Ermes Monaco

From: Ermes Monaco
Sent: November-18-16 11:31 AM
To: Ermes Monaco
Subject: VALUED CLIENT MAIL LIST: Economic Outlook - Post Election Thoughts

HollisWealth
MonacoAdvisorTeam

IS IT TIME TO LEAVE THE NEST?

Source: Google Images

In this post U.S. election phase, the U.S. financial markets have been enjoying a honeymoon period on relief that the election is over and the Republican majority that will allow freer passage of legislation. However, current market behaviour is based on presumption of what is to come rather than any policy implementation or action yet. As a result, trading volumes have been light and considerable institutional cash remains in waiting for direction.

All indications in terms of policy sentiment point to a protectionist "America First" posture which is not favourable for other nations relying on trading relations with the U.S. As we've discussed in recent newsletters, the trade flows for countries trading with the U.S. have had a surplus of balance advantage which the new administration is opposing. This is not a simple situation that be easily reversed given U.S. manufactured goods for export are a modest component of GDP, the fact that so many components of U.S. made goods for domestic consumption are made with imported parts and that protectionist policies have historically proven to trigger inflation and unemployment.

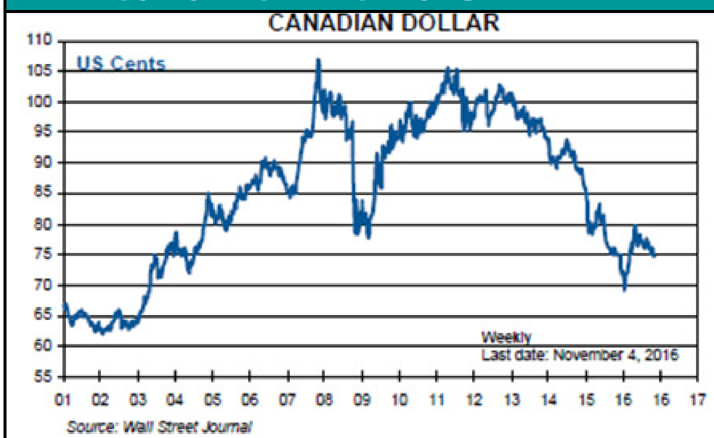
U.S. trading partners have enjoyed an advantage for so long that the status quo has arrested the development of their own domestic demand versus production for export to the U.S. and elsewhere. And now all indications are that the relationship is about to take a less favourable direction. The downside implications for inflation and unemployment are significant for the U.S. if duties on imported goods are increased and trading agreements are repealed. Blocking immigration bringing capital and withdrawing from geo-political arenas will also allow other countries to move in and fill the void economically and militarily. The U.S. represents approx. half of the global arms industry and is one of its primary manufactured goods.

However, it may also be a sign that the U.S. is no longer prepared to serve exclusively as the engine for the global economy. It is not reasonable to expect an implementation of these protectionist policies will result in growth to the extent that the U.S. can continue to play this role singularly. ***Therefore, it may become appropriate to consider leaving the "nest" to develop stronger economic relationships beyond the U.S. across and within regions around the world***. Indeed, it may become a necessity if commerce with the U.S. becomes more difficult. It would be a challenging evolution and a substantial amount of trade would continue to occur between Canada and the U.S. given our proximity, historical ties and compatibility. However, recent attempts by Prime Minister Trudeau to hold business summits with global parties as well as trade agreements and missions abroad may become more common as Canada and the rest of the world adjusts to the new U.S. posture.

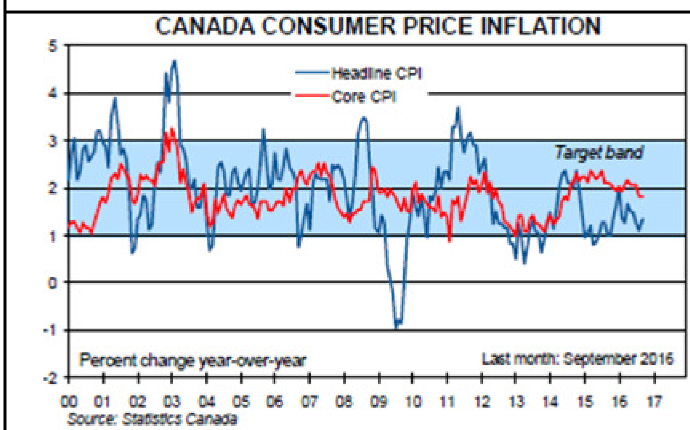
The appropriate strategy at this time is to relax the defensive profile slightly due to the conclusion of the U.S. elections and an expectation that changes, positive or negative, will unfold gradually through 2017 with market volatility progressively moderating. This will allow an increase in measured market participation as the Canadian and global economies move forward.

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

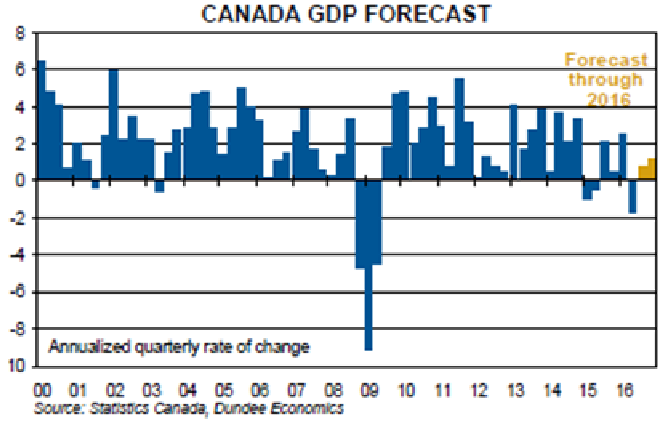
KEY ECONOMIC INDICATORS



The Canadian dollar remains largely tied to energy prices which will be affected by the outcome of the upcoming OPEC meeting.



Inflation remains contained as softer consumer consumption and increased debt reduction is avoiding a stimulation of inflationary pressure. While this has allowed lower interest rates, it is also a sign of sub-optimal economic performance and interest rates have also increased recently in response to the move in U.S. rates.



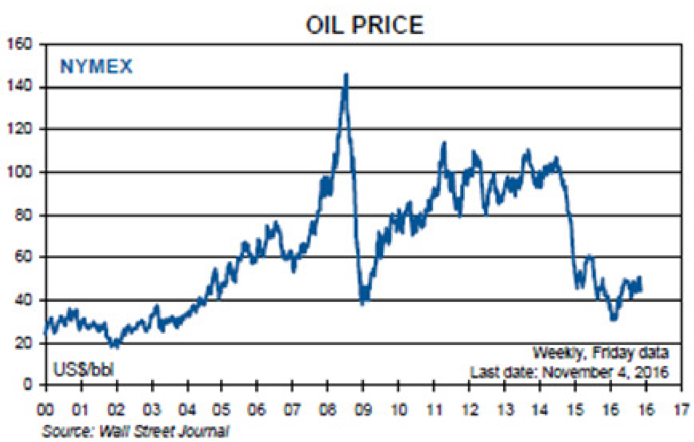
Canadian GDP is forecasted to remain sub 2% which will be a challenge for the level of general employment. Non-energy related industrial production, which is largely dependent on U.S. strength, continues to show moderate improvement to offset the weakness in the energy sector. This may become increasingly important depending on the direction of trade relations with the U.S.

	Actual				Projected						
	16-I	16-II	16-III	10-Nov	Dec	Jan	Feb	17-I	17-II	17-III	17-IV
Canada											
Treasury Bill (91-day)	0.46	0.52	0.52	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45
Government Bond (10-yr)	1.20	1.33	1.02	1.38	1.35	1.30	1.35	1.38	1.50	1.55	1.65
Prime	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70
Target Overnight Rate	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***
Spread: 10-yr - T Bills	0.74	0.81	0.50	0.93	0.90	0.85	0.90	0.93	1.05	1.10	1.20

The current level of interest rates in Canada is expected to move sideways now that long term yields have increased approx. 50 bps.

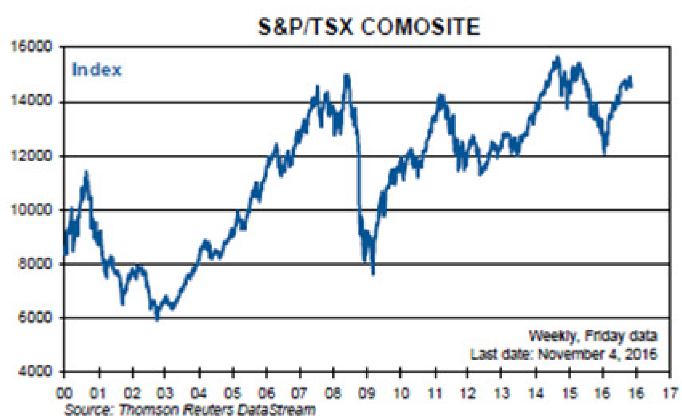
KEY SECTORS

ENERGY



Current indications are that a production cut will be adopted at the
next OPEC meeting although this will be divergent from the new U.S. administration's intentions to increase domestic production.

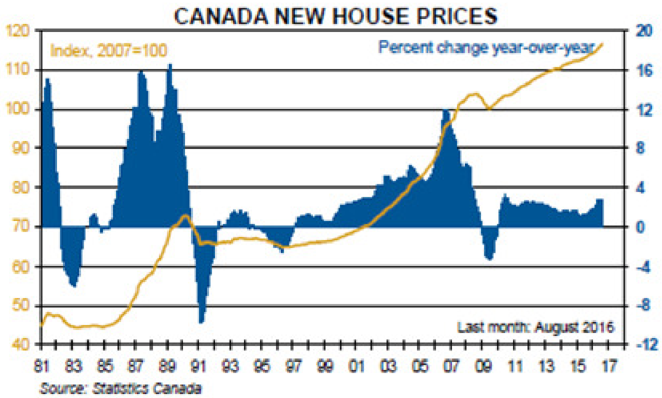
FINANCIAL MARKETS

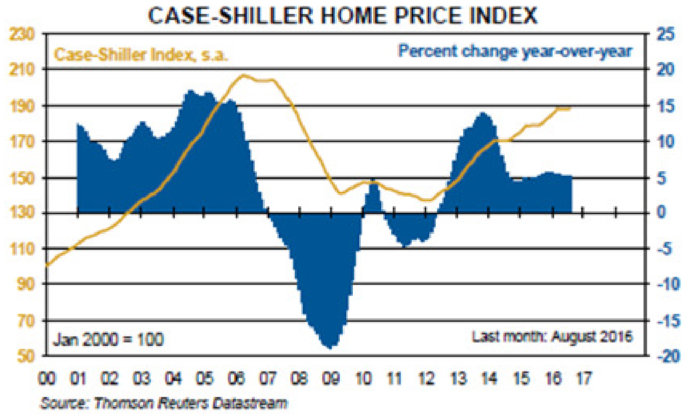


The U.S. markets have enjoyed a post-election recovery which the Canadian markets have gradually followed largely on the strength
of energy and gold although financials have also had renewed strength
on the prospect of higher interest rates being sustained.

REAL ESTATE

The U.S. real estate sector has softened recently following previous strength. The Canadian real estate market is also likely to moderate due to increased regulatory mortgage



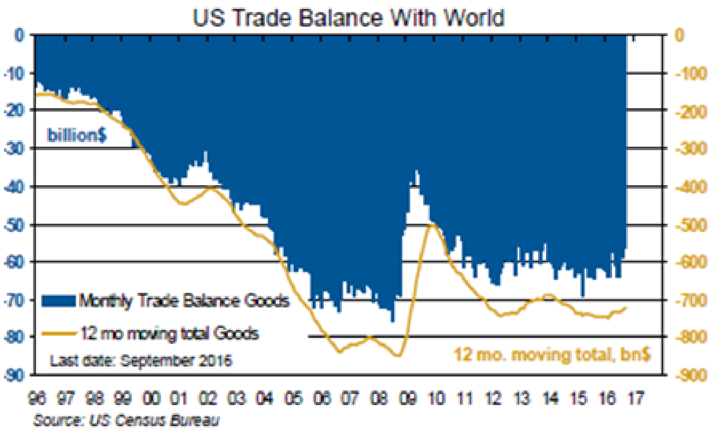


requirements
and higher interest rates.

TIMELY ITEMS

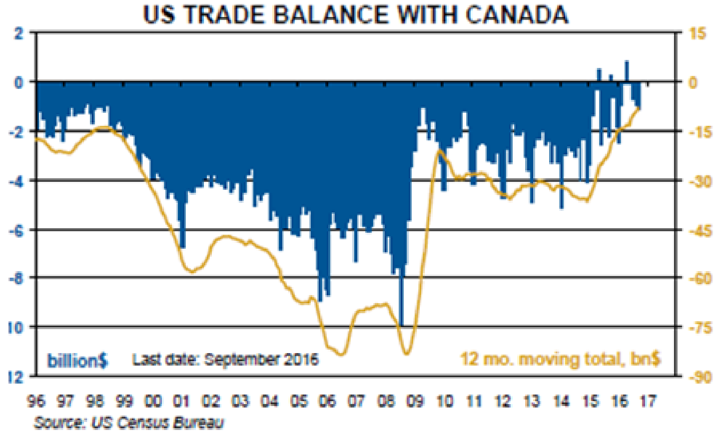
U.S. TRADE BALANCE

With World



With Canada

The U.S. trade deficit which has not improved materially over the past 5 years is now a major agenda item for the new U.S. administration. However, trade with Canada has improved
and is more balanced.



QUOTES FROM THIS MONTH'S MONITOR

U.S. post-election expectations

So what might we conclude at this stage on the economic front:

- The US budget deficit will rise significantly ... independent estimates suggest Trump policies will add $5-7 trillion to the national debt over the next 10 years
- US Inflation is likely to rise somewhat faster
- The US dollar will decline – against overseas currencies – once new trade initiatives are introduced
- US long-term yields will rise under budget and inflation pressures …
- … unless the Fed adopts QE4 or something similar
- Lower taxes will help equities – generally
- Import tariffs will help domestic import-competing and export industries
- The Fed will hike in December, provided post-election volatility remains subdued and yields do not rise excessively
- Business investment will pick up in 2017

It is early days however, so these views are all very preliminary!

On interest rate expectations

▶ The **FED** to hike in December – market volatility has been surprisingly muted in the wake of the election;

▶ The **BANK OF CANADA** to stand pat on interest rates this year and next;

▶ **BOND YIELDS** in the US and Canada to rise on the back of significant fiscal expansion in the US, and higher inflation resulting from increased trade protectionism;

On currency expectations

	The **CANADIAN DOLLAR** to trend sideways/ downwards; The **US DOLLAR** to trend flat until the Trump Administration decides what policies it will employ to "discipline" trade surplus countries – after which the US dollar risks declining rather sharply.
Regards **Ermes Monaco, CIM** **Investment Advisor** **Portfolio Manager** **HollisWealth, a division of Scotia Capital Inc.** **416-412-4254** **MonacoAdvisorTeam**	***The Economic Monitor is available through the HollisWealth website.***
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