Market Update

23 June 2017

Investors might welcome a boring Federal Reserve after a decade of hanging on to every word of the Fed. First, the American economy will have to continue to strengthen. Not only will growth have to pick up but inflation will need to meet the Fed's target of 2% growth. The unwinding of the Fed's $4.5 trillion balance sheet, an unprecedented move in central banking history, will have to go off near flawlessly. Chair Yellen and her cohorts have defied the odds and beat out critical skepticism in the past. Given the historic and unprecedented unwinding, it will prove to be a tougher go this time around.

Yellen desperately wants the unwinding to be an easy, smooth and a "paint drying" type of process. The whole purpose of quantitative easing (QE) was to propel markets higher. Logic states that if quantitative easing pushes markets higher, then when reverse quantitative easing is applied, it should deflate markets. Economic optimism in America is surging, according to the latest CNBC reports, with several key components hitting record highs, which has not helped President Trump. The CNBC survey of 800 Americans across the country finds that 30% of the public are optimistic about the economy now and for the future, the first time the percentage has been that high in two consecutive quarters during the survey's 10 year history. The 54% of Americans who think their home prices will rise in the next year represents a record and 44% who believe their wages will go up in the next year is the second highest in a decade. There's similar optimism around stocks, where 44% of Americans believe this is a good time to

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invest, a level only eclipsed by last quarter's record. The positive economic attitudes are not bolstering the President's approval rating, which has in April fallen to 37% in the current survey from 39%. His approval on the economy has also fallen to 41% from 44%. There has been a rise in pessimism, driven by groups such as retirees, blue collar workers and independents, including some core Trump supporters.

Currently, Britain's economy is growing much slower than Greece's. Households are getting poorer due to inflation and Prime Minister Theresa May's Government is struggling to stay in power. The EU has found renewed vigour after the Brexit due to the strong mandate in France's pro EU leadership with Emmanuel Macron. The table has rapidly turned seeing the EU enjoying growing sentiment and economic upswing. The EU is becoming the clear winner of Brexit with the full impact on Britain not clear yet. All expectations were that the EU would enter into a recession as Britain was the fastest growing economy among the G7 (group of seven industrialized nations).

Oil prices fell about 3% to a 10 month low in heavy trading on Wednesday, as nagging fears about the global crude glut fuelled a sell off that was interrupted only briefly after news of a larger than expected drop in American inventories. Crude oil futures touched a low of $42.13, the lowest intraday level since August 2016. Since peaking in late February, crude has dropped by more than 20%. Oil rallies over the same time period have not been sustained. The bear market in oil prices is all about inventory over supply. Rebalancing oil supplies has not proved effective by OPEC. Investors want tangible proof that OPEC cuts are shifting petroleum balances. Crude prices are now on the hunt to find the stress point for the American producers which has not been reached.

Production is rising in Nigeria and Libya. Both countries are exempt from the OPEC deal, which has been erasing cuts by other OPEC members. Nigeria's crude exports are set to surpass 2 million barrels per day (bpd) in August, the highest in 17 months, as the country recovers from militant attacks that crippled production in 2016. Additionally, investors were discouraged by data showing that oil refineries in China, the world's top crude

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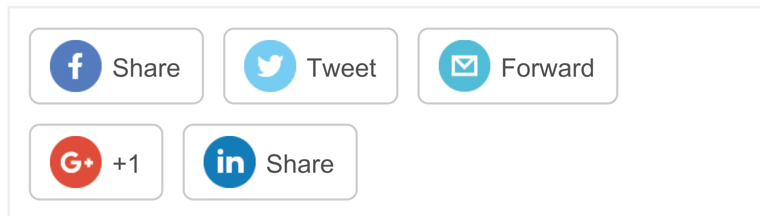
importer, are cutting operations during the peak demand summer season. So far this year, oil has slid 20%, its weakest performance since 1997 for the first half of the year, a period when prices tend to rise. Brent crude has risen in the first half of the year in all but six years over that period. Oil prices ran up in late 2016 and in early 2017 in response to OPEC's efforts, but several weeks of surprising inventory figures shifted sentiment among speculators, who have shed long positions as the crude glut has persisted.

Interesting data was released today about how imports of foreign oil has continued to decrease. China is the largest importer of energy. Could this be another signal that GDP is actually slowing down? Debt lies at the heart of China’s economic problem. China’s GDP ratio stands at a staggering 277%. Greece, who is seen as a basket case, is just at 179%. China can no longer rely on foreign investment flows and infrastructure spending. As Chinese leadership withdrew easy money supplies and tightened credit lending rules, the economy sank. As it was clear that by mid 2015, it would not be transforming rapidly to a nation of consumers. The Peoples Bank of China hit the stimulus button and began throwing money at everyone and everything to ensure the economy goes into recession. As many of my readers know, I have been calling for China to be recessionary for quite a while. It has however avoided full economic collapse by printing money, uncontrolled lending and burning through foreign currency reserves. How has it survived so long? Nearly everything in China is state run. The state will simply have direct control of state owned corporations. Off the official books lending known as shadow banking has another $12 trillion of unreported loans. As Government leaders have been tightening lending this year, state owned corporations have been going to shadow banks for more funds. This would be akin to any of us taking on second and third mortgages just to keep up appearances. Credit lending fuelled growth will become more challenging. A house of cards.

The Canadian dollar weakened against the American greenback. Canadian manufacturing sales rose more than expected to record levels in April as sales of petroleum and coal products rebounded after two months of solid declines. Chances of an interest hike in Canada surged to more than 90% odds. The Bank of Canada may

have finally decided to act as there are concerns it may be fuelling an asset bubble due to low interest rates. Resale of Canadian homes dropped 6.3% in May from April as Toronto home sales dropped by a staggering 25.3% as new policy changes to stem property speculation. Listings are up while sales are down. We are seeing a rebalancing of the housing market take root. Let's hope this holds.



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