Your weekly market update

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Market Update

16 June 2017

A surprise slowdown in America's inflation rate this year is tightening monetary conditions a lot faster than the Federal Reserve officials wanted. Inflation data released by the American Labor Department showed the so called "core" inflation rate, a closely watched measure of the underlying inflation trend that excludes volatile food and energy components, softened to 1.7% in May. This is down from 2.3% in January which means inflation adjusted, or "real" interest rates have gone up about half a percentage point this year purely due to declines in the rate of inflation. What does this signal in the underlying economy? Disruptive economic processes have been the main catalyst since China gained access to the WTO and before that was when Japan entered the auto manufacturing market in North America during the 1960's. Lower cost manufacturing was the underlying culprit lead by robot automation. Enter the age artificial intelligence which will do more to create deflationary pressures than China or Japan ever could. Economic data makes clear when the unemployment rates in developing nations do not decline as productivity gains and economic performance increases. Gross Domestic Product (GPD) along with formative wage inflation should go hand in hand. Wage inflation should be very healthy when an economy hits full employment capacity. Earnings have gone up as individuals work longer and harder. Once you back the added hours out you find that pay for entry level jobs are in at all time lows and new entry

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positions are not readily available. Artificial intelligence (AI) will do more to reshape our future than the mass migration form farming into industrialization. Why is AI so important? Up until recently, all the mountains of data our digitized world has created have not been fully utilized due to the fact that you needed to have massive computing speeds to collect, analyze, process and forecast with all raw data. Artificial intelligence can quickly and efficiently achieve this enormous task in cost effective ways. We are seeing this pop up everywhere as Facebook, Amazon, Google and Apple all learn how to apply their data collection abilities to forecast and reliably predict outcomes.

What does this mean to us? Automation or AI will start to remove the middle layer of jobs which at present pay quite well. So wage disparity will only grow. It is important to note, that AI and robots do not pay income tax like living people due. Nor do they consume and buy homes. They do not require health benefit and sick days. As corporations look for greater efficiency stepping into the realm of smart robots and software programs that automate services is an obvious evolution. Welcome to a world that is all interconnected and constant data collection and processing is a must. We have just entered this world and my time in San Francisco was a real eye opener as to the power of this new technology. California is the new money state of wealth, leading thought and commerce. New York State has lost out. New York City may be the capital for mergers but not the centre of the wealth generation anymore and leading thought. So the ability to reflate the economy and have inflation rates above will prove to be challenging.

Core inflation has become a bit like “Where’s Waldo?”. Being at the early stages of AI and low oil prices will see bouts of deflation, stagflation and sudden inflation. The most important inflation number outside of core inflation is wage inflation which so far is weak. Amazon buying Whole foods is point in fact. Jeff Bezos’ ability to drive cost down, increase quality and extract higher profit margins in a dying retail sector is amazing all driven by being able to accurately pin point what customers want.

The American Federal Reserve increased rates by 0.25% citing moderate growth and downward revision for inflation rates. The Fed has made it clear it will start to unwind their balance sheet at a rate of $600 billion a year.

Trump's administrations seems to dive deeper into the bog as testimony keeps the Russian intervention of elections real. In fact, so real that in America the Senate less that 24 hours ago (at the time of this writing) passed a sanctions bill on Russia. These new sanctions are directed to major oil producers and energy suppliers working on the Russian Nord stream 2 Baltic gas line. Talk about a new era of cold war with hackers leading the attack. In Russia's defence is that National pride runs high in Russian culture and he cannot stop individual hackers from doing so against American interests. All this does is add to the uncertainty that President Trump's Administration has the depth, breadth and reach to execute on policy as promised to further strengthen ties with Russia. To make matters even more complex 190 Democratic law makers are suing president Trump over business affairs while sitting as President. This represents the single largest law suite against a president in the history of America.

European markets rallied as the much awaited bail out of Greece took place since Greece's collapse in 2009. Finally, the ECB (European Central Bank) has the authority and ability to act as a central bank should by issuing needed debt relief to much member states. This will open the door for the ECB to do the same in other member states such as Italy. The London exchange did the reverse posting the widest weekly loss in two months.

In recent years, countless headlines have declared the Chinese economy would surpass America or even that it already has. Chinese officials admitted this week and not for the first time that its leadership has been cooking the books. The admission calls into question, once again, those proclamations of Chinese economic dominance. Chinese anti-graft authorities said in a statement Monday that two local governments Jilin Province and the Inner Mongolia region, both of which lie in the North had falsified financial data. The statement comes months after similar findings were released on the local government of Liaoning Province, also in the North. The exact scope of those inflated performance evaluations was not revealed.

Observant economists, as well as Wall Street analysts, have always been skeptical of China's economic data. Good times or bad, China always seems to post numbers that meet the targets set by central planners. These problems, which arise from China's central leadership setting targets for its local leadership to meet, are nothing new. During Chairman Mao Zedong's "Great Leap Forward" economic campaign of the late 1950s and early '60s, local officials famously misreported crop yields to central authorities, resulting in crippling famine. So, it is no surprise that yet again the official statement is that China is on target to hit gap of 6.7%.

Oil prices are more than 12% below prices in late May. The spike in May's prices was a result of when energy producers led by the Organization of the Petroleum Exporting Countries (OPEC) extended for nine months a pledge to cut output by 1.8 million barrels per day (bpd). Rising American oil output has undermined the impact of OPEC led production cuts. Data from the American Energy Information Administration (EIA) this week show growing gasoline stocks and shaky demand, despite the peak summer driving season, sent prices tumbling.The problem is that there is too much oil on the market. There is too much oil from America, Libya and Nigeria. I firmly deliver that the battle for market share by energy producers in not over with American energy producers grabbing the Lion's share.

The Bank of Canada offered its strongest signal yet that it's ready to raise interest rates as the economy gathers steam, in surprise comments that sent the Canadian dollar and bond yields soaring. Canada's economic recovery is broadening across regions and market sectors. The remarks are an indication policy-makers anticipate the next interest rate move will be higher as economic momentum shifts pain to recovery from a slump in oil prices. It's also effectively a rebuke of pessimists betting on a disorderly unwinding of Toronto's housing bubble that has left the Canadian dollar one of the worst performing currencies this year. The Canadian dollar extended gains appreciating 0.9% to $1.3350 per American dollar, the steepest increase since March. The gain helped turn the Loonie's year-to-date loss against the greenback into a gain. As early as January, governor Stephen Poloz had been talking about the possibility of another rate cut, after lowering the key rate twice in 2015 to 0.5%. Investors are placing an 11% probability of an interest rate increase next month, and a 56% chance by the end of this year. On Friday, those probabilities were 5% and 30%. The Central Bank hasn't raised interest rates since 2010.

Real estate prices are top of mind for all Canadians. Economic studies and forecasts indicate house prices are in for a decline on the scale seen during the financial crisis from which Toronto's market quickly bounced back. The risk is that even more homeowners will put their houses on the market, and/or demand for homes will decline even further than it has already. Sales dropped by a steep 20.3% in May. Pointing to the fact that home affordability is out of reach. As more and more people rush to put their home up for sale, it will only worsen the decline in prices. Having met with top real state offices, the length of a listing has increased dramatically with many home owners delisting their homes as they realize their home will not fetch fantasy price levels. For those needing to sell, we have gone from multiple offers with significant over bids to homes selling at a 10% to 15% below asking prices. Is demand still there for housing in Toronto, Vancouver and South Western Ontario? Absolutely, however as I mentioned above we are shifting form a sellers market to a buyers market. I firmly believe is governmental policy that will put the dampers on housing such as seen in British Columbia and now in Ontario. The province of Ontario is just getting started. At the Federal level, Ottawa is looking to put in place a capital gains inclusion rate of 100% for those selling real estate beyond their principal residence.

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