Ermes Monaco

From: Ermes Monaco
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To: Ermes Monaco
Subject: VALUED CLIENT MAIL LIST: Economic Outlook - End of Summer Thoughts

HollisWealth
MonacoAdvisorTeam

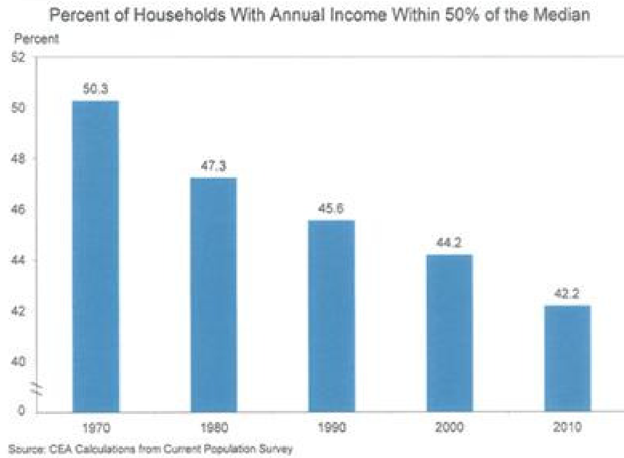
OF CHAMPAGNE TASTES AND BEER BUDGETS …

Source: Google Images

It’s understandable how the average observer can assume the post-recession recovery has found its strength judging by new highs in real estate and the stock market prices. However, on closer examination, a number of critical economic behaviours are apparent which, although not irreversible, are likely to lead to further downturns in the process of longer term recovery.

Economists have been pointing to the shrinking middle-class, based on the deviation of annual income from the median. Nonetheless, the North American economy is relying on the consumer to drive the recovery. According to

Figure 6: The Size of the Middle-Class has Fallen



World Bank and OECD statistics as of 2014, approx. 68% of U.S. GDP is attributable on household consumption (56% in Canada). However, given the diminishing strength of the middle-class, the consumer is definitely challenged in trying to meet this expectation. **IT HAS BECOME A MATTER OF HAVING CHAMPAGNE TASTES ON A BEER BUDGET.**

As a result, ever resourceful households have been adjusting their spending practices in a struggle to avoid a decline in their standard of living. Here are a couple of key behaviours being used to permit them to continue to consume even as their buying power marginally erodes:

1. **Increased consumer borrowing**

   According to a C.D. Howe commentary, #346, as of 2012, **"Consumer credit, apart from mortgages, has risen to 43% of disposable personal income in Canada, or double its level 20 years ago."** For example, food is routinely purchased at grocery stores on credit cards. In the case of automobile purchases, 84 month loans have become common, even in cases where economical models are purchased with the likelihood that the vehicle will not last 7 years. Not all cars are created equal even if they look similar. In both cases, it is a case of spending tomorrow's dollars to pay for today's consumption, a disturbing situation which could lead to nasty credit bubbles down the road.

2. **Compromising on Quality**

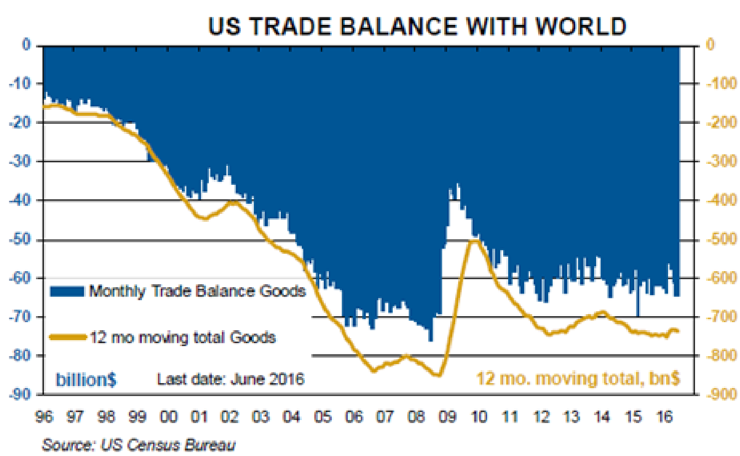
   Popular culture today largely ignores the quality of goods in the interest of having the latest product model which comes so frequently that it become obsolete before the functionality becomes outdated. Apple produces new iphone models almost annually which prompts a ritualistic rush to buy the new handset with last year's used phone being sold on-line at a significant discount to the original price.

   Manufacturers are only able to service the demand from consumers with diminishing middle-class buying power by building the products using less durable and reliable materials in countries with lower labour costs. In a word, they make them "cheap" in both quality and price so that they're affordable and not likely to last. Gone are the massive TV sets made in solid wood cabinets using long lasting metal components which would be kept working for years by the TV repair man. Today's TV set is virtually made of plastic not worthy of a service plan for future repairs. Many consumer products are becoming consumable disposables. Another future bubble we can anticipate is the risk of harzardous waste from these goods being thrown away as they pile up in garbage landfills.

These are just two of a number of unsustainable economic conditions representing possible disruptions to the rate of recovery. However, they can be modified provided a profitable business rationale can be applied. In the process, some larger economic dynamics will have to be addressed in order to create the necessary conditions for this to occur. For example:

- Global trade has to become more balanced with the surpluses of $U.S. foreign currency reserves held outside of the U.S. re-invested in the U.S. for production. Trade with emerging and Asian markets continues to be largely export driven to the U.S., causing significant amounts of capital being held idly outside the primary U.S. market. This results in:

    - The need to continue to print U.S. currency which depresses the value of the dollar and lessens the consumer's buying power.
    - The currencies of nations holding large U.S. reserves effectively trading as alternative U.S. currencies. Witness Japan which has been in a state of, or on the verge of, recession for many years. Nonetheless, the Yen continues to recognized globally as an important currency. This impacts the exporting country's price competitiveness.

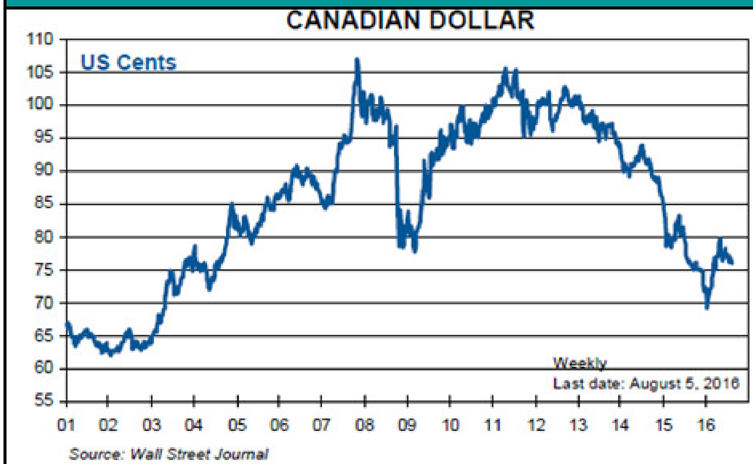


    - This will result in the currencies of North American and European countries strengthening, requiring higher value employment to be created in order to effectively deploy capital internally. However, this will also benefit middle-class purchasing power and support the standard of living. Concurrently, exporting nations will be encouraged to stimulate domestic consumption to avoid dramatically declining currency value, a situation which would greatly contribute to the development of their middle-class sector and prosperity.

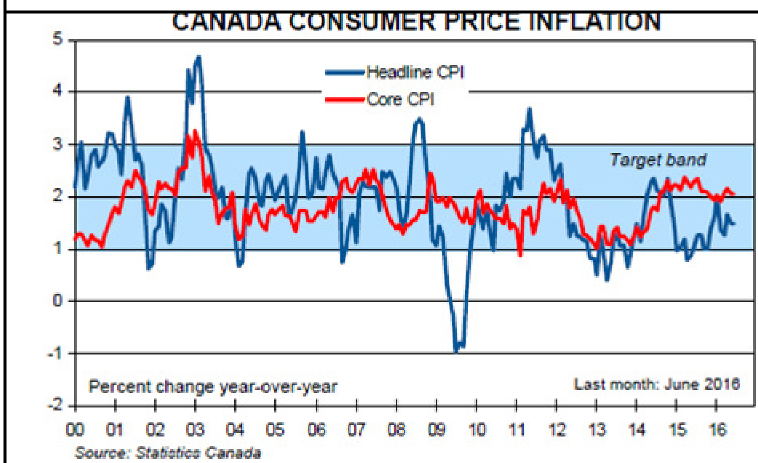
I have great faith in the open markets because they're bigger than any one political leader or business mogul. Given money, like water, always finds it course, it is quite likely these developments will occur regardless of deliberate intervention. Therefore, the path of recovery over time can be considered a certainty although, as always, there will be those times where we will have to tolerate bumps in the road.

(Source for all charts and statistics: HollisWealth Economic Monitor unless otherwise indicated)

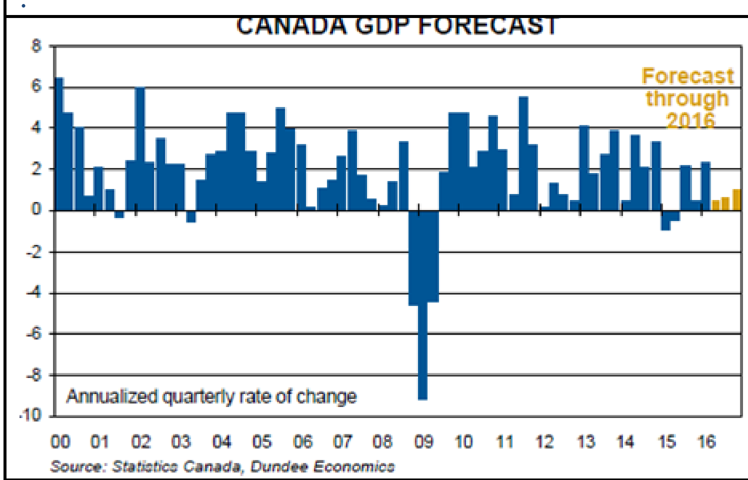
KEY ECONOMIC INDICATORS



The Canadian dollar continues to perform relative to oil prices as a petro-currency. Non-energy related industrial production as a driver of growth continues to be muted.



Despite the weaker Canadian dollar, inflation remains contained as softer consumer consumption and increased debt reduction has largely mitigated the risk of the weaker currency.



Canadian GDP is forecasted to remain sub 2% which will be a challenge for the level of general employment. Non-energy related industrial production, which is largely dependent on U.S. strength, continues to show moderate improvement to offset the weakness in the energy sector which has represented a predominant component of Canadian GDP.

Actual				Projected						
15-IV	16-I	16-II	4-Aug	Aug	Sep	Oct	16-IV	17-I	17-II	17-III

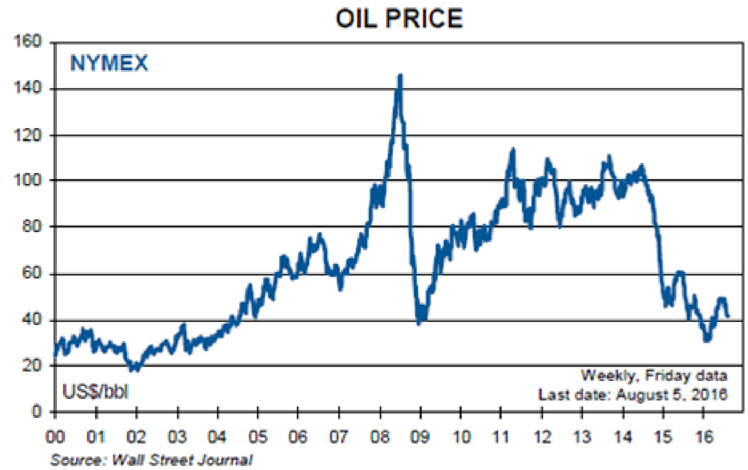
Canadian interest rates are likely to lag the upward direction of U.S. interest rates due to our

Canada											
Treasury Bill (91-day)	0.47	0.46	0.52	0.51	0.55	0.55	0.55	0.55	0.55	0.55	0.55
Government Bond (10-yr)	1.49	1.20	1.33	1.04	1.05	1.05	1.05	1.10	1.30	1.45	1.60
Prime	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70

weaker GDP performance.
Pressure on The Bank of Canada to raise interest rates has been reduced due to the strength of the Canadian dollar since the beginning of the year which has helped contain inflation. However, longer term bond yields are still being forecast to drift gradually upward in anticipation of an improvement in economic performance.

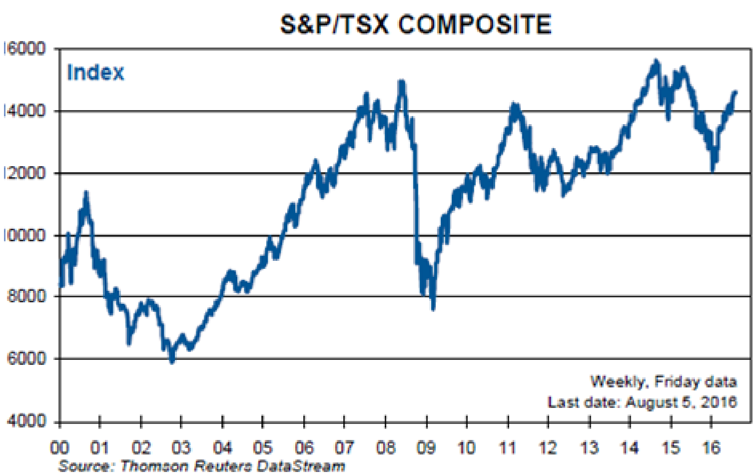
KEY SECTORS

ENERGY



Recovery in oil prices remains uncertain due to the role of political suasion as well as economic fundamentals driving supply and demand.
Oil production outside North America, particularly from the middle east, remains active and reserves remain high.
The next OPEC meeting is scheduled for November.

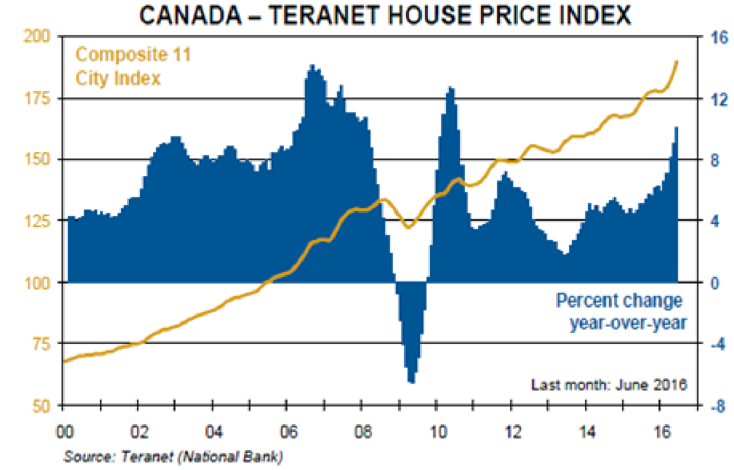
FINANCIAL MARKETS

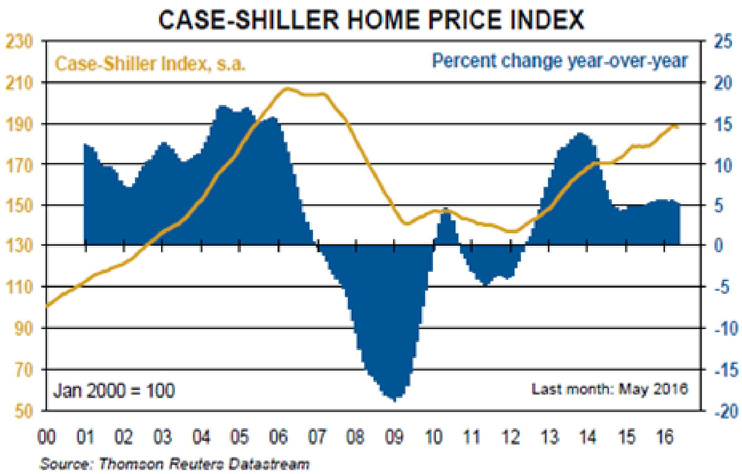


Recent market gains have been driven partly by lower interest rates and higher real estate prices making the stock market a more reasonable value alternative. However, volumes remain light.

REAL ESTATE

Real estate remains an attractive asset class benefiting from low mortgage rates. Recently, the "FOMO" factor, fear of missing out, has accelerated activity due to eventual interest rate and supply concerns.

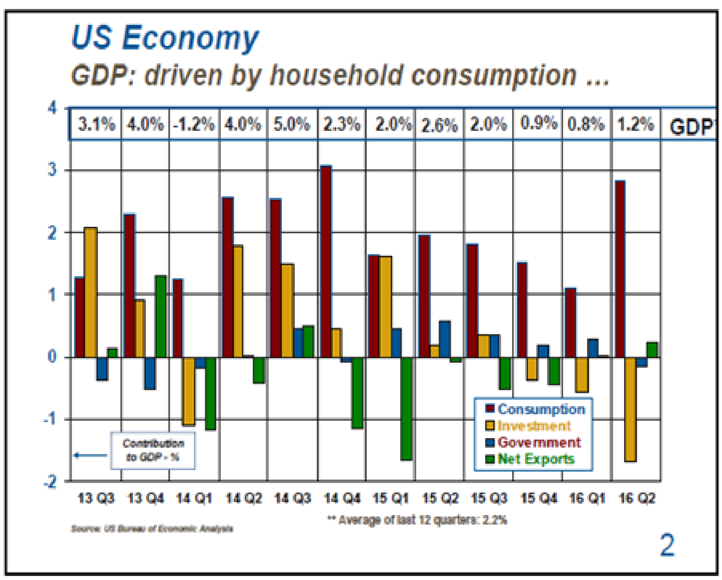




TIMELY ITEMS

ECONOMIC GROWTH

U.S.



Consumption remains critical to U.S. and global recovery although non-consumer investment has been lagging.

The table below illustrates the magnitude of the gap.

Average	GDP	C	I	G	X-M
Since Last Recession	2.08	1.55	0.90	-0.18	-0.18
For Last 12 Quarters	2.23	1.99	0.43	0.08	-0.27
For Last 4 Quarters	1.23	1.82	-0.57	0.16	-0.18

QUOTES FROM THIS MONTH'S MONITOR

On interest rate expectations	The **BANK OF CANADA** to stand pat on interest rates; **BOND YIELDS** in the US and Canada to increase modestly on the back of fiscal expansion in the US after the November election and a moderate increase in the rate of headline inflation – though yields will be held in check by the very low interest rates abroad;
On Canadian currency expectations	The **CANADIAN DOLLAR** to show periodic weakness, because we don't expect oil prices to increase significantly above $50 for the time being and economic growth will remain very sluggish;
On U.S. currency expectations	The **US DOLLAR** to trend broadly sideways until after November, when a new administration will likely encourage the currency to decline.
Oil price expectations	Oil prices have declined again on the back of supply concerns. The next OPEC meeting is scheduled for November 30.

Regards
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The Economic Monitor is available through the HollisWealth website.

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