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Market Update

29 January 2016

The American Federal Reserve chairwoman Janet Yellen did little to provide comfort to market makers and speculators alike. The general tone of Janet Yellen's speech was muted providing no clear guidance as what may come next. Whether March of this year brings further interest rate hikes is unclear. What is clear to the Federal Reserve is the American economy is moving at their desired pace and can temporally with stand the global slowdown. As Americans ready themselves for voting in a new leadership in November of this year, more uncertainty will be brewing around who will lead the world's greatest super power. The proceeding 12 months of any federal election brings smoke and lack of transparency as to what policies a new government may bring. Canada just witnessed such an event with the Liberal's winning a majority. Following the initial days after the election, greater uncertainty about Canada's economic future was expressed and whether the new government has what it takes to keep Canada growing. Now much of the doom saying is behind us and the Liberal's have made clear their economic plan that shifts the burden away from monetary policy stimulus to enhancing economic growth by deficit spending (fiscal policy).

Given the election climate in America with Donald Trump looking to take hold of a populist movement, uncertainty is very high. Confidence levels are at all time lows during these periods both amongst voters and business owners. Historically, when both monetary policy transitions coupled with change in leadership, market confidence falls. Equity markets are a good barometer of the next 6 to 9 months. Markets have been pricing in the worst such as a collapsed China, raising interest rates and super low global GDP. History repeats itself and economic data exists to learn from the past. However which makes this period unique in economic history is adding in the rapid fall of oil. Falling oil prices are usually a sign of economic stimulations. It cost all of us less to transport ourselves and the goods we buy.

Central Banks around the world continue to diverge from the interest rate hike policy of the American Federal Reserve. The Bank of Japan just announced it will be moving interest rates lower into negative territory to ensure the Yen stays lower.

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Japan's steps to lower interest rates into negative territory are a direct result of China's aggressive currency cuts in the last 12 months. All Japan is doing is ensuring trade and manufacturing deals keep growing and not lose any more business to China. An 11% decline in the Chinese currency the Yuan would make life very difficult for Japanese manufactures and exporting overall.

Let's be clear on oil Canada has always sold tar sands oil at a major discount to WTI and New York quoted prices. Canadian oils hit an all time low of $8.50 a barrel in the past two weeks. Canadian oil has always sold at a steep discount of 2/3 to the New York market price. Why? Many reasons ranging from quality, cost to refine and transportation expenses. A long standing question about oil could not be answered. “What is the price of oil without the OPEC cartel?” Well, now we have the answer. Everyone believed the Arab spring had no effect on the dictatorships of the Middle East. Well it has. The oil cartel has been busted up and to make matters just a little more interesting America entered into talks with Iran which was and will shortly be the second largest exporter of oil in the Middle East. America has effectively removed the political clout oil producing nations have over Western economies. Based on current productions numbers the North American continent is the number one producer of oil with no mandate to export oil out of the continent. How quickly will Iran reintegrate themselves into global markets is becoming clearer daily. Just this week the Pope welcomed the leader of Iran to Rome as eager Italian corporations signed business agreements with Iranian delegates. The president of Iran, Hasan Rouhani, will be very busy in the weeks and months to come touring the globe signing new business agreements beneficial to his nation.

Right now we are seeing traders losing ground on bringing the equity markets lower. The EU and Japan have made clear that unlike America both nations will continue to apply quantitative easing into the future as needed at the central bank level. America's reluctance to pursue any tools or method which would allow for further deflation is partially anchored around the already murky presidential election coming this November. Second, China is still an unknown. Will the Dragon nation resist the desire and clamp down on domestic capital markets or will it actually move towards open markets? Currently, the signals are mixed. In one hand China states it's desires to have free movement in capital markets on the other hand it directly and aggressively manipulates both equity and forex markets. If Chinese leadership can resist becoming a Russia like nation (oppressor of personal wealth) and transition into a free market society over the near term markets clarity will be had.

Canada is on path of deficit spending focused on infrastructure, job creation. Deficit spending nations all have subdued currency prices. How does a lower currency price play out for Canada? A weak Loonie means foreign investor will be happy to buy Canadian hard assets like real estate. Our weak Loonie will not make a difference to small and mid size business as most product makers in Canada rely heavily on buying materials priced in USD. So the only competitive advantage is labour prices which in today's world of manufacturing make up only a small percentage of the overall

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cost to produce goods. Manufactures will not see the same boost of a low Loonie as in the 1990's when Canada had an abundance of raw material supplies. Most suppliers, if not all, have moved overseas or closed shop completely leaving Canadian corporations vulnerable to American suppliers and USD pricing.

Despite all the volatility and slowing global growth in the month of November, Canadian GDP was up 0.3%. Wholesale trade was the biggest benefactor with manufacturing coming in second after September and October contracted. The data released by Statistics Canada also point that November saw an increase in the oil and gas sector of 2.1%. There is no doubt that declining oil prices have deeply hurt western Canada and put a major slump in GDP growth. At the Federal level, our government is betting manufacturing and infrastructure will make up the losses from oil and Ontario will bring most of the GDP growth.

Alberta's desire to shake up the royalty fees energy extractors pay the province will be closely watched and expect energy markets in Canada to react. The province collected 5.1 billion from Bitumen producers, 2.3 billion from crude oil extractors and $989 million from natural gas and gas by products.