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Market Update

13 January 2017

The Trump reflation trade train pauses as President Elect Donald Trump failed to inspire investors and give little reason to believe that he will be able to spur economic growth. As a result the dollar fell from a 14 year high along with treasury yields hitting their lowest since November. Scant details about Trump's fiscal policy proposal saw equity markets pull back also. Since July of last year, the initial fiscal policy proposals have seen both institutional and individual investors believing that markets are in rally mode. In fact Trumps vague comments tipped markets from being risk adverse to full on risk. Is the honeymoon over and will Trump mania fizzle out?

To be seen. Trump bump and slump or Trump bump, slump and dump.

Trump's biggest challenger to his lofty proposal will be the American Federal Reserve. Chairwoman Janet Yellen believes the American economy is on strong footing and will continue to make slow and steady expansion. However let's be clear, corporate earnings have had their slowest growth if any over the last two years. Trump mania has only driven price expectations up along with evaluations. If earning performance doesn't meet expectations the market will correct the disparity quickly. The Fed has stated repeatedly that such shock waves to the American economy will

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put not just America but all of North America into a recession. Donald Trump and his team have set the bar very high along with expectations. Failure to materialize will force markets to quickly correct. Both bond and equity markets take a pause waiting to see promises materialize.

The two main objectives for Trump's team is to not just get markets to grow, but also to push trend growth rates to stay inclined. Economic growth needs to exceed 2.2% GDP. Trend growth needs to be consistently higher indicating near term growth patterns. Since 2009, the American economy has been in a cyclic style growth mode booming in the good times with dramatic drops in the weak periods. So there is a definite reason for Trumps lofty promises by attempting to shift the world's largest economy from cyclical growth to sustained trend growth.

Europe is under strain with Germany and Italy posting early signs of economic growth. Germany, the EU's largest growth engine had faster paced growth in the last quarter of 2016 according to the Bundesbank. Germany has been the biggest benefactor of the ECB stimulus policies. An overall upswing in consumption with growing demand for exports will sustain the Uber nation in 2017. Political uncertainty will act as strong headwinds for the Euro zone ranging from Brexit, re-elections in both France and Germany all for which on a stand alone basis will weaken economic growth and erode business confidence. All eyes will be on Germany as it is the pillar of economic growth in the EU and will continue to dominate in 2017 while Britian's future remains in temporary limbo.

Oil prices are seeing a fork in the road. As OPEC's struggles to cut supply among members has not seen the dramatic rise in energy prices as desired. The American Energy Information Administration announced on Wednesday that oversupply of crudes stocks rose by 4.1 million barrels to 483.11 million barrels. Over supply is still an issue in America and will continue in the foreseeable future as energy producers in North America ramp up production. Forecasts for 2017 oil prices are bound between

$52.00 a barrel and $60.00.

China is not waiting for President Elect Donald Trump to invoke tariffs. Ironically, China has become the defender of global trade as America is forced to look inward. Just as China has been the largest benefactor of a 30 year long global trade expansion, under the proposed tariffs China will be the biggest loser. By America withdrawing established free trade deals the Trans Pacific partnership is meaningless as confirmed by the Prime Minister of Japan. Without the world's largest economic and most robust consumption engine thing could collapse.

Canada on the surface looks to be strong and robust with strong job growth. However most of those jobs were part time. As oil prices look to improve and the American Federal Reserve looks to increase interest rates, our Loonie will see force appreciation putting further strain on Canadian corporations. Couple this with rising mortgage rates and utility costs; it will make for a difficult year for consumers. Homeownership will be pushed to high levels making owning a home financially onerous. Good news which points to trend growth. For the first time in two years Canada has seen a trade surplus. All sectors have been booming as they have been doing the same in Mexico. Fortunately for Canada and Mexico is America is in growth mode. However, Trump talk on renegotiating NAFTA will be a definite headwind.

As for real estate prices in Canada they have definitely overheated. The driver to such hefty home prices is many. However, the largest culprit is policy. Once all municipalities in Ontario and British Columbia decided to stop limit urban sprawl land prices were set to rise. The cost of building a home has not changed significantly over the last 10 years. What has changed is land prices have rocketed to no end. This has driven much needed gentrification of neighbour hoods. As high density homes have sprouted up across Ontario so have the tax collection coiffeurs of municipalities. All should be grand, right? Wrong! As land prices rise, this forces developers and home builders to build larger and larger homes on smaller lots.

The square footage of homes keeps rising as builders look to maximize profits as there is very little room on marking up lot prices. On the consumer side home prices are driven by supply and demand. The issue at hand is supply. By opening up land for residential development, home prices will fail and correct bring affordability into range.

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