Your weekly market update

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Market Update

17 February 2017

As we close on the first month of President Trump's administration, consumer spending, consumer confidence, wage inflation and overall inflation are on the rise. In fact, January saw inflation hit well above the Fed's desired 2% mark at 2.5% and well above the previous month's reading of 2.1%. Federal Reserve chair Janet Yellen stated a rate hike in March. Her hawkish comments during her congressional testimony focus on managing America's economy from over heating. The Fed chair also stressed that America's new administration must move forward with fiscal policy as monetary policy (QE) has reached its limits. It was unfortunate that Yellen's testimony was derailed by questions on the repealing of Dodd Frank. All you need is to look at the Basel IV which demands banks deemed "too big to fail" increase their cash reserves. Basel III and IV look to prevent the very event that brought about the great recession of 2008. Canada is always looked at in admiration on it's well regulated banking system. Regulated is the key word.

The volatility index (Vix), another indicator of the market moving forward, hit 52 week lows on January 23rd, 2017. Since then, Vix has risen by 9.59%, at the time of writing my update. Even at 11.77 the Vix reading is very low. Moving forward Trump's administration must effectively tackle two potential fiscal policy forks in the road. The implementation of the proposed American boarder tax which is a hefty 20% value added like tax and the proposed decrease in

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corporate tax which is currently at 35% and the elimination of the alternative tax and reductions to the overall personal taxation. Failure of either proposal to be implemented will cause a loss of confidence in the new administration and put the brakes on America's economy. A boarder tax would hurt multinationals and American corporate profits would fall as all corporations import product as part of the finished manufactured product. While a cut in corporate taxation would directly increase profits and allow capital repatriation. It is important to note a rising interest rate tide is already squeezing corporate profits, as is wage inflation. If for any reason Trump's proposed border tax gets approved and the proposed tax cuts undergo protracted delays or worse not approved at all, institutional investors will withdraw and a sharp correction will be triggered.

Fractures and polarization in the new administration are becoming visible. What has been reassuring is that traditional Republicans are in control behind the scenes as seen with the support of Vice President Pence. I believe market confidence is coming from the assumed understanding that moving forward we will see the unfolding of a Republican economic policy and not Trump mantra. Trump and his team are newbies to the political arena and expect more faux pas and falls from grace. The Michael Flynn fiasco is not over as an investigation by the FBI is now public. Trump's nominee for post of Department of Labor, Andrew Puzder was aggressively blocked by the Democrats. A lawsuit was filed on Feb 8th against Mr. Puzder's company for wage and labor violations by restaurant workers, which has resulted in the withdrawal as nominee. Two strikes for Trump and a strike three is lining up.

As the world looks to expanding global trade, the EU just approved and signed the CETA (Comprehensive Economic and Trade Agreement).The Trans Pacific Partnership would have had a significant boom to economic growth as it would open trade for American corporations and turn the trade imbalance tide.

The treaty that gave life to the European Union just celebrated it's 25th anniversary. The EU and ECB's inability to effectively right size the Greek economy by restructuring long term debt is weighing down the Eurodollar. Add to this that fact that both 2017 is an election year for France and Germany. Fears that populist government in both countries might continue to be major head winds for the Eurozone. The ECB announced in December that it would reduce the amount of bonds it buys each month starting in April from 80€ billion to 60€ billion. Deflationary pressures and fears have subsided in Germany. The first month of 2017 showed headline inflation rose from 0.8% in December to 1.7%. Across the EU and Europe we move away from fears of deflation to inflation. Currently, most of the run up in inflation globally is due to oil prices rising from below $30 a barrel to above $50. The main drivers of inflation in the rich world is rising cost of imports. China can no longer manufacture as cheaply as it once did along with other emerging economies.

Oil prices steadied as record crude and gasoline inventories in the America dragged on prices, though OPEC supply cuts helped to support prices. Light crude gained 10% to $53.21.

Organization of the Petroleum Exporting Countries (OPEC) and other exporters have agreed to cut output by almost 1.8 million barrels per day (bpd) during the first half of 2017, with industry data showing that most producers are sticking to the deal. Despite this, inventories remain bloated and supplies high, especially in America, oil and gasoline inventories soared to record highs last week as refineries cut output and gasoline demand softened according to the Energy Information Administration, EIA.

China's economy woes may have slipped down the global worry list, however significant risks remain, including an abrupt end to a massive credit boom.

While a hard landing is not there for 2017, a modest slowdown is. Economists warn that a push to rein in cheap loans will weigh on key sectors such as housing. Government officials are trying to keep a lid on frothy house prices without harming the wider economy. Growth remains heavily reliant on government spending.

The scale of the lending boom was laid bare in data Tuesday showing China added more credit in January than the equivalent of Swedish or Polish economic output, fuelling worries about the spree's sustainability. Aggregate financing, the broadest measure of new credit, climbed to a record 3.74 trillion yuan ($545 billion). Despite the headline number, the growth of total credit continues to ease moderately, according to Bloomberg Intelligence.

Policy makers have begun to tighten money market rates and analysts expect further measures to cool lending.

External risks include a sharp drop in exports due to slowing demand or rising trade barriers. President Donald Trump promised tariffs on Chinese goods and faster than expected interest rate hikes by the Federal Reserve have only weakened the economic forecast for the dragon nation.

Canada has spent the last decade positioning itself as the best place in the world to do business with the biggest changes coming into effect in 2012. It was in that year that the Conservative government lowered our corporate tax rate to 15 per cent (down from 28 per cent in 2006) and that the one for one rule came into effect. Recognizing that extreme regulatory burden on businesses was an impediment to growth and investment, the one for one rule provided that for every new regulation that imposed an administrative burden on business, one would have to be removed. Canada was the first country in the world to legislate such a rule.

These changes produced results. Foreign direct investment into Canada skyrocketed between 2012 and 2013 while the one for one rule eliminated over 20 regulations from Canada's books and saved businesses tens of millions in just the first two years of its implementation. Following the announcement of these changes, Forbes ranked Canada as the best place in the world for business and we have remained in the top 10 ever since.

Such grand success is at risk.

Canada is set to lose its tax advantage in North America after the

Trump administration follows through on its campaign commitment to lower America's corporate tax rate to15%, matching ours. Additionally, the new administration is set to undergo more stringent regulatory reform with the adoption of a two for one rule. Canada's competitive edge is rapidly eroding.

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