Ermes Monaco

From: Ermes Monaco
Sent: October-31-16 3:43 PM
To: Ermes Monaco
Subject: VALUED CLIENT MAIL LIST: Economic Outlook - Pre-election Thoughts

HollisWealth
MonacoAdvisorTeam

STANDING AT THE EDGE ON A WINDY DAY

Source: Google Images

The theme of this month's Economic Monitor is the potential economic impact of the Presidential election and the ability of the U.S. to improve in the current global economic environment. At the time of writing, the U.S. is 10 days from voting following one of the most combative and acrimonious U.S. Presidential campaigns in memory. Accusatory campaigns focused on character have veered the election focus away from policy largely due to the dissimilarity of the candidates, their backgrounds and lack of common experience.

Regardless of the outcome, the new President will have to address the fundamental global economic issue of trade imbalances if they are to improve America's outlook. This singular question is at the heart of unemployment, interest rates and currency valuation. Given the U.S. remains the global economic engine, the rest of the world is not immune from the election outcome.

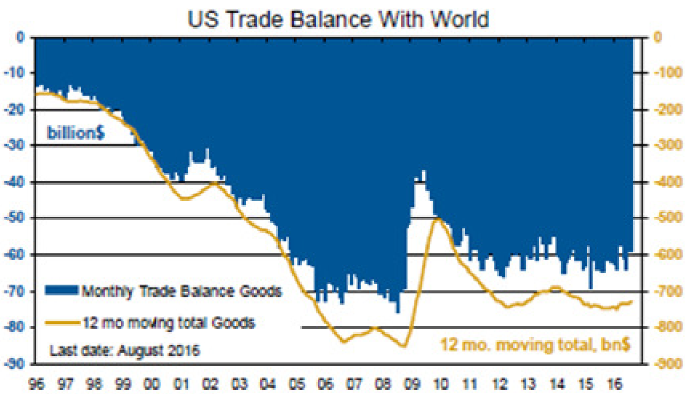
Serious policy discussion has been almost absent during the campaign. However, even within the realm of triviality, there are numerous overlooked considerations which have not had equal time in the media, some of which are:

- The Clinton emails are the latest media buzz as authorities search for criminality. However, little is being said of the criminality stemming from the emails having been hacked in the first place. Lawyers routinely argue against any evidence being obtained by illegal means. Oddly there has not been any evidence or release of hacked emails from the Trump camp. The political implications of the one sidedness are glaring but also overlooked.
- After two terms of a Democratic President, there is an undercurrent that change is due and is good whether justified or not.
- There is a re-emerging presence by those which have been most disaffected by global re-industrialization and economic imbalances demanding a return to previous North American industrial dominance through pronounced protectionism. This echoes Brexit, the negative implications of which are significant.
- The reality is that North America has evolved to a service economy <u>away from manufacturing</u>. According the Bureau of Economic Analysis, U.S. Dept. of Commerce, services now account for approx. 80% of U.S. GDP.
- The Trump business background being suggested as the character quality for economic recovery is not principally related to services and has been largely domestically based versus the global nature of the country's macro-economic issues especially in the context of geo-politics.

And now to the next elephant in the room:

As we have been identifying in our recent newsletters, the situation of the U.S. trade imbalance continues to grow. However, the situation is not a product of NAFTA as much as it is the status quo between the U.S. and non-NAFTA regions. The trade imbalance with China is the most often referred to because of its economic and political significance although the same exists with the Middle East and India. Collectively it can be seen how this trade imbalance represents a double digit GDP shortfall which is being made up through continued borrowing.

Source: The Economist



Source: US Census Bureau

Domestic debt has been able to maintain demand and the expression of the U.S. currency as the "safe haven". However, the risk of declining confidence in the U.S. dollar would result in a serious dislocation throughout the global economy, not only in terms of offshore employment, but the value of foreign currency reserves held by countries holding substantial surplus U.S. dollars to support their currencies. <u>One solution which would not threaten global diversification would be an increase in the purchase of U.S. services allowing the U.S. to reduce its borrowings</u>. Otherwise, the U.S. dollar, as it stands, is highly overvalued by all economic metrics.

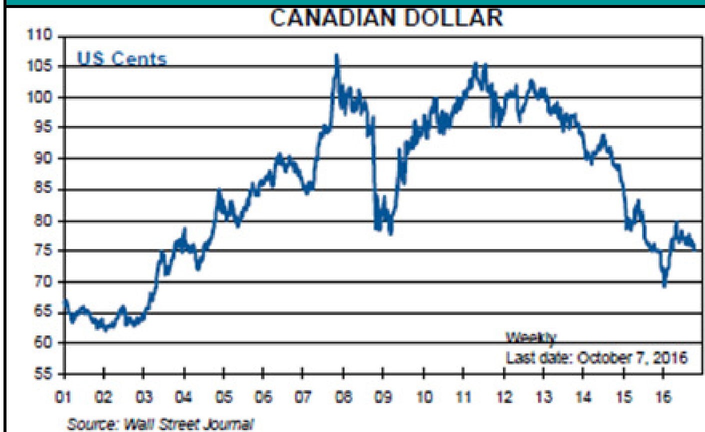
I maintain my investment advice at this time regarding important steps to help weather the uncertainty and be positioned for the post-election markets:

- *Maintain a defensive profile through the election and post-election period. This should include a near cash component and the utilization of market hedges as available.*
- *Plan for continued 1-2% GDP growth over the next 12 months. Therefore, continue to seek income and tax efficiency as alternative forms of returns to capital gains.*
- *Be vigilant about accepting business media news at full face value. Volatility and low actual trading volumes will produce optics suggesting far more dramatic market reaction than what is actually occurring.*

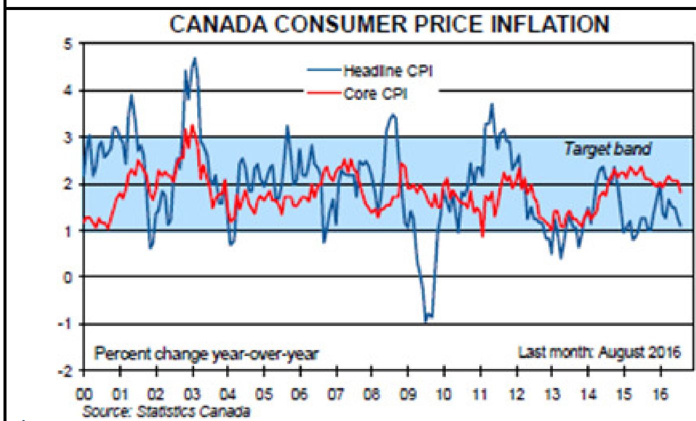
- *Be open to purchasing quality investments moving in sentiment with, but not fundamentally impacted by, market sell-offs. These provide good market entry points.*

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

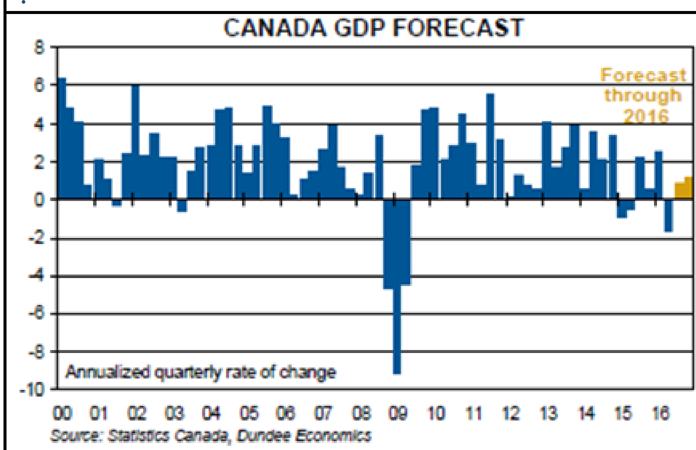
KEY ECONOMIC INDICATORS



The Canadian dollar has resumed weakness due to the due to a stagnation in oil prices and the continued absence of non-energy related growth.



Despite the weaker Canadian dollar, inflation remains contained as softer consumer consumption and increased debt reduction is avoiding a stimulation of inflationary pressure. While this fosters lower interest rates, it is also a sign of sub-optimal economic performance.



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						
16-I	16-II	16-III	12-Oct	Nov	Dec	Jan	17-I	17-II	17-III	17-IV

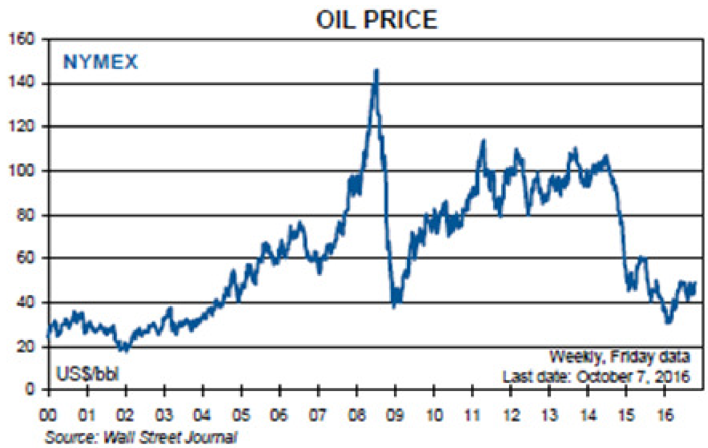
The Canadian dollar's strength earlier in the year lent some

Canada											
Treasury Bill (91-day)	0.46	0.52	0.53	0.50	0.51	0.50	0.50	0.50	0.50	0.50	0.50
Government Bond (10-yr)	1.20	1.33	1.04	1.21	1.20	1.30	1.25	1.35	1.45	1.50	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
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	0.51	0.71	0.69	0.80	0.75	0.85	0.95	1.00	1.10

pressure on The Bank of Canada to consider a rise interest rates although market chatter is now speaking of a potential rate cut. However, longer term bond yields are still being forecast to drift gradually upward approx. 25-35 basis points in anticipation of an eventual improvement in economic performance.

KEY SECTORS

ENERGY



Oil prices continue to trend sideways and recovery remains uncertain due to the role of political suasion as well as economic fundamentals driving supply and demand.

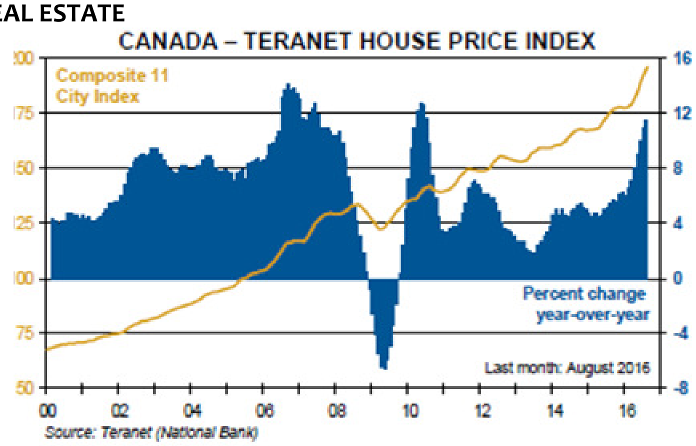
Oil production outside North America, particularly from the middle east, remains active and reserves remain high.

The next OPEC meeting is scheduled for November although latest indications are that a resolution is still a challenge.

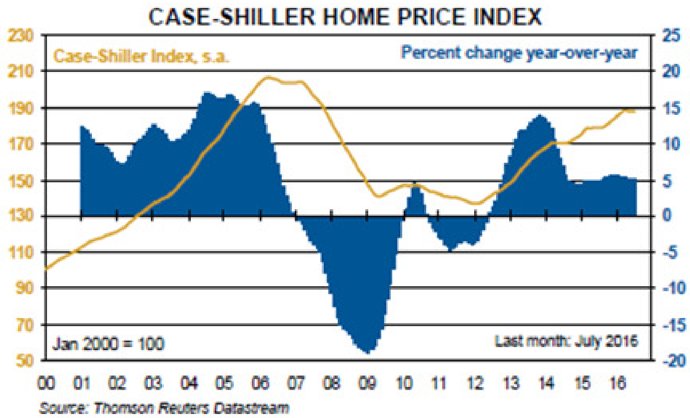
FINANCIAL MARKETS

Recent market gains continue to be driven partly by lower interest rates and higher real estate prices making the stock market a more reasonable value alternative. However, volumes remain light and sizeable cash reserves are being held institutionally and by the retail investor.

REAL ESTATE



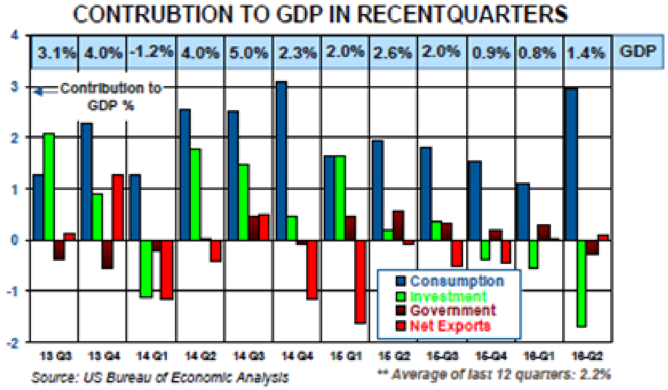
Recent government efforts to moderate real estate activity have had some impact, particulary in B.C. where measures have targeted specific buyers. However, the sector remains an attractive asset class benefiting from low mortgage rates and economic uncertainty. Therefore, a decisive change in economic conditions will be required in order to re-direct capital to other sectors other than real estate.



TIMELY ITEMS

ECONOMIC GROWTH

U.S.



The U.S. consumer continues to be the main driver of GDP. However, consumer consumption is largely comprised of imported goods. As a product of global diversification, an increase in service exports would benefit the U.S. trade imbalance without affecting consumer behaviour and employment abroad.

QUOTES FROM THIS MONTH'S MONITOR

On global economic prospects

We have noted many times that if China was the size of Jamaica no one would care what policies it followed or how cheap its currency was. But China and the rest of SE Asia encompass more than two billion hardworking, entrepreneurial people. If the currencies of that region are significantly undervalued global problems will inevitably follow ... and they now have!

On interest rate expectations

1.▶ The **FED** to hike in December;

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

3.▶ **BOND YIELDS** in the US and Canada to rise on the back of more fiscal expansion in the US and uncertainty regarding ECB and BoJ policy going forward;

On Canadian currency expectations

4.▶ The **CANADIAN DOLLAR** to trend sideways;

On U.S. currency expectations

(2) The Overvalued Dollar …
… is a major headwind for the US economy …

A headwind for GDP:

- *The US foreign balance (X-M) is contributing to US GDP – US imports (M) are contributing to foreign GDP however …*
- *(I) Investment (notably non-residential) will remain weak because of an overvalued dollar - which doesn't help US GDP either …*

A headwind for inflation:

- *The US imports deflation - frustrating Fed efforts to boost inflation*

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.