Weekly Updates Issue # 649

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1. Weekly Markets Changes

[February 2, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,606.03 -633.2 -3.90%	2,762.13 -110.7 -3.85%	25,520.96 -1,095.8 -4.12%	7,240.95 -264.8 -3.53%	$0.8116 -0.38c -0.47%	$1,333.39 -15.73 -1.17%	$65.45 -0.69 -1.04%

2. This is why the Dow is plunging

[February 2, 2018] Stocks were pummeled on Friday, capping the worst week in two years. Here's what's going on.

1. Concerns that the Fed will raise rates

Stocks have been rising steadily since the election in part because the economy is so strong. Unemployment is historically low, and there are more open jobs than people to fill them.

Companies are starting to pay workers more to retain existing employees and attract new hires. Businesses will eventually have to raise prices on the stuff they sell to afford their growing payrolls. In economics, that's called inflation.

Though the economy has been growing steadily for almost nine years, inflation has remained stubbornly and mysteriously low. The Federal Reserve combats inflation by raising its interest rates. The central bank has been unable to significantly raise its interest rates over the past decade, fearing it could stymie the economic recovery and perhaps cause prices to fall.

The Fed planned on raising interest rates slowly this year-- just three times in 2018. But if inflation picks up, the Fed could raise rates more often and more steeply than it had planned.

2. Rising interest rates

When the Fed raises rates, the cost of borrowing money increases. That means companies have to pay more for their loans, which cuts into corporate profits. It also means Americans will pay more for mortgages and loans.

Another reason the stock market has risen so much over the past year has been the steady growth in corporate profits. Companies are healthy, and investors have rewarded them by pushing up their stock prices.

When interest rates rise sharply, stocks often fall. Investors worry that businesses' profit parade will slow down.

3. Worries about the bond market

Stocks have also been on a tear because they have been one of the only investments with a decent return. U.S. Treasury bond yields have been so low that many stock dividends are paying better.

But stocks are a higher-risk investment than bonds, which are backed by the United States Treasury. If bond yields start to rise, investors will want to take some of their money out of stocks and put it into safer bonds.

Sure enough, bond yields hit a four-year high Friday. The recent tax bill has forced the Treasury to borrow more money, which will put more bonds into play. A supply glut could devalue bonds. Prices and yields move in opposite directions, and bond buyers will want a higher yield (and lower price) to make it worth their investment.

Inflation is bad for bonds, too. If borrowing costs increase, bond investors will want more return -- a higher yield.

Attractive yields on a safer investment have made stocks suddenly less attractive.

4. Ugly politics

Politics has played a part in stocks' steady march higher, too. The Republican tax cut is great for corporate profits. Investors have rewarded companies' promises of bigger stock buybacks and dividends by raising their stock prices. Business confidence is on the rise, in part thanks to the Trump administration's push to cut regulation.

On Friday, the controversial release of a once-classified memo about the Russia investigation gave investors pause. Turmoil in Washington could be bad for business. It could create a logjam in Congress.

It's not top of mind for investors, but it's adding to their concerns.

5. Too far, too fast

Stocks have been rising pretty much in a straight line since November 2016, and that's not exactly healthy. Stock market analysts believe the stock market is long overdue for a 5% pullback or even a 10% correction.

A cooling-off period would be a good thing. It would make stocks cheaper and more attractive to investors, especially if the underlying companies are healthy, cranking out strong sales and profits.

The market finally began to come down to earth -- just a bit -- this week, and investors wonder whether this is the beginning of a correction. There could be a little groupthink taking place in the downturn.

3. Federal Conservatives propose tax credit for parental leave

[February 1, 2018] The federal Conservatives are proposing a tax break for parents of newborns.

The Tories say they will introduce the proposed measure as a private members' bill in the hope of having it passed into law in the current sitting of Parliament.

But party officials acknowledge the plan is effectively the first major policy announcement for the Conservatives leading into the 2019 election campaign.

The proposal, called the Supporting New Parents Act, would see Canadians on parental leave get a credit on their employment insurance benefits equal to the federal tax on those benefits.

Conservative Leader Andrew Scheer says the credit would be worth $4,000 for a parent who earns $50,000 annually.

He says the government should not be taxing the time parents take to be with their children during their early years.

4. Alan Greenspan: 'We have a stock market bubble'

[January 31, 2018] Alan Greenspan is sounding the alarm about the booming stock market.

"There are two bubbles: We have a stock market bubble, and we have a bond market bubble," the former Federal Reserve chairman told Bloomberg TV on Wednesday.

The trouble in the bond market "will eventually be the critical issue," Greenspan said, adding that "for the short term it's not too bad."

Many Americans recall that Greenspan, known as the Maestro when he led the Fed, described the dotcom mania of the 1990s as "irrational exuberance."

That memorable phrase, from late 1996, ended up being right -- albeit several years early. The Nasdaq didn't peak until March 2000.

Greenspan, who was appointed Fed chair by both Republican and Democratic presidents, raised doubt in the interview about President Trump's economic agenda.

"I was very much surprised that in the State of the Union all those new initiatives were not funded," Greenspan told Bloomberg.

Trump's tax overhaul is expected to add to the federal deficit, something Greenspan has previously called a "mistake." Trump's plan to ramp up infrastructure spending could do the same. He has not detailed how he plans to pay for it.

Asked what happened to the "frugality and prudence of the GOP," Greenspan replied: "Good question. If you find out let me know."

The worry is that the government spending, from new programs and existing social safety nets, will blow a hole in the budget. That could cause interest rates to rise rapidly, speeding up inflation.

"We are dealing with a fiscally unstable long-term outlook in which inflation will take hold," Greenspan said. "We're working our way towards stagflation."

Greenspan's skepticism of the bond market isn't new -- or surprising. Last July he said that bonds, but not stocks, were in a bubble.

Bond prices have cooled since then, but the stock market has kept heating up. The Dow has zoomed another 4,000 points since mid-summer. Stocks retreated a bit this week: The Dow suffered its worst two-day percentage drop since September 2016.

There are valid reasons for stocks to be booming. The U.S economy is healthy, and the global economy is growing even faster. Corporate profits have never been higher -- and they're getting a big boost from the tax cut for businesses.

The relentless rally has led some analysts to warn that the markets are in a "melt-up," a rapid rise in prices based on emotion, not fundamentals.

Greenspan is going a step further by calling the market an outright bubble. The Dow has surged 44% since Trump's election.

Most market strategists acknowledge high levels of optimism, but not exuberance.

"I don't see big bubbles," said David Kelly, chief global strategist at JPMorgan Funds. "I see small bubbles, but on a rising tide of enthusiasm."

Kelly said there is no "obvious bubble like tech stocks in 1999 and the housing bubble in 2007."

The overheated housing market last decade laid the groundwork for the 2008 financial crisis, the worst since the Great Depression.

The Federal Reserve has been criticized for helping to inflate the housing bubble by keeping interest rates too low. The leader of the Fed at the time? Alan Greenspan.

5. Widespread growth—including in financial services—boosts GDP

[January 31, 2018] Real gross domestic product (GDP) increased 0.4% in November, says StatsCan, with growth reported in 17 of 20 industrial sectors. The finance and insurance sector grew 0.3% in November, after four consecutive months of decline. Financial investment services, funds and other financial vehicles were up 0.5%, says StatsCan, as market activities involving securities, mutual funds and trusteed pension assets increased.

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"Still, today's results only keep us in the 2% or so range for Q4, slightly under the [Bank of Canada]'s recently released, and unchanged, 2.5% forecast," he says. "That suggests a pause through the winter and spring is still the most likely outcome for rates."

Derek Holt, vice-president and head of capital markets economics at Scotiabank, has a different take on potential BoC action.

"Strong growth in November, combined with last week's further increase in core CPI, present[s] evidence to somewhat hawkishly inform the BoC's data-dependent posture in support of our forecast for another rate hike by spring," he says in a report.

However, Holt acknowledges "we'll still need a rather strong December reading or difference in GDP tracking sources" to reach the BoC's growth forecast of 2.5%.

The nitty-gritty

Goods-producing industries rose 0.8% after declining 0.5% in October, says StatsCan. The gain in November was largely due to increases in the manufacturing and mining, and quarrying and oil and gas extraction sectors as production returned to capacity.

The manufacturing sector was up 1.8% in November, the largest monthly increase since February 2014, says StatsCan, as the majority of subsectors grew.

Says Exarhos: "Most of the strength in manufacturing was tied to autos, which after four straight months of declines totalling over 20%, closed most of the gap by expanding at a 14.3% clip."

On the oil and gas sector, he comments, “We’re looking for more growth in the sector in the year ahead, as firmer pricing for light crude incentivizes conventional production, while a major oil sands facility gears up for what is likely to be 200k [barrels per day] of output sometime in 2018.”
Services-producing industries rose 0.3%, led by the real estate and rental and leasing, wholesale, and retail trade sectors.
In particular, real estate and rental and leasing rose 0.4% in November. Although there was increased home resale activity in Ontario and Alberta, the level of activity of this subsector remains below its March 2017 level, says StatsCan, following provincial government changes to housing regulations in Ontario that came into effect in April 2017.

6. Toronto home sales to slip, prices to climb

[January 30, 2018] Canada’s largest real estate board predicted a slower year is ahead for Toronto’s housing market after it overheated in 2017 and sent home prices surging.
In a preview of its annual forecast, the Toronto Real Estate Board (TREB) said it expects home sales this year to slip to somewhere between 85,000 and 95,0000, slightly lower than 2017 when there were 92,394 sales.
However, that dip in sales will come as the average selling price will creep higher, TREB said.
It forecast that the average home will sell for between $800,000 and $850,000—the same as TREB predicted for 2017. That year the average selling price reached $822,681.
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TREB also says it expected year-over-year declines will be more pronounced in the first four months of this year, but sales will be up in the late spring and summer months when compared with last year.

Toronto home sales started 2017 on a hot streak, but slowed after the Ontario government moved to cool the market after a busy first quarter.

The market was further dampened after an interest rate hike from the BoC in January, a rise in five-year fixed mortgage rates and the Office of the Superintendent of Financial Institutions' stress test that came into effect on Jan. 1.

The test requires would-be homebuyers with a more than 20% down payment to prove they can still service their uninsured mortgage at a qualifying rate of the greater of the contractual mortgage rate plus two percentage points or the five-year benchmark rate published by the BoC.

"Federal and provincial policy decisions will act as a drag on demand for ownership housing," says TREB in a release. "In response to the stress test, many intending buyers will change the type and/or location of home they are looking to purchase or potentially tap other down payment sources, rather than simply deciding not to purchase a home."

However, it noted first-time buyers are an exception because they have the flexibility of being able to rent or live with family while deciding when, where and what type of home to buy.

TREB's forecast comes about two weeks after the Canadian Real Estate Association slashed its outlook for 2018 to predict a 5.3% drop in national sales to 486,600 units this year. When compared with previous estimates, that's a drop of 8,500 units.

It says it was already seeing signs that the country was "fully recovering" from last year's heated conditions that sent the market into a frenzy.

7. Is the Eurozone out of the debt crisis?

[January 30, 2018] The eurozone economy, for so long a source of uncertainty, has enjoyed its best year in a decade, clear evidence it has broken out of the prolonged debt crisis that raised fears about the very survival of the euro currency.

In its first estimate for the fourth quarter, Eurostat, the European Union's statistics agency, says Tuesday that the eurozone expanded by 0.6% in the October-December period from the three months before.

That more-than-healthy level of growth means that for the whole of 2017, the eurozone economy expanded by 2.5%. That was up from 2016 and its best performance since 2007, when it grew 3%. The eurozone even grew faster than the U.S., which expanded by 2.3%.

"Economic growth has shifted to a substantially faster growth path over the course of 2017," says Bert Colijn, senior eurozone economist at ING. "While detailed breakdowns have yet to be released, it seems that the eurozone economy continues to fire on all cylinders."

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In the decade since 2007, the eurozone has had to grapple with one crisis after another, starting with the financial crash of 2008 that prompted the deepest worldwide recession since World War II. That exposed the weak underbelly of the eurozone — the state of the public finances in a number of member economies.

Four countries — Greece, Ireland, Portugal and Cyprus — had to be bailed out by their partners in the eurozone and the IMF, and in return they made deep budget cuts to get their public finances into shape, hitting their economies hard. The Greek economy, for example, shed around a quarter of its output, and saw unemployment and poverty levels ratchet higher.

It's only recently that existential concerns surrounding the euro have eased. Greece, notably, is set to emerge from its bailout era this summer, eight years after it first faced potential bankruptcy.

With fears of a breakup of the eurozone largely evaporated, confidence across the bloc has risen. That's evident in the fact that growth isn't just reliant on the big economies of Germany and France. Stronger growth is being recorded in those countries that were at the forefront of the crisis and that's helping to bring down unemployment, potentially reinforcing the recovery even more.

Following the defeat of several populist political movements in elections in 2017, such as in France and the Netherlands, there are fewer fears about the prospect of anti-euro politicians taking the helm.

The ECB and euro

Meanwhile, the recovery has been boosted by the European Central Bank's massive stimulus program and its move to slash interest rates. The wider global economy — in particular trade — is also on the up, and that's supporting the eurozone's exporters.

That combination of positive factors is expected to hold in 2018 and growth is anticipated to come in around 2017's level.

Potential headwinds include the recent rise in the value of the euro, particularly against the dollar, which makes eurozone exports less competitive in international markets, and less stimulus from the ECB.

Following the growth figures, the euro advanced further towards its recently hit three-year high-rate against the dollar, and was trading 0.4% firmer at $1.2433.

Meanwhile, electoral considerations will remain a feature of eurozone life. The next potential hurdle is the Italian election in March, when euroskeptic parties are predicted to do well if not win outright.

"A hung parliament is one of the most likely outcomes as established parties continue to lose ground against the populist Five-Star movement, Silvio Berlusconi's Forza Italia movement and the nationalist Northern League," says Kay Daniel Neufeld, managing economist at the Centre for Economics and Business Research.

8. ICBC's losses add up as premiums fail to cover payouts

[January 29, 2018] The financial crisis at British Columbia's public auto insurer is deepening, as $1.3 billion in net losses are now projected by the end of the current fiscal year.

The Insurance Corporation of B.C. said the "sizable and significant loss" is evidence of the growing financial pressures from a rapid increase in the number of collisions in the province, as well as the rising costs of those claims.

"The number of crashes occurring across B.C. is continuing to escalate year-after-year. As a result, the number of claims we are receiving is growing by thousands each year," the corporation said in a news release on Sunday.

The cost of injury claims is closing in on $3 billion annually, ICBC said.

The number of large loss claims, with an average payout of $450,000, has also spiked by 80% in the last 12 months.

The spike in the number of claims is also causing a slow-down in how quickly settlements are delivered.

"This has particularly been the case with represented claims, which are taking even longer to settle. The longer a claim takes to settle, the more expensive it becomes," ICBC said.

ICBC said $935 million in net losses have already accumulated between April 1 and Dec. 31 last year, signalling that premiums are not covering payouts.

The insurance provider asked the provincial utilities commission to hike basic and optional rates last fall to combat its financial crisis.

Attorney General David Eby said in September that the rate hikes would mean the average driver can expect an annual increase of 8%, or $130 per year, on their insurance bill.

Eby has previously said the Crown corporation's financial problems are the fault of the former Liberal government for failing to address issues years ago.

But Liberal caucus executive director Shane Mills said the previous government implemented strong measures to control costs, including a distracted driving campaign, raising premiums for some high-level vehicles and reducing executive pay.

"As well, a third-party review was conducted on how to tie any rate increases to inflation, and is in the hands of the new government," Mills said in a statement.

Eby is expected to deliver his response to the latest losses Monday in Vancouver.

Finance Minister Carole James was not available for comment Sunday on how the loss will affect the upcoming provincial budget.

Have a nice and fruitful week!