to show underlying inflation below their 2% target, ranging from 1.5% to 1.7%. CPI common, which the central bank says is most closely correlated with the output gap, rose from 1.5% to 1.6%. The overall figures are in line with market expectations.