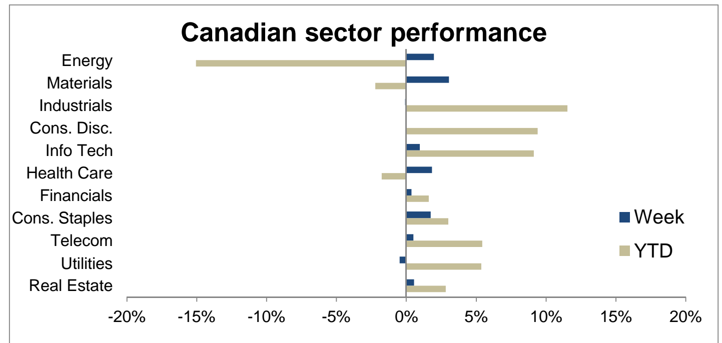
Weekly Market Snapshot

For the week ending July 14, 2017

Equities (local currency, price only, % change)	7/14/2017	Week	QTD	YTD	1 Year
S&P/TSX Composite	15174.81	0.98%	-0.05%	-0.74%	4.55%
S&P/TSX Small Cap	614.64	1.71%	-1.42%	-6.68%	-5.10%
S&P 500	2459.27	1.41%	1.48%	9.85%	13.66%
NASDAQ	6312.47	2.59%	2.80%	17.26%	25.40%
Russell 2000	1428.82	0.92%	0.95%	5.28%	18.85%
Euro Stoxx 50	3525.94	1.79%	2.44%	7.15%	19.00%
FTSE 100	7378.39	0.37%	0.90%	3.30%	10.88%
Nikkei 225	20118.86	0.95%	0.43%	5.26%	22.78%
Shanghai Composite	3222.42	0.14%	0.94%	3.83%	5.51%
MSCI EM Index (USD)	1047.05	4.45%	3.59%	21.43%	20.92%

Fixed Income (total return, % change)	7/14/2017	Week	QTD	YTD	1 Year
FTSE TMX Canada Universe Bond Index	1026.94	-0.10%	-0.81%	1.54%	-1.17%
FTSE TMX Canada All Corporate Bond Index	1163.33	0.08%	-0.57%	2.28%	1.70%

Interest Rates - Canada (change in bps)	7/14/2017	Week	QTD	YTD	1 Year
3-month Tbill	0.73	-2	2	27	27
GOC bonds 2 yr	1.19	2	9	44	64
GOC bonds 10 yr	1.89	2	13	18	84
GOC bonds 30 yr	2.24	-2	9	-7	56



Currencies and Commodities (in USD, % change)	7/14/2017	Week	QTD	YTD	1 Year
CDN $	0.79	1.83%	2.51%	6.28%	1.93%
US Dollar Index	95.15	-0.89%	-0.50%	-6.90%	-0.96%
Oil (West Texas)	46.54	5.22%	1.09%	-13.37%	1.88%
Natural Gas	2.98	4.05%	-1.81%	-16.64%	-4.12%
Gold	1228.70	1.34%	-1.04%	7.08%	-7.98%
Copper	2.69	1.66%	-0.74%	6.70%	18.47%
CRB Index	176.28	2.16%	0.86%	-8.43%	-7.27%

NORTH AMERICAN EQUITIES

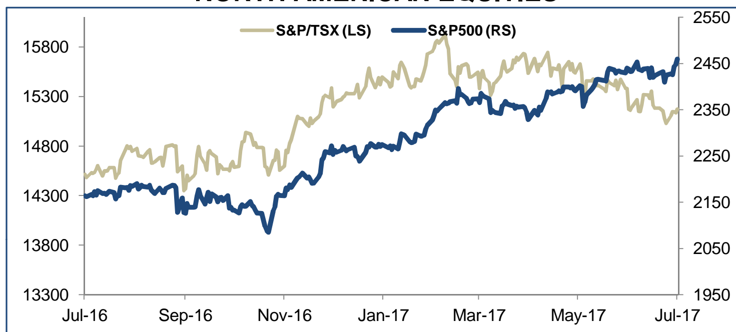
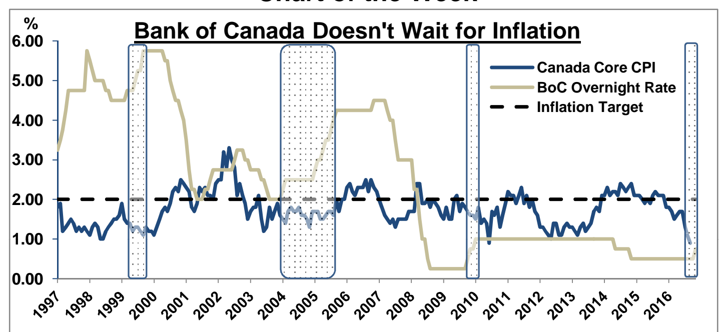


Chart of the Week



HIGHLIGHTS

After several weeks of unrelenting upward pressure for bond yields and squishy equity markets, the past week brought some respite for bond investors and solid synchronized results for equities. All ten of our tracked global equity indices registered gains, with the S&P 500 and Russell 2000 each posting a fresh record high.

Each of the four US banks that kicked-off Q2 earnings season beat analyst estimates by 4-6%. Yet despite this solid start to bank earnings season, the S&P 500 financial sector slumped mildly (-0.65%). A number of factors weighed on the sector, including US yields falling across the curve on weak inflation and retail sales data, along with dovish testimony from Federal Reserve (Fed) Chair Janet Yellen. Specifically, US June CPI missed expectations for a 0.1% m/m rise, coming in unchanged and bringing the annual rate down 0.1% to 1.6% y/y. Likewise, retail sales were a disappointment, falling 0.2% m/m vs. expectations for a 0.1% rise. After steadily rising for six months into January 2017, the y/y pace for retail sales has been falling ever since, going from 5.6% y/y to now stand at 2.8% y/y.

The above noted inflation and consumer data were reported after Fed Chair Yellen had delivered remarks that were more 'dovish' than recent Fed communications. Her remarks contained several references to inflation, saying that *"We're watching this very closely and stand ready to adjust our policy if it appears the inflation under-shoot will be persistent."* Furthermore, she stated that *"…the federal funds rate would not have to rise all that much further to get to a neutral policy stance"*. In addition to sending yields lower, these remarks (coupled with the weaker than expected data) took the US Dollar Index to a 2017 low. The combination of factors also turned the tide for gold prices, which rose after falling for much of the past five weeks.

All told, the outlook for the federal funds rate and the Fed's balance sheet is cloudier now than it was a month ago. This is happening while central banks in other parts of the world are making their intentions more clear. With the US having the highest bond yields among the G7, and growth and inflation in other economies converging with the US, there remains room for non-US yields to rise while US yields pause. For example, German 10-year bund yields have doubled in the past two weeks, hitting their highest level (+0.60%) since January 2016.

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Canadian 2 and 10-year yields were up slightly as the Bank of Canada (BoC) did what it had already signaled, delivering the first rate hike in seven years, raising the overnight rate by a quarter percent to now sit at 0.75%. The BoC also raised their GDP forecasts by 0.2% to 2.8% for 2017, and by 0.1% to 2% for 2018. The BoC did, however, lower its 2019 forecast by 0.1% to 1.6%; doing so in anticipation that higher rates will cool the economy by then. The BoC now believes the output gap will close by the end of the year – a view that signals their intended path of additional policy tightening should follow along a similar timeline.

The Canadian dollar, after having already appreciated by nearly 7% from its 2017 April low, jumped even further. Levels reached this past week had not been seen since May of 2016. The Loonie's rise was aided by strengthening oil prices. US WTI Crude prices are now up over 10% from their June 2017 low of $42/bbl. A number of factors boosted oil prices:

- Reports that Russia is open to deepening output cuts,
- OPEC may place production caps on Libya and Nigeria,
- A greater than expected decline in US crude inventories (down 7.6 million barrels vs. 2.9 million barrels expected, the biggest weekly drop since September 2016), and
- The International Energy Agency (IEA) raising its global oil demand outlook. The IEA is expecting demand to grow by 1.5% to 98 million barrels per day in 2017, and for growth to continue into 2018.

Looking ahead:

We feel the pace of tightening in North America is anything but clear. Both the Fed and the BoC are weighing economic growth that requires rate hikes, against the current reality of falling inflation. The difficulty lies in the fact that policymakers cannot, and should not, wait for inflation to rise to their target before initiating a rate hiking cycle. The effects from a change to the policy rate come with a substantial lag. For Canada, four out of the past five tightening cycles began while inflation was below the bank's 2% target (See Chart of the Week). In each of those instances core inflation eventually rose above the 2% target. In fact, in 2002 when the bank held off hiking rates until core CPI reached their target, the result (18 months later) was the highest core inflation of the past 30 years. Having said that, core inflation* is currently the lowest on record back to 1985 (*StatsCan CPI ex 8 volatile items and indirect taxes).

The ability for the BoC to raise rates beyond another ¼ point hike will be impacted by: the strength of the Canadian dollar; stubbornly low inflation; and the potential of a more moderate pace of US rate hikes. Currently the US rate is just 50 bps above the Canadian rate and both institutions believe their neutral rate to be lower than historic.

Bottom line, we see the developments over the past month (higher policy rates, higher yields, higher commodity prices, and the orderly acceptance of all of this by equity markets) as very healthy and constructive. Ultimately, modest inflation, modest economic growth and modest rate normalization are the best ingredients to extend the life of the business cycle and the bull market. The lingering issue remains equity valuations, something only a substantial earnings beat, or a run-of-the-mill equity market pullback can fix. We'd prefer the former, but wouldn't balk at the later.

The week ahead brings 68 S&P 500 and 7 S&P/TSX Composite companies reporting Q2 earnings. The European Central Bank and Bank of Japan hold policy meetings. In Canada, we receive updates to inflation, retail sales and housing data. China delivers updates to industrial production, retail sales, fixed asset investment and the first look at Q2 GDP.

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