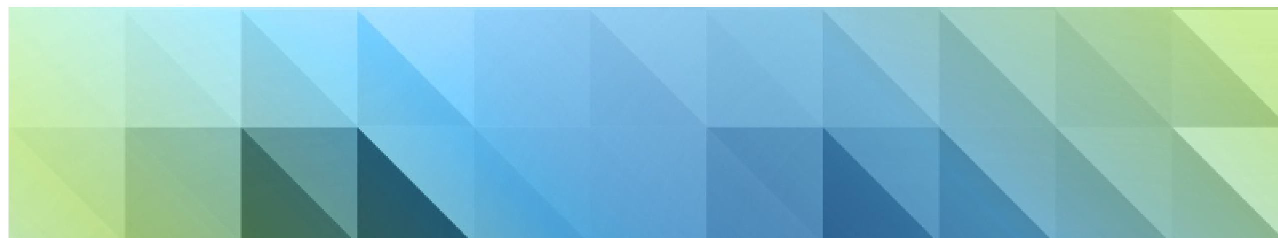

Market Update

17 Nov 2019

As the American economic engine continues to push forward with strong data fuelling growth with equity markets digesting the news, the state of politics as bi partisanship collaboration is non existent which makes even the most certain fiscal proposal a high volatility event.

The antiquated structure of the American tax system effects overseas business earnings. Large American companies hold more than $1 trillion overseas, on which they can defer taxes as long as the money stays abroad. Republicans want to make that tax holiday permanent. To finance such a magnificent corporate tax break, the Trump administration will give 14% of middle-class families earning between $50,000 and $200,000 a tax hike next year. In the Republicans' view, the main reason companies keep earnings overseas is America's top corporate tax rate of 35%, the highest in the developed world. They argue that lowering the rate to 20% will persuade multinationals to bring their tax-free earnings back from overseas to invest in the America. Companies might bring money back to the US but give it to shareholders instead of investing it, as they did after a tax holiday in 2004. Or they might invest it in the US, but in automating their factories rather than paying factory workers. Or they might just keep it abroad and invest in China and other growing markets, where the returns on investment could be higher than in the America. But most importantly, it's missing the problem of profit shifting when companies move domestic earnings overseas to avoid taxes.

A permanently lower corporate tax rate that doesn't increase the

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national debt would make America a more attractive place to invest, benefitting the entire economy. Economists aren't sure how big that effect will be. Past research found that each percentage point decrease in the corporate tax rate leads to an increase in companies' reported income by 2.25%. A recent Oxford University report noted that profit shifting is most affected by statutory tax rates.

The count down for the United Kingdom to agree to a December dead line is highly unlikely. Prime Minister Theresa May has been facing lack of support by her ministers and other conservative party members. As a leader she has been placed in a lose-lose scenario. Brussels on the other hand wants Britain to pay the bulk of the cost of the effective divorce bill and will push hard to ensure that there will be little to no impact on the EU. German banks are preparing for a hard Brexit and the spoils that come from the departure of the United Kingdom from the EU could be shared by multiple European cities. German central bank executive board member stated German banks were planning to a void a hard Brexit which would leave the EU banks locked out of financial markets as Europe's financial hub resides in London. EU market disruptions and uncertainty will remain heightened as the count down marches on.

Oil prices fell for a fourth session on Wednesday, weighed down by worries that data would show American crude inventories rising after this week's gloomy global demand outlook from the International Energy Agency (IEA). Oil bulls have been left nursing a heavy hangover after the bearish lead from the IEA report sent skittish buyers scurrying. The IEA cut its oil demand growth forecast by 100,000 barrels per day for both 2017 and 2018 to an estimated 1.5 million bpd and 1.3 million bpd respectively. The demand slowdown could mean world oil consumption may not, as many expect, breach 100 million bpd next year, while supplies are likely to exceed that level. Rising American shale output has also been putting pressure on prices. American oil production has increased by more than 14% since mid 2016 to 9.62 million bpd and is expected to grow further. The IEA stated that non OPEC production would add 1.4 million bpd of production in 2018, undermining efforts by the Organization of the Petroleum Exporting

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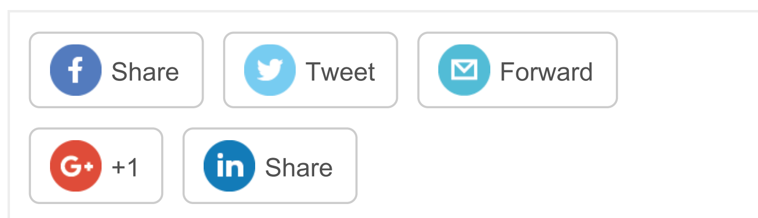
Countries, Russia and other producers to reduce by oversupply with production cuts. Expect to see down ward pressure on oil as marginally softer global oil demand outlook for 2018 coupled with a sizeable expansion in non OPEC supply.

China's economic data has been slowing for the last two months. The Federal Reserve looks ready to raise interest rates in December, again. A slowing growth in China and a strengthening green back make American assets more attractive. So, money starts to move out of China and the Yuan starts to fall and the growth that was in place for the last few months begins to unravel. Each year, a rise in Fed rates drives volatility for the dragon nation and upsets the balance in China's delicate economy. Outflow of funds from China push the Yuan down.

This year, though, Chinese President Xi Jinping has consolidated power becoming the most powerful leader in the country in decades. The grip on the country has been secured. Now leadership will go about the dirty business of deflating the debt bubble building in China's financial system since 2009. The bubble has expanded in China's banking system from $9 trillion to $35 trillion in less than a decade.

In Canada, British Columbia continues to lead the way in real estate reform by announcing it will slap a 1% tax on vacant real estate properties starting 2018. I do see the same coming to Ontario. UBS, Swiss banking giant has put Toronto's real estate market as the most over valued and prime for bubble burst. A price growth of greater that 10% a year with values doubling every seven is not sustainable.



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