Weekly Updates Issue # 618

1. Weekly Markets Changes
2. Tech stocks stumble, but don't expect catastrophe
3. Amazon buying Whole Foods in US$13.7-billion deal
4. CSA's embedded commissions ban falls short for clients, say advisors
5. Monthly home sales activity drops most in nearly 5 years
6. Tax on insurance premiums in Saskatchewan coming soon
7. BoC talk takes hawkish turn, loonie rises
8. Average payments on new mortgages climbing faster than inflation
9. Is Canada's economy set to surge? Here are banks' forecasts

1. Weekly Markets Changes

[June 16, 2017]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,192.54 -280.7 -1.81%	2,433.15 +1.38 +0.06%	21,384.28 +112.3 +0.53%	6,151.76 -56.16 -0.90%	$0.7567 +1.44c +1.94%	$1,255.20 -13.60 -1.07%	$44.68 -1.22 -2.66%

2. Tech stocks stumble, but don't expect catastrophe

[June 16, 2017] Technology stocks have taken a stumble over the last week after soaring to heights they last saw just before the dot-com bubble collapsed 17 years ago. Here's why this time might be different.

Technology companies are the main reason the stock market has climbed in recent months. The technology index of the Standard & Poor's 500 index is up 17% this year, twice as much as the broader S&P 500.

Last week they got close to the highs they set all the way back in March 2000– at that time, Mark Zuckerberg was in high school, the iPod didn't exist, and few people had any idea how a company could make money from internet searches.

What's different now? Unlike then, many of the market's favourite tech companies are actually making gobs of money.

"The sector is delivering on a lot of the promises that investors hoped for during the bubble years," Jack Ablin, chief investment officer for BMO Private Bank.

And yet, when the tech index seemed to be just minutes away from breaking a record last week, the stocks went into a steep slump. And some analysts think the stocks will fall a good deal further.

That might bring up bad memories of the tech bubble and its aftermath: the technology index peaked on March 27, 2000, but it nosedived following numerous high-profile company failures, the disastrous AOL-Time Warner

merger, and the recession and stock market slump that followed the September 11th terrorist attacks. By late 2002, the tech index had fallen a staggering 80% from its peak.

Few investors expect that kind of catastrophe this time. One reason is that technology companies are very profitable now compared to then. After adjusting for inflation, the three largest technology companies of 2000, Microsoft, Cisco Systems and Intel, reported $113 billion in combined revenue that year. Apple alone reported $217 billion in revenue in 2016.

"We don't look at this to be the beginning of the end for the sector," said Terry Sandven, chief equity strategist for U.S. Bank Wealth Management. "Conditions are good for growth-oriented companies like tech."

Before the 2000 bubble burst, S&P 500 technology companies were trading at about 68 times their earnings. Today they are trading at about 21 times their earnings, a number that is much closer to where S&P 500 companies are usually valued.

To put it another way, investors value the technology sector at almost $5 trillion now. After adjustments for inflation, it was worth about $6.4 trillion in March 2000. That's for a group of companies that were newer, less tested, had far smaller profits and fewer sales, and paid smaller dividends.

According to numerous experts, the problem today is not that technology companies are trading on overly rosy growth projections or profits that may never materialize. The stocks have simply risen a lot more than the rest of the market. That can't continue indefinitely without a break.

While the possibilities of technology companies seemed intoxicating in the late 1990s, today it's easier to argue that the stock gains make sense because the really have changed the world. They've remade entertainment, and video game makers Activision Blizzard and Electronic Arts are some of the highest-flying technology companies this year.

Design software maker AutoDesk and Salesforce.com have rallied as new technology has reshaped business. With so much critical data now stored in the cloud, cloud computing-focused companies like Microsoft and Adobe Systems have surged. So have numerous chipmakers.

That said, some of the gains this year have been staggering.

Despite their recent losses, Apple is up 23% this year and Facebook has jumped 27%. Alphabet, Google's parent company, has climbed 19%. Microsoft has gained 11%. Those are four of the five most valuable companies on the U.S. stock market today. The other member of the top five is Amazon, which isn't classified as a technology company.

After the huge losses of 2000-02, many investors steered clear of technology stocks. It took about six years for the S&P 500 to recover from the losses it took in 2000, and it took the tech index twice that long.
"Tech bounced along the bottom for six years" after the bubble burst, Ablin says. "Investors are always fearful of the last crisis, and investors may have just washed their hands of tech."
That, too, is hard to picture today. Sandven, of U.S. Bank, said the stocks should do well as long as the U.S. economy keeps growing and their earnings rise.
"We think there's still more upside," he said. "We still like the outlook for many of these companies."

3. Amazon buying Whole Foods in US$13.7-billion deal

[June 16, 2017] Online giant Amazon is buying Whole Foods in a deal valued at about $13.7 billion, including debt (all figures in U.S. dollars).
Amazon.com Inc. will pay $42 per share of Whole Foods Market Inc. That marks an 18% premium to Whole Foods closing price on Thursday.
The deal, which is targeted to close in the second half of the year, comes a month after Whole Foods announced a board shake-up and cost-cutting plan amid falling sales. The grocery store operator was also under pressure from activist investor Jana Partners.
As of close on June 15, Whole Foods Market's stock was trading down at US$33.06, but it opened on June 16 at US$42.06 (the stock was halted until 9:50am). Amazon closed up on June 15 at US$964.17 and opened on June 16 at around US$990.
Whole Foods, known for its organic options, had been facing increased pressure from rivals, including European grocery chain Lidl, which is planning to enter the East Coast market, along with Aldi and Trader Joe's.
Amazon, meanwhile, has been expanding its reach in goods, services, and entertainment.
Under the deal, Whole Foods will keep operating stores under its name and John Mackey will remain as CEO, with headquarters in Austin, Texas.
The company, founded in 1978, has struggled to differentiate itself as competitors also now offer a plethora of fresh and organic foods, and has said customers may be choosing "good enough" alternatives closer to home.
In addition to other natural and organic grocers, it has cited pressure from restaurant chains, meal-delivery companies and traditional supermarkets such as Kroger.

4. CSA’s embedded commissions ban falls short for clients, say advisors

[June 15, 2017] Regardless of how they’re compensated, advisors are often the only thing standing between an investor and a poor, life-altering investment decision.

That comment to CSA on the proposal to ban embedded commissions comes from Brian Hein of Hein Financial Group. In his comment letter, he notes he’s been an advisor for 37 years and has a mostly fee-based business, so doesn’t have a vested interest in opposing the proposal.

His remark about investors and their poor decisions is made in the context of robo-advice, which CSA says will likely fill any potential advice gap resulting from the proposal (for mass-market households).

Though Hein supports investing with fintech, he notes its deficiencies. For instance, investors can be apathetic about their portfolios, rarely changing them as their life circumstances change. Further, investors often assume they can take more risk than they can actually stomach.

“The next big market downturn — and I’ve seen a lot of them — will shake the robo-advice industry to its very core,” he says.

Apathy gap

But more significant than an advice gap is an apathy gap.

“You can’t regulate consumer apathy, inaction or a disciplined approach to personal financial management,” says Hein, adding that apathy is evident in the underuse of RRSPs and TFSAs by average Canadians.

Citing research from the University of Calgary and describing the discipline advisors offer to clients, he adds, “There’s a reason, investors save 45% more when they have an advisor.”

However, he says the proposal does nothing to increase the numbers of investors seeking advice.

“People need more options to obtain financial advice, certainly not less,” says Hein. “This is what is missing in this debate.”

More managers, more problems

For instance, if the proposal results in more advisors becoming discretionary managers — one potential outcome for which CSA asked for comment — that’s not of benefit to investors, says Hein.

“Discretionary managers don’t create […] savings discipline […] any more than a good advisor [who] receives embedded compensation does.”

In fact, he says this potential outcome could be a recipe for disaster, leading to client abuse and fraud.

"After almost four decades in this business, I can easily name a half dozen ways to really rip off a client, and none of them are related to embedded commission[s]," says Hein. "But every way to do it is made that much easier if you are a discretionary manager."
He adds that CSA should enforce existing rules before proposing a ban.

Industry stagnation

David Rupert, a branch manager at Desjardins, says in his comment letter that the proposal won't help meet the demographic challenges faced by the industry.
"Many advisors are baby boomers, and they and their clients are getting older. If we do not allow new independent advisors to be fairly compensated for the effort that goes into finding and servicing clients, we will have no new young people coming into the industry."
The proposal serves to drive independent, commission-based advisors from the industry, says Rupert, "leaving those who actually need help at the mercy of the banks" and other big fund companies.
Letter writer Troy Iwanik, an associated investment and insurance advisor at HollisWealth, describes himself as a younger, independent advisor who relies on embedded commissions for a large percentage of his income.
"Banning embedded costs will have a negative outcome for younger advisors, like myself, who have multiple smaller accounts, as well as the middle-class clients that we serve," he says, referring to the potential for an advice gap.
He thinks recent regulatory changes like CRM2 and Fund Facts are "a great start to full disclosure."
But: "Having the fund companies send out an annual fee letter should be introduced also, so the investor can see the full costs of the funds. It is important to have the banks send out the same letters and materials as well."

How to best lower fees

The proposal outlines potential outcomes if embedded commissions are banned, such as increased price competition and the ability of new lower-cost product providers to enter the market — outcomes that would put downward pressure on fees.
CRM2 has already resulted in lower fees, says Hein, though, like Iwanik, he doesn't think it goes far enough.
"The complete, full disclosure of all fees and taxes on investment funds [would] be good for the investor and [would] undoubtedly drive down total investor fees," he says.
Further, he calls out CSA for favouring ETFs and index funds because they have perceived lower fees. In fact, these funds could be more expensive, he says, when things like trading fees or tax preparation costs are taken into

account. (The concern about how the influx of ETFs and index funds affects the markets is a whole other discussion, Hein adds.)

Further, CSA's endorsement of one type of investment "ironically flies in the face of the fundamental mantra of knowing your client," he says.

On the other hand, Hein supports reducing the number of fund series, saying a ban on DSC and low-load funds would solve several issues in one simple step.

"Don't carpet bomb and risk a lot of collateral damage when a surgical strike will yield you far better results," he concludes.

Rupert suggests CSA cap the compensation that manufacturers can offer advisors.

That way, "the CSA can protect investors while ensuring this industry […] is allowed to offer Canadian investors, big and small, the opportunity to obtain [un]biased, independent advice."

He urges CSA to build on "the findings and spirit of the Stromberg commission."

5. Monthly home sales activity drops most in nearly 5 years

[June 15, 2017] Home sales activity across the country dropped sharply last month, driven by a plunge in the Greater Toronto Area (GTA) after the Ontario government imposed a tax on foreign buyers aimed at cooling the red-hot market.

The number of residential properties sold nationwide fell by 6.2% in May compared to April, the largest month-to-month decline in nearly five years, the Canadian Real Estate Association said Thursday. The industry group, which represents real estate agents, brokers and salespeople in Canada, noted sales transactions were down a whopping 25.3% month-over-month in the GTA.

The data showed that while real estate may be local, the impact of changes in a market the size of Toronto can have a sweeping effect nationally.

"This is the first full month of results since changes to Ontario housing policy made in late April. They provide clear evidence that the changes have resulted in more balanced housing markets throughout the Greater Golden Horseshoe region," CREA chief economist Gregory Klump said in a statement.

"For housing markets in the region, May sales activity was down most in the GTA and Oakville. This suggests the changes have squelched speculative home purchases."

The Ontario government introduced more than a dozen measures, including a 15% tax on foreign buyers, aimed at stabilizing Toronto's blistering housing market. Prices have spiralled out of reach for many potential homebuyers both in and on the outskirts of the city.

Sal Guatieri, a senior economist with BMO Capital Markets, said while the rules have had an effect, they merely brought back "some semblance of normalcy after a manic winter" that will likely be short-lived.

"Given the strong economic, demographic and financial backdrop, don't expect the GTA market to stay down for the count," Guatieri said in a note to clients.

"Policy tinkering will do little to cool demand on a sustained basis. Time to take out the heavy artillery: higher interest rates. The ball is now firmly in the Bank of Canada's court."

The central bank has dropped hints that the era of historically low interest rates may be coming to an end. Just this week, governor Stephen Poloz said cuts to the benchmark rate have "done their job" as the economy builds momentum, a statement that some market watchers have interpreted as a sign that a hike could be six to 12 months away.

In the closely watched Vancouver market, sales transactions were up by 22.8% month-over-month. There are concerns that the city may be returning to bubble territory less than a year after the British Columbia government instituted a tax on foreign buyers of properties in the Vancouver area.

Nationally, the average price for all homes sold last month was $530,304, pulled up by Toronto and Vancouver, where it was $863,910 and $1,110,376, respectively.

6. Tax on insurance premiums in Saskatchewan coming soon

[June 14, 2017] With its March 2017 budget, Saskatchewan expanded its tax base to include provincial sales tax (PST) on individual life, accident and health insurance premiums — a broader approach than taken by other provinces on insurance premiums.

The tax is effective August 1, 2017.

In a LinkedIn post, Ami Maishlish, president of CompuOffice Software, notes that for taxpayers, the PST is essentially a tax on a tax. That's because the province already collects a 3% premium tax on these insurance premiums.

Further, the new tax could also be considered a tax on borrowing.

That's because, for premiums paid monthly, the tax is essentially applied to the financing cost hidden within premiums.

"As such, Saskatchewan's budget […] distorts the tax treatment of borrowing — charging PST on the cost of financing insurance premiums by the insurer while exempting the financing of the same premiums if done by loans from other financial institutions," he says.
He warns that other provinces could follow suit.

7. BoC talk takes hawkish turn, loonie rises

[June 13, 2017] The Bank of Canada is sending more signals that it's moving closer to a hike in its benchmark interest rate as the economy continues to strengthen.
Governor Stephen Poloz told the CBC in an interview broadcast Tuesday that rate cuts introduced by the bank amid the oil-price slump have done their job.
The bank reduced its trend-setting rate twice in 2015 to the very low level of 0.5% to help the economy as it struggled with the effects of the oil-price shock.
Poloz's remarks come a day after the bank's second-highest ranking official indicated the governing council is assessing whether the considerable stimulus from the low rates is still required.
In response to Poloz's more hawkish tone, the loonie rose sharply this morning, trading at 75.64 cents US, up from Monday's average price of 74.54 cents US. That puts the loonie at its highest level since late February, when it fell below 76 cents US.

If not now, when?

Senior deputy governor Carolyn Wilkins said in recent months the economy has registered impressive, broad-based gains not seen since before the oil-price collapse nearly three years ago.
Analysts say these types of comments suggest the bank is beginning to assess when, not if, the bank might introduce its first rate increase in nearly seven years.
Yesterday at the University of Manitoba, Wilkins delivered a speech focused on diversity and Canada's economic strength. Despite her remarks on growth, Brian DePratto, senior economist at TD bank, says in an economics report that the bank isn't signalling imminent action on rates.
"As economic data remains robust and inflation begins to come back, we would expect a gradual monetary tightening cycle to begin, but think this is most likely to take place in early 2018," he says.
In an industry note released after Governor Poloz's remarks to CIBC, Nick Exarhos, director at CIBC World Markets, says: "Recent communication from

the Bank of Canada [is] commensurate with the 50 basis points of tightening we have penciled in for the first half of 2018 — or slightly earlier."

8. Average payments on new mortgages climbing faster than inflation

[June 13, 2017] Canada's federal housing agency says the average scheduled monthly mortgage payment for new loans climbed to $1,328 in the fourth quarter of 2016, up 4.6% from $1,269 a year ago.

The increase came as house prices continued to rise, particularly in the cities of Toronto and Vancouver and their surrounding areas.

Canada Mortgage and Housing Corporation (CMHC) says the fact that the average scheduled monthly payment is growing faster than inflation is concerning because it suggests homeowners could struggle to make their payments going forward.

In Toronto, the average payment was $1,826 during the fourth quarter of last year, up 11.5% from $1,638 a year prior. In Vancouver, it rose by 4.5% to $1,936 from $1,853 in the fourth quarter of 2015.

CMHC, which obtained data from credit monitoring agency Equifax, says mortgage delinquency rates during the fourth quarter of 2016 were 0.34% nationwide compared with 0.35% a year earlier.

9. Is Canada's economy set to surge? Here are banks' forecasts

[June 12, 2017] The economy will grow at nearly double the average pace of the prior two years, predicts RBC Economics in a June 9 release and in its latest quarterly outlook report.

Even better, "Canada's economy is on track to post its strongest gain in three years," says Craig Wright, senior vice-president and chief economist at RBC, in the release. He adds, "While we don't discount the risk of a slowdown resulting from the pending renegotiation of NAFTA or the expected cooling of the housing market, we remain confident the economy will continue to grow at an above-potential pace for the remainder of this year."

Following solid GDP numbers for Q1 and hints of strength in March specifically, RBC Economics expects real GDP to grow 2.6% in 2017 and 2.1% in 2018, with B.C. leading the provinces; Newfoundland and Labrador will bring up the rear.

The bank does forecast "a period of weakening" for the loonie, saying it will "end 2017 at 71.4 U.S. cents." But that will change in 2018, it adds, "as the

Bank of Canada starts to raise the overnight rate and oil prices continue to march upward."

RBC isn't the only bank with a sunny outlook: in a June 6 forecast, Scotiabank calls for "solid acceleration" of global growth, relative to last year, "with growth of 3.5% in 2017," and it has increased its forecast for Canada's growth for the year.

Scotiabank says, "We expect growth to stabilize around a 2% annualized rate for the remainder of the year, leading to annual growth of 2.6%, double the Bank of Canada's estimate of potential output growth." As such, it adds, that could "lead Governor Poloz to raise interest rates sooner than 2018Q2."

BMO and CIBC are also positive on GDP, with BMO calling for 2.7% real GDP growth in 2017 and CIBC expecting an uptick to 2.6% due to "momentum being carried forward." CIBC also points to "upgrades to the profile for household consumption."

TD Bank and Desjardins are optimistic but cautious.

In a May 31 release, TD says, "The Canadian economy roared ahead in the first quarter of the year," and consumers and business spending were the main drivers. But, even though "boring old Canada saw a first quarter pace of growth that more than tripled what was seen for the U.S," says TD, "there are reasons to expect a less exciting pace of expansion going forward. " The bank expects another strong quarter, but no BoC action until 2018.

In a June 12 report, Desjardins says that Canada's excess production capacity is being absorbed — a good sign. This means "upside pressure on prices could sharpen in the coming years," leading the BoC to reduce stimulus. However, the bank also highlights "major uncertainties surrounding the economic outlook, and weakness in core inflation."

Have a nice and fruitful week!

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