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Market Update

17 June 2016

The American Federal Reserve opted again to delay planned interest rate hikes. Fed chairwoman Janet Yellen cited the looming British vote on leaving the European Union and a recent slowdown in job creation for holding off. The Federal Reserve kept U.S. interest rates unchanged on Wednesday and signalled it still planned two hikes this year, although a slowing economic growth path for 2016 and 2017 prompted a downgrade in where the U.S. central bank thought rates would peak.

Even this year's rates projection was less secure than previously, however. Six of the Fed's 17 individual forecasts from governors and regional Fed presidents projected just one hike this year, compared with one such outlook when the forecasts were last issued three months ago. America added just 38,000 jobs in April, worst showing since 2010. The U.S. central bank lowered its economic growth forecast for 2016 to 2.0 per cent growth from 2.2 per cent and its outlook for 2017 to 2.0 per cent from 2.1 per cent. It also cut its longer term view of the appropriate federal funds rate by a quarter to 3 per cent and indicated it would be less aggressive in tightening monetary policy after the end of this year. Fed chair Yellen gave no clues as to whether a rate hike could come as early as the Fed's next rate setting meeting in July, or whether the central bank would wait for a slew of firmer data as it headed into its September meeting. Markets have all but priced out any rate rise in 2016. Ms. Yellen acknowledged "Brexit" was one of the factors in Wednesday's rate decision and said Britain's decision whether to remain or leave the European Union would have

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"consequences for economic and financial conditions in global financial markets". The Fed has implemented just one rate rise in a decade and its target range for overnight lending rates between banks remain between 0.25% to 0.50%. Recent data indicates that last month's jobs report may have been a blip. The Fed statement stated economic activity has picked up since April.

The Ipsos MORI poll for the Evening Standard newspaper shows Leave with 53 per cent of the vote and Remain on 47%. The "Leave" camp was up 10% on the previous poll while "Remain" side was down 10%. The survey comes exactly a week before polling day as the Remain campaign loses ground on the issues of immigration and contributions to the EU budget. It follows surveys in the past week from ORB, ICM, and YouGov. All show poll data that the Leave campaign is opening up a margin over Remain. Supplementary questions in the poll suggest that key economic arguments made by Leave are resonating. Remain is floundering. Just 17% of voters believe George Osborne's key claim that households will be £4,300 worse off after Brexit. On the other side 47% polled accept the Leave's statement that Britain pays £350 million to the EU every week. Polls show older voters backing Leave while the young overwhelmingly want to stay in the EU. Voter turn out will be key.

Oil supplies at Cushing, Oklahoma dropped by 189,000 barrels the first time in four weeks. Distillates decreased by almost three million barrels. Gasoline inventories, on the other hand, rose dramatically with a build of 3.6 million barrels instead of a draw of 1.5 million. Last week, the amount of crude oil at hand dropped by 1.1 million barrels, less than the three million barrel dip forecasted by S&P Global Platts.

During the week ending on May 13th, crude oil supplies fell by 1.14 million barrels. Over supply is drawing down quicker than anticipated. So why the weakness in oil prices over the past week? Brexit. Britain leaving the Euro zone would put the region in uncertainty and a potential recession. Gasoline and Diesel fuel prices are all together a separate issue. China's over production of refined petroleum products is behind the falling prices of gasoline and diesel fuel. Falling gasoline prices are the result of the current

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bout of deflation we are seeing in North America. Yes, cheap gasoline prices are a win for all when low cost energy extraction and refinement are the drivers not product dumping. Over the last 15 years, China has managed to get raw energy supplies at near zero cost. How? Poor struggling nations need infrastructure development but have no budgets to do so. Additionally, emerging nations are rich in resources and oil but also lack the capital to properly develop them. In comes China, develops roads, hospitals, schools and builds the needed infrastructure in exchange for the rights to extract the riches deep in the ground. Cheap Chinese labour, steel and building supplies fund the development in exchange for oil and resources. Barter not money is currency of trade. This is how China can afford to product dump well below market prices. If these practices don't stop, just like with Japan in the late 70s and 80s developed nations will be forced to put in place tariffs. At present political momentum is strong in America to institute such reforms. The Donald is all over it.

Extreme economic effort is being made to stimulate the dragon economy. China's total debt was more than double its gross domestic product in 2015, according to government economist, warning that debt linkages between the state and industry could be "fatal" for the world's second largest economy. The country's debt has ballooned to almost 250% of GDP thanks to Beijing's repeated use of cheap credit to stimulate slowing growth, unleashing a massive, debt-fuelled spending binge. While the stimulus may help the country post better growth numbers in the near term, analysts say the rebound might be short-lived. China's borrowings hit 168.48 trillion Yuan ($25.6 trillion) at the end of last year, equivalent to 249% of economic output. The country's total debt had quadrupled since 2007 and was likely as high as $28 trillion by mid-2014.

Earlier this week, David Lipton, first deputy managing director with the International Monetary Fund, also singled out China's corporate borrowing as a major concern, warning that the issue is "imperative to avoid serious problems down the road". Despite the concerns, China is having difficulty kicking its credit addiction. On Wednesday, the People's Bank of China announced that new loans extended by banks jumped to 985.5 billion Yuan last month, up

from 555.6 billion Yuan in April. The country's economy grew last year, at the slowest rate in a quarter of a century, and weakening economic figures have signalled the slowdown has continued this year.

Canadian manufacturing sales rose more than expected in April. Statistics Canada says manufacturing sales rose 1.0 per cent to $50.4-billion in April, the first increase following two consecutive months of declines. Economists had expected a gain of 0.6 per cent from March, according to Thomson Reuters. The Alberta forest fires that destroyed parts of Fort McMurray in May are expected to be a significant drag on the economy with many predicting a contraction for the second quarter. In it's monthly survey of manufacturing for April, Statistics Canada said the 1.0 per cent increase was due to higher sales in the petroleum and coal product, transportation equipment, and primary metal industries.

Sales in the petroleum and coal product industry gained 8.3 per cent to $4.1-billion in April, following a 13.4 per cent increase in March. Meanwhile, transportation equipment sales increased 2.1 per cent to $11.0-billion, helped by a 6.3 per cent gain in the aerospace products and parts industry which totalled $1.7-billion.Sales increased in 10 of 21 industries, representing 55 per cent of Canadian manufacturing sales. In constant dollar terms, sales were up 1.4 per cent, indicating a higher volume of manufactured goods were sold in April. Sales were up in six provinces, with Alberta, Quebec and Ontario posting the largest gains. Alberta gained 3.5 per cent to nearly $5.1-billion, helped by the 19.6% increase in petroleum and coal products. Quebec increased 1.4 per cent to $11.6-billion, driven by an 11.2% increase in the aerospace product and parts industry, while Ontario climbed 0.4% to $24.9-billion due to higher sales in the primary metals industry. Foreign investors bought a net $15.52-billion in Canadian securities in April, the fourth straight month of relatively significant purchases, Statistics Canada said on Thursday.

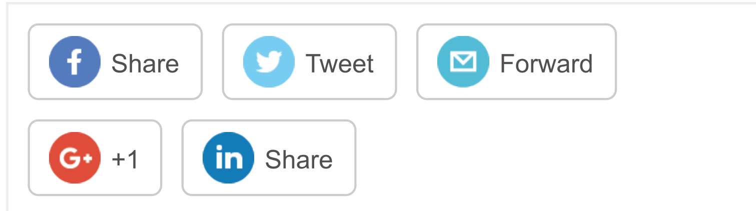
Non-residents snapped up $7.45-billion worth of Canadian bonds, with most of the investment taking place in new corporate bonds denominated in non-Canadian currencies. Foreigners also bought

$6.04 billion in money market paper, most of it denominated in non-Canadian currencies, and $2.02-billion worth of stocks. Canadian investors bought $4.67-billion in foreign securities, the third consecutive month of investment, most of it accounted for by $3.67-billion worth of bond purchases.

The Bank of Canada now estimates that the economic fallout from the massive Fort McMurray fire could be slightly less severe than it initially thought. The Bank of Canada estimates the blaze will knock one to 1.25 percentage points off gross domestic product in the second quarter. BOC previously estimated the hit would be 1.25 percentage points. This lost output is expected to be made up between July and September. The net result is that Canada's economy will be flat or shrink in the second quarter and "show an outsized recovery" in the third quarter, according to Mr. Poloz, governor of the Bank of Canada. Additionally Stephen Poloz stated the economy is likely to be "very choppy" through to the end of the summer. Most economists don't expect the Bank of Canada to start raising its key rate until late next year. In the longer term, Mr. Poloz insisted he's optimistic that Canada's economy is on the right track. There is continuing evidence that exports outside the energy sector are coming back, buoyed mainly by the gradually strengthening American economy. As many firms are close to their capacity limits, which augurs well for future investment and new job creation. So while the whole process has been disappointingly slow and uneven, confidence remains strong. Mr. Poloz noted in particular that exports of building materials, furniture and fixtures, as well as pharmaceuticals, are all up strongly and have regained pre-recession levels. Tourist spending in Canada is also way up as more Americans take advantage of the cheaper Canadian dollar and fewer Canadians head south. Mr. Poloz acknowledged that the recovery from the resource price shock continues to be bumpy. "The process has been uneven, and probably will remain so, but we are making real progress," he said. The governor of the Bank of Canada did not disclose his stance on future interest rates. He firmly believes the Bank of Canada will not act independently of the American Federal Reserve and choose to wait and see. This leaves corporate Canada in a delicate spot in the drive to maintain competitiveness. In order to do so, corporations must look to shed cost, streamline and invest in technology in order to remain

competitive. On the other hand lending institutions did respond by dropping borrowing rates on 5 year mortgages.

Our client held portfolio modelling remains stead fast on a North American focus strategy with an eye on to increasing energy in the near term. Uneven choppy markets are still ahead of us and will remain as we draw close to next weeks vote on Brexit. Confidence and investment flows into North America continue with growing appetite.



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