Ermes Monaco

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Subject: VALUED CLIENT MAIL LIST: Economic Outlook - Early Fall Thoughts

HollisWealth
MonacoAdvisorTeam

WHERE IS THE FIRE?

www.alamy.com - E7A2W1

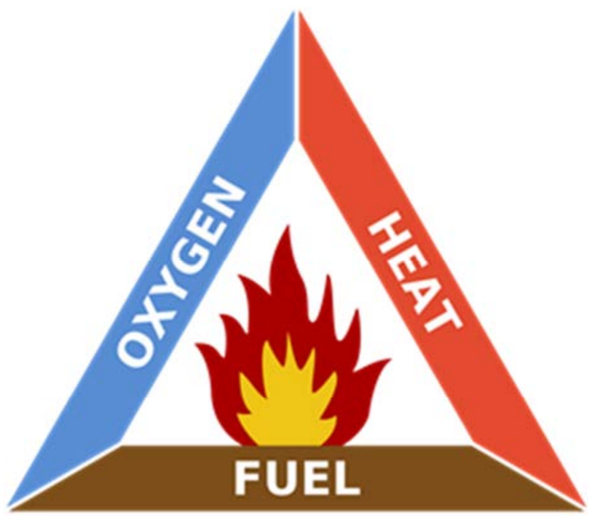
Source: Google Images

We have had a number of significant market influencing events this year which have not managed to change the direction of the current trend. Specifically, after brief periods of uncertainty, the financial markets have absorbed the risk related to the Brexit vote, oil pricing instability and U.S. Central bank interest rate setting meetings. In the process, a period of heightened volatility has been followed by a continued trend of moderate but consistent market growth.

The next pending event is the upcoming presidential election. This is significant because of the dramatic differences between the candidates. A major televised presidential debate is scheduled this evening as I am writing this and the market is expressing its uncertainty with the Dow Jones Industrial Average down -166 points and the TSX down -78 points.

But, once the Presidential election is decided in November, then what? We can reasonably expect dramatic volatility immediately following the election, both up and down, as the financial markets try to assess the direction of the incoming President on the business environment. The markets have a much lower understanding of Mr. Trump's policies and, as a result, will likely experience an extended phase of uncertainty if he's elected. However, thereafter, economic fundamentals will once again be key drivers of market performance.

Let's consider a burning fire as an analogy for economic and financial market growth. Key ingredients needed to be present for combustion and fire include oxygen, an energy source (heat) and a combustible material (fuel). There are many ingredients and scenarios that can light an economic "fire" but they must also be in the right combination. Using consumer momentum as the scenario for heightened economic growth, the necessary ingredients must include employment, labour income growth and currency purchasing power amongst other also useful ingredients. However, in the U.S., it is only jobs which have reached near full employment. The lack of salary increases and a weaker U.S. dollar (against a global basket of currencies making the purchase of imported consumer goods more costly) is undermining more robust growth. As a result, the U.S. consumer is surviving but not necessarily prospering, undermining its ability to take the economy and financial markets to the next level. Similar situations also exist around corporate and government scenarios which are also lacking the combination of key ingredients for growing the economy.



Source: Google Images

As a result, what we are witnessing is smoke but not a lot of fire. Various favourable economic drivers are creating some but not all the necessary required conditions. We continue to experience consistent but modest growth accompanied by above average volatility as economic strength is not sufficiently robust to absorb the greatest of the market uncertainty. ***This is what we should expect post-election once the political drama and media circus subsides. Furthermore, there are no imminent factors that would prevent this level of performance from continuing into 2017. We will be starting the new year off with prevailing global supply overcapacity and capital imbalances, geo-political turmoil, etc., all economic conditions that remain unchanged. But, change has to be instigated; the passage of time is not enough.***

Historical data around presidential elections corroborates the variability and uncertainty of outcomes on the financial markets. **This underlines the reality that, as critical presidential elections are as market events, ultimately future market direction will have to rely on economic fundamentals.** More smoke but not necessarily a hotter fire.

Time Period	Average Return for the DJIA
President Election Years Overall	+7.6%
Incumbent Party Wins	+15.1%
Incumbent Party Loses	-4.4%
If Democrat Wins	+3.9%
If Republican Wins	+10.3%

Political Control	Average Return for the S&P 500
Democrat President / Republican Congress	+21.3%
Republican President / Democrat Congress	+4.5%
White House / Congress Controlled by Same Party	+12.1%
Either Party in White House / Split Congress	+7.1%

Source: Forbes Magazine, August 2, 2016

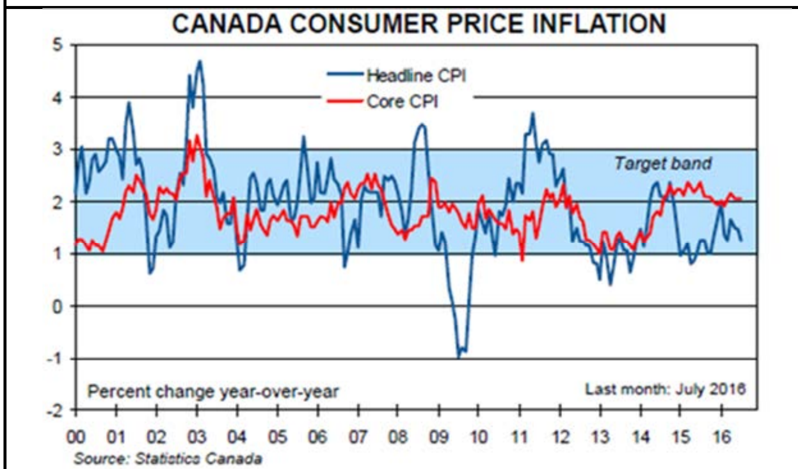
So what are important steps to help weather the uncertainty and be positioned for the post-election markets?

- *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.*

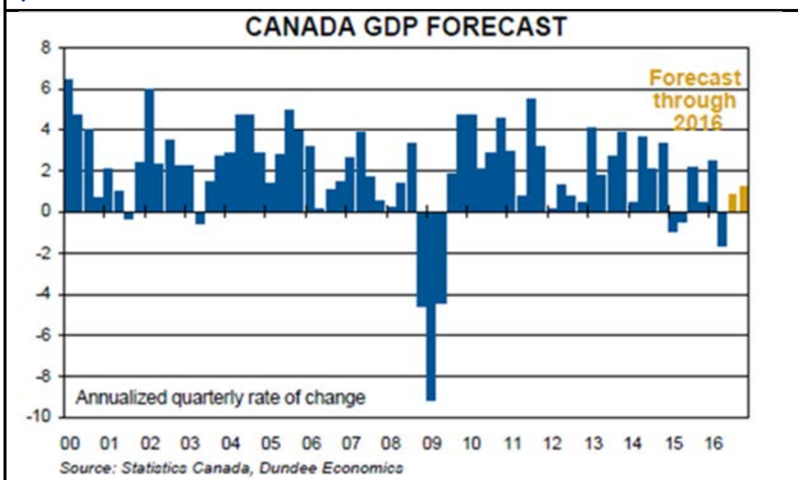
(Source for all charts and statistics: HollisWealth Economic Monitor unless otherwise indicated)

KEY ECONOMIC INDICATORS

The Canadian dollar has been trending sideways recently 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.



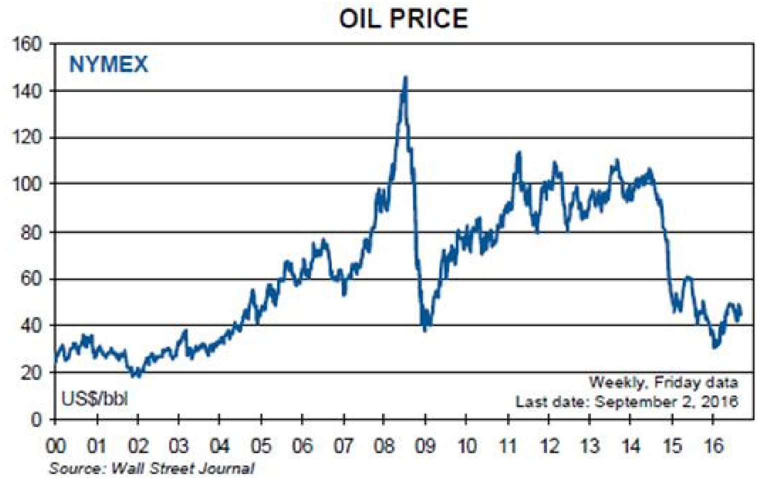
Canadian GDP is forecasted to remain sub 2% which will be a challenge for the level of general employment. Non-energy related industrial production, which is largely dependent on U.S. strength, continues to show moderate improvement to offset the weakness in the energy sector which has represented a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

	Actual				Projected						
	15-IV	16-I	16-II	7-Sep	Oct	Nov	Dec	17-I	17-II	17-III	17-IV
Canada											
Treasury Bill (91-day)	0.47	0.46	0.52	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Government Bond (10-yr)	1.49	1.20	1.33	1.00	1.05	1.10	1.15	1.20	1.30	1.35	1.40
Prime	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70

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. Market chatter is 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

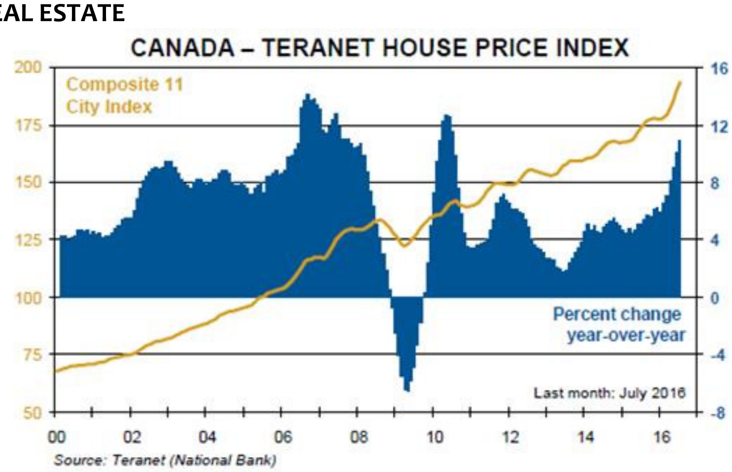


Oil prices have been trending sideways and recovery remains uncertain due to the role of political suasion as well as economic fundamentals driving supply and demand.
Oil production outside North America, particularly from the middle east, remains active and reserves remain high.
The next OPEC meeting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

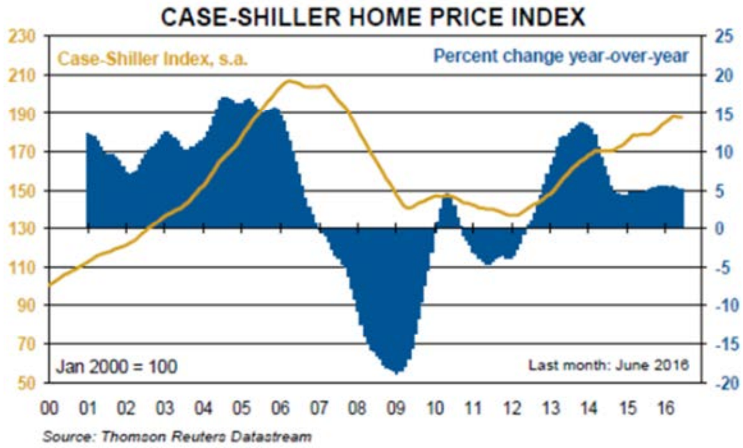
FINANCIAL MARKETS

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

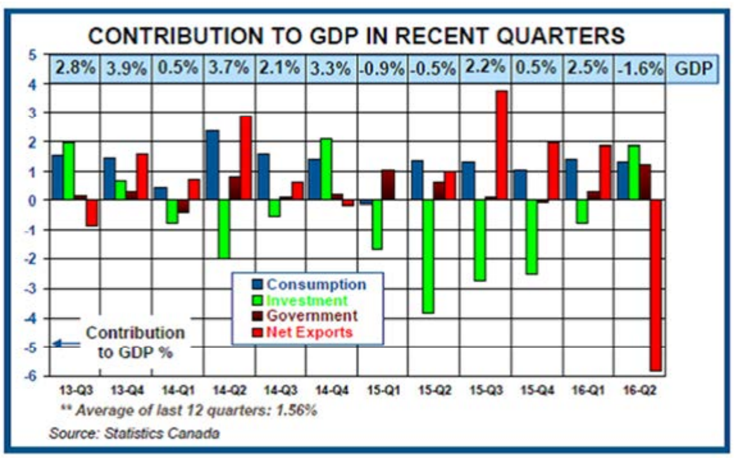


Real estate remains an attractive asset class benefiting from low mortgage rates and economic uncertainty. Values are under regulatory scrutiny which might have a moderate impact on values. However, a decisive change in economic conditions will be required in order to re-direct capital to other sectors other than real estate.



TIMELY ITEMS

ECONOMIC GROWTH
CANADA



With the decline in the value of energy exports, the Canadian economy is now relying on the other primary sectors of consumption, investment and government stimulus to drive GDP.

QUOTES FROM THIS MONTH'S MONITOR

On interest rate expectations

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

BOND YIELDS in the US and Canada to increase very modestly on the back of more fiscal expansion in the US after the November election (and in Canada), along with a moderate increase in the rate of headline inflation. Yields will be held in check by very low yields abroad however;

On Canadian currency expectations

The **CANADIAN DOLLAR** to continue trending broadly sideways;

On U.S. currency expectations

The **US DOLLAR** to trend broadly sideways until after November, when a new administration will encourage the currency to decline.

	The M2 money supply increased at 7.1% year-over-year in July ...
On U.S. Growth	The US continues to post very large trade deficits with China, the EU, and Japan. The US trade deficit has been flat in recent months on the back of weaker domestic growth ...
On Canadian Growth	**Bottom line:** We see no recession on the horizon, notwithstanding negative growth in Q2. Other than net exports, the other components of GDP were OK in Q2. Investment will not continue at the torrid pace of Q2 on account of inventories, but net exports will pick up. We expect growth in 2016 to average less than 1%, which is below the 1.3% projected by the Bank of Canada in its July *Monetary Policy Report*.
Oil price expectations	Oil prices have leveled off in the $45-50 range. The next OPEC meeting is scheduled for November 30.
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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