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Market Insights SPECIAL EDITION

2017 At the Close

Canada:

After months of exceptional growth, the economy has begun to show subtle signs of fatigue despite sustained momentum in the manufacturing sector and higher valuations in commodities and resources. The S&P/TSX Composite, still lagging other global indices in Canadian dollar terms, closed at an all-time high on the second last trading day of the year, December 28th, to eventually close the year at 16,209, a price return of 6%.

- *GDP:* On pace with its fastest growth since 2011, our economy was the envy of other global economies on the backs of strong spending by consumers and businesses and fueled by a continuously surging housing market. Despite flat growth in October, the economy is forecasted to expand by 3% for the year, tops among G7 nations.
- *Interest Rates:* On signals the two rate hikes in 2017 have done their part, Bank of Canada (BoC) governor Stephen Poloz took his foot off the gas pedal, at least for now. The BoC kept its key benchmark rate at 1% and took a more dovish posturing as Mr. Poloz takes a wait-and-see approach to the effects of the interest rate changes on the economy. The strengthening of the economy could possibly see as many as three rate hikes in 2018.
- *Inflation:* Struggling for most of the year to break above the Bank of Canada's 2% target for CPI, inflation did just that in November on rising prices at the pumps and food products. The month's 2.1% annualized growth may be a deciding factor, if it can be maintained, in the BoC's rate decision at their next meeting in January 2018. Excluding volatile components, annual core inflation jumped to 1.3% during the month.
- *Unemployment:* The nation's labour market continued to tighten as the jobless rate hovered at 5.9% in November, a low not seen since February 2008, just after the start of Great Recession. Jobs continued to be added in the manufacturing sector as the economy has added jobs for 12 straight months with over 440,000 people finding employment. The majority of the jobs were of a full-time nature, boding well for the structural stability of the market, with the participation rate remaining constant between 65.6 to 65.9%.
- *Dollar:* The Loonie had an up and down year touching a low of 72½ U.S. cents in May and a high of just under 83 U.S. cents in September. Most of the Dollar's gain was attributed to the exceptional performance of the Canadian economy but much of the volatility can be blamed on the fluctuation of resource and commodity prices, namely oil. At year's end, the Loonie closed at 79.71 U.S. cents, a twelve month gain of 7%.
- *Oil:* Amidst industry reports of falling U.S. crude supplies and coupled with continued co-operation to cut global output, oil ended the year on a high note with expected increased demand in 2018. A February contract for a barrel of West Texas Intermediate crude ended at US$60.10, a 11.6% gain for the year.
- *Housing:* Canada's housing market continues to defy with little signs of letting up. **Home starts** rose to 252,184 units (Nov) with a rise in condo development. The value of **building permits** rose 3.5% (Oct) on increased demand for commercial and residential buildings. Sales of **existing homes** were higher by 3.9% MoM (Nov), the 4th straight monthly increase and up 2.6% YoY. National **home prices** were higher by 3.9% MoM (Nov) and up 2.9% from a year ago.

United States:

The Bulls continued to push U.S. equity markets higher into record territory throughout the year, taking steps back momentarily on Russian involvement in the 2016 elections, tensions with North Korea, and health care reform failure that has hampered the Trump Administration. The S&P500 and Dow Jones were higher by 11.6% and 16.9%, respectively, on an annual price return basis in Canadian dollar terms, while the tech-heavy Nasdaq led with 19.8%.

- *GDP:* After a slow start to the year, the U.S. economy picked up the pace in the second and third quarters on higher inventory investment, which helped counter lower consumer consumption and construction slowdowns related to hurricanes in the U.S. south. Forecasts of strong Q4 on a strong holiday season should propel the world's largest economy to 2.2% growth for the year (IMF).
- *Interest Rates:* The Federal Reserve held true to their word in 2017 with three rate hikes, the latest coming recently in December, pushing the federal fund rate to a range of 1.25% to 1.50%. Under the guidance of a new Fed chairman Jerome Powell in March 2018, the policy of the U.S. central bank is not expected to change with three hikes expected pending GDP, inflation, and unemployment data.
- *Inflation:* The Consumer Price Index accelerated in November supporting the Federal Reserve's most recent rate hike and providing fodder for more increases in 2018, in line with expectations as shelter, autos, health, and tobacco prices rose. Inflation rose 0.4% in November and 2.2% on an annualized basis, while core inflation gained 0.1% in November, pushing the YoY period to 1.7%.

- *Unemployment:* The American unemployment rate achieved a 16 year low as the U.S. economic engine revved up. On a YoY basis as of November, 6.6M people were unemployed, a decline of 799,000, while the unemployment rate fell 0.5% to 4.1%. The labour market continues to be healthy as the number of jobless claims remained below 300,000 and the participation rate holds steady at 62.7%.
- *Economic signals mixed*: Factory orders slipped 0.1% (Oct) but were up 5.2% YoY; industrial output gained 0.2% (Nov) and higher by 3.4% annually; manufacturing PMI higher to 55.0 (Dec), retail sales jumped 0.8% (Nov) and 5.8% compared to same period a year ago; and consumer sentiment fell from a record high of 100.7 in October to 95.9 (Dec).
- *Housing:* U.S. housing data signaled strengthening as a low rate environment, tight supply, and strong job growth propelled the sector forward. **Housing starts** increased 3.3% (Nov) to a seasonally adjusted annual rate of 1.297M units and up 12.9% YoY. **Building permits** dipped 1.4% (Nov) to 1.298M units but up 3.4% annually. The S&P CoreLogic Case-Shiller **Home Price** Index rose 0.2% (Oct) and gained 6.4% in the last 12 months. **Existing home sales** gained 5.6% (Nov) and 3.8% YoY, while **new home sales** rose 26.6% annually (Nov) to 773K units.

Europe & Asia:

- The Eurozone's economy continued to strengthen after years of austerity measures, advancing 0.6% in Q3 and setting annual growth at a 2.6% pace.
- The European Central Bank (ECB) held its key interest rate in October at 0%. With increased stability in the Eurozone economy, ECB president Mario Draghi announced a reduction of its monthly asset purchasing to €30B and extended the program to September 2018.
- Consumer price growth stabilized in the Bloc holding at 1.5% (Nov) annualized on higher energy costs as inflation crept within reach of the ECB's five-year old 2% target. Core inflation also held steady at 0.9% annually.
- The Eurozone labour market continued to gain traction as the jobless rate fell to an 8½ year low of 8.8% (Oct), the lowest since January 2009. The Czech Republic (2.7%) and Germany (3.6%) lead the 19-country union as the number of unemployed fell 1.473M from a year ago.
- In Q3, China's GDP advanced 6.8%, slower than the previous quarter, as factory output and retail sales increased while public and private asset investment slowed. Trade data was positive as exports rose 12.3% annualized (Nov) as shipments to the U.S. and EU rose, while imports increased at a faster 17.7% rate over the same period.
- Japan's economy gains momentum: Q3 GDP expanded for a seventh straight quarter rising 0.6% in Q3 supported by increased exports and business spending, which offset a decline in consumer spending. Annual inflation rose to 0.6% (Nov), while Services PMI drops to 51.2 (Nov) as Manufacturing activity rose to 54.2 (Dec). In terms of trade, exports gained 16.2% and imports fell to 17.2%, on an annualized basis in November.

Looking Ahead…

2017 was a stellar year for the markets as the second longest Bull run treads steadily forth after 8½ years and numerous record all-time highs. But with every record high achieved, markets become more complacent thereby overstretching valuations and increased susceptibility to a correction or a bear market.

For Canada, it was the stand-out of all developed nations recovering from the plummet in crude oil prices in 2014 with a strengthening GDP, rising inflation, and low unemployment. However, the economy remains vulnerable to exogenous factors such as the NAFTA renegotiations and highly correlated to the price of crude and its inherent volatility. The BoC has more to contend with as a rising housing market has pushed household debt of Canadians to record highs.

In the U.S., the economy is firing on all cylinders and with the legislative passing of new tax reform policies, the cornerstone of Trump's campaign platform, should see increased strength in 2018 to forecasted 2.3% growth. This will likely mean more intervention by the Federal Reserve to take monetary action to keep the economy from overheating.

The Eurozone has been an illustration of perseverance as ECB president Mario Draghi stayed the course with his policy and been rewarded with a steadily improving economy and falling unemployment. The next critical phase will be for him to decide on when to end the accommodative policy that's been in place since March 2015. The tapering has begun and expected to end in September 2018, but it's unknown if the economy can organically sustain itself where it's forecasted for 1.9% growth in 2018.

Lastly, China will remain the powerhouse of Asia with 2017 growth, and 2018 for that matter, hovering between 6.5% to 7% as it continues its transition more towards a service oriented economy instead of a solely manufacturing one. Japan will be interesting to follow where after decades of muted growth, Prime Minister Shinzō Abe's victory in securing a super-majority in his country's Parliament should allow him to continue to move forward with his Abenomics "three-arrow" reform policies.

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