Weekly Updates Issue # 669

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1. Weekly Markets Changes

[June 22, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
16,450.14 +135.72 +0.83%	2,754.88 -24.78 -0.89%	24,580.89 -509.59 -2.03%	7,692.82 -53.56 -0.69%	$0.7514 -0.75c -0.99%	$1,270.56 -8.38 -0.66%	$69.28 +4.22 +6.49%

2. Inflation rises for second straight month, but data disappoint

[June 22, 2018] The country’s annual inflation rate rose 2.2% in May for the second straight month as the higher cost of energy applied upward pressure on prices, Statistics Canada said in a new report Friday.

The latest inflation reading followed the 2.2% number for April and 2.3% for March, the agency found in its consumer price index.

The main contributors to inflation last month were led by gasoline prices. Compared to a year earlier, they climbed 22.9% in May and helped drive overall energy prices for the month 11.6% higher.

Inflation also received a lift because Canadians paid more last month for restaurants, airline tickets and mortgage interest costs.

Consumers, however, paid less in May for telephone services, natural gas and digital devices and computers.

The report also found the average of the Bank of Canada’s three measures of core inflation, which leave out more-volatile numbers like pump prices, slowed to 1.9% last month.

The core reading shows these underlying numbers, which are closely monitored by the central bank, cooled somewhat compared to April, when the average hit 2.03%—its strongest pace in six years.

“Expectations for a steep rise in inflation were running high, but today’s numbers came in miles below the street’s consensus,” says CIBC’s Royce

Mendes in a research note. “The lack of hotter inflationary pressures owed to weakness across a handful of categories, but the Bank of Canada’s core measures are still hovering around the 2% target.”

But, even though there’s just over two weeks until the central bank’s next announcement, he adds, “there are still a number of events which could affect the decision.”

In a separate report Friday, Statistics Canada said retail trade delivered disappointment in April with a contraction of 1.2% that pulled total sales down to $49.5 billion. It marked its first month-to-month decline since December when sales also fell 1.2%.

The April decrease was mostly due to a 4.3% decline in sales by motor vehicle and parts dealers—with new car dealerships reporting a 5.1% drop and used car lots seeing a contraction of 4.1%.

The overall decline was concentrated in Canada’s largest provinces, the agency said. In Ontario, sales fell 2.3%, while Quebec saw a drop of 2.7%.

Statistics Canada, however, did release an upward revision to its retail sales data for March. The updated reading shows a 0.8% increase, compared to its preliminary 0.6% estimate.

National Bank’s Krishen Rangasamy says in a Friday report that April’s cold weather was a main driver of the data’s weakness. “The Canadian retail data for April was much weaker than expected. [But] does that mean Canadian consumers are finally folding under the weight of elevated household debt? True, a rough start to the year for the labour market (if you believe the Labour Force Survey) and rising interest rates could be weighing on consumers somewhat. But a colder than normal April also weighed on the results […].”

Excluding Ontario and Quebec data, he adds, “[…] Canada’s retail spending was actually up in April! So, the overall weak retail results have to be interpreted with caution.”

Friday’s data will help feed the Bank of Canada’s deliberations as its governing council considers its next interest rate decision.

The central bank’s next interest rate announcement is scheduled for July 11.

For inflation, the bank can use interest rate hikes as a tool to help prevent it from climbing too high. The Bank of Canada tries to keep inflation from moving outside a range of between 1% and 3%.

Recent inflation readings—including Friday’s—have been just above the mid-point of the bank’s target range.

It’s unlikely, however, to have a significant impact on upcoming rate decisions because governor Stephen Poloz has predicted inflation to stay above 2% for all of 2018.

In the spring, the bank raised its inflation projections because of what it described as the temporary effects of higher gas prices and the introduction of minimum wage increases in some provinces.

Poloz has predicted inflation to average 2.3% this year before settling back down to 2.1% in 2019.

He's raised the trend-setting interest rate three times since last July, but he hasn't touched the rate since January. It's been at 1.25% ever since.

For months, experts have been predicting Poloz will raise the interest rate at the July meeting.

But, because of growing uncertainty linked to U.S. President Donald Trump's protectionist agenda, some experts are starting to wonder if Poloz will wait a little longer.

3. Warning: Don't be fooled by the working income tax benefit tax scheme

[June 22, 2018] The Canada Revenue Agency (CRA) is warning Canadians about getting involved in schemes where promoters, usually tax representatives or tax preparers, are claiming they can get a tax refund for participants from the working income tax benefit (WITB) even if they have no work income.

Setting the record straight: What is the working income tax benefit?

The working income tax benefit (WITB) is a refundable tax credit intended to give tax relief for eligible low-income individuals and families who are currently in the workforce. It also encourages Canadians to enter the workforce. You can only claim the WITB if you are earning income from working in Canada.

Be careful—here's how the scheme works:

Here is what to watch for in the WITB scheme:

- The promoter, who is usually a tax preparer or tax professional, will tell you they can increase your tax refund.
- They will tell you that they will prepare a T4 (a T4 is a slip that shows your work earnings, or employment income) in your name and they will list an income amount in box 14 of the slip that will maximize your tax refund.
    - **If you have not worked as an employee in Canada, then you should not have a T4 slip with your name on it.** Reporting this amount may result in serious consequences to you.
- By law, when preparing a T4, an employer must subtract certain amounts from your work earnings. These include deductions such as:

income tax and mandatory employee contributions to certain programs (Employment Insurance (EI), the Canadian Pension Plan (CPP) and the Quebec Pension Plan (QPP)). The promoter will tell you that you must pay them the tax deductions they noted on the T4 slip as well as a fee for them completing your tax return. A legitimate tax preparer will never ask you to pay back deductions and will not prepare a T4 for you when you did not earn income in Canada.

A good rule of thumb – If something sounds too good to be true, it most likely is.

What are the consequences to you if you participate in these schemes and what can you do?

The WITB is not intended for individuals who have no work income. If someone claims it is, they are misleading you and there may be serious consequences.

Those who choose to participate in these schemes and those who promote them face serious consequences, including penalties, court fines, and even jail time.

People who avoid or evade taxes take resources away from social programs that all Canadians benefit from.

All taxpayers, including those who pay tax experts to prepare their taxes, are legally responsible for the accuracy of their tax returns.

The CRA encourages all Canadians to seek an independent second opinion from a reputable tax or legal professional on important tax and legal matters.

If you suspect someone of promoting or participating in an abusive tax scheme, you can report it at Canada.ca/taxes-leads or by calling the Leads program at 1-866-809-6841. You may give information anonymously.

For more information on tax schemes, please visit Canada.ca/tax-schemes.

4. Manulife cuts 700 jobs as part of digital transformation

[June 21, 2018] Manulife announced on Thursday it will cut 700 jobs as part of a digital transformation plan.

Manulife has launched a program to digitize customer transactions and consolidate “administrative and operational back office functions.” The resulting job cuts will come from voluntary exits and natural attrition in the next 18 months, said the financial services company in a release.

The cuts will largely target customer service positions that are no longer necessary as the company automates customer transactions, said Michael Doughty, CEO at Manulife.

“Our industry, including us, are still doing too many things the old way: processing paperwork, accepting mail, answering telephone calls on information requests that clients should be able to access on their own.”

Manulife is hiring and retraining staff to focus on expanding its digital capabilities. The company also says it plans to “re-orient its customer service” throughout its business.

The company plans to focus personal client services on the 20% of services dealing with major life events like a death in the family, while automating the 80% of client interactions that cover submitting claims, asking questions and other routine tasks.

The company will combine its two Kitchener-Waterloo offices into one Canadian division headquarters.

5. Wholesale sales rose 0.1% in April: Statistics Canada

[June 21, 2018] Statistics Canada says wholesale sales gained 0.1% to $63.1 billion in April.

The small increase came as gains in machinery, equipment and supplies and the food, beverage and tobacco subsectors were offset by a drop in the motor vehicle and parts subsector.

The agency says wholesale sales in volume terms were unchanged.

Sales were up in three of the seven subsectors.

The machinery, equipment and supplies subsector climbed 2.3% to $13.0 billion, while the food, beverage and tobacco subsector rose 1.9% to $12.1 billion.

The motor vehicle and parts subsector fell 4.0% to $11.5 billion.

The wholesale report is unlikely to change forecasts for GDP in Q2, said Royce Mendes, senior economist at CIBC Economics, in a note. Attention will now focus on CPI and retail sales reports expected tomorrow, “the next major hurdle to pass for the Bank of Canada to hike rates in July,” he said.

6. Why aren’t Americans benefiting from robust U.S. economy?

[June 18, 2018] “The economy,” Federal Reserve Chairman Jerome Powell declared last week, “is doing very well.”

And it is. Steady hiring has shrunk unemployment to 3.8%—the lowest since the 1960s. Consumers are spending. Taxes are down. Inflation is tame. Factories are busy. Demand for homes is strong. Household wealth is up.

Yet the numbers that collectively sketch a picture of a vibrant economy don’t reflect reality for a range of Americans who still feel far from financially secure even nine years into an economic expansion.

From drivers paying more for gas and families bearing heavier childcare costs to workers still awaiting decent pay raises and couples struggling to afford a home, people throughout the economy are straining to succeed despite the economy’s gains.

They are people like Katy Cole, a 33-year-old music teacher from North Creek, New York, who’s still repaying her student loans. It took her two years of working a second job to repair her credit and amass enough money to try to buy a home with her boyfriend. She just gave birth last month—the fourth child in her blended family—which means having to take unpaid leave from her school job.

“As far as the numbers saying everyone is working, that’s great,” Cole says. “But is everybody surviving? I don’t think so. In a great economy, everybody is thriving—and not just a certain group.”

When analysts at Oxford Economics recently studied American spending patterns, they found that the bottom 60% of earners were essentially drawing on their savings just to maintain their lifestyles. Their incomes weren’t enough to cover expenses.

“Many people are still living on a paycheque-to-paycheque basis,” says Gregory Daco, head of U.S. economics at Oxford.

Daco and other economists describe the economy as fundamentally healthy, a testament to the durable recovery from the 2008 financial crisis. The job market, in particular, is booming. But even many people who have jobs and are in little danger of losing them feel burdened and uneasy.

Here’s a look at the economy from their perspectives:

Commuters

Even with inflation running at a relatively low 2.4%, one particular expense is weighing on anyone idling in traffic: gasoline prices have surged 24% over the past year to a national average of US$2.94 a gallon, according to AAA. (All figures are in U.S. dollars.) That’s the highest average since 2014.

Analysts at Morgan Stanley have estimated that the increase this year will likely eat away a third of people’s savings from Trump’s tax cuts. Gas prices are still below their high reached roughly a decade ago. Yet the increase this year represents an additional financial burden on consumers and businesses compared with a year ago.

Homebuyers

A strong job market can actually be a curse for would-be homebuyers. With more people drawing paycheques and able to afford a home, demand has intensified. Yet the number of homes listed for sale is flirting with historic lows. The combination of high demand and low supply has driven prices to troubling high levels.

It’s not just that homeownership is largely unobtainable in San Francisco or Seattle. The Case-Shiller index shows that home prices are rising more than 6% annually in Atlanta and Minneapolis. In the Detroit metro area, they’re up nearly 8% over the past 12 months. By contrast, average hourly wages have risen just 2.7% over the past year.

The real estate brokerage Redfin says the median sales price in the 174 markets it covers has jumped 6.3% over the past year to $305,600. A general rule of thumb is that buyers can afford a home worth roughly three times their income. So the median home sales price far exceeds what a typical U.S. household earning a median $57,000 income can manage.

On top of that, 30-year fixed-rate mortgages are growing costlier. The average interest rate on these mortgages has jumped to 4.62%—from 3.95% at the start of the year—according to mortgage buyer Freddie Mac.

The middle class

$100 trillion. That’s roughly the net worth of U.S. households and nonprofits, according to the Federal Reserve.

Problem is, America’s wealth is increasingly lopsided, with the affluent and the ultra-wealthy amassing rising proportions and everyone else benefiting modestly if at all.

The top 10% of the country holds 73% of its wealth, a share that has crept steadily up since 1986, according to the World Inequality Database. The most sweeping gains are concentrated among the top 1%; this group holds nearly 39% of the wealth. And they’re arguably poised to become even more prosperous because Trump’s tax cuts largely favoured the wealthiest slice of individual taxpayers.

Contrast that with the middle 40% of the country, a group that would historically be considered middle class. In 1986, they held 36% of the country’s wealth; now, it’s just 27%.

Worse off is the bottom 40% of Americans: they have a negative net worth and almost no financial cushion in case of an emergency.

Most Americans can’t draw on stocks, rental properties, capital gains or significant home equity to generate cash. They depend almost exclusively on wages. And after adjusting for inflation, the government reported that Americans’ average hourly earnings haven’t budged over the past 12 months.

High school–only grads

Employers increasingly favour college graduates over people with only a high school diploma. Out of the 2.6-million jobs added in the past year, the government's job data show that 70% of them went to college graduates. Workers who have graduated only from high school made up less than 1% of the job gains.

It wasn't this way in May 2000, when the unemployment rate was nearly as low as today. Back then, only 30% of new jobs went to college graduates. Census figures show that only 30% of Americans older than 25 have college degrees, which means a majority of the country isn't receiving the full benefit from the sustained job growth.

College grads

For all their good fortune as the favoured recipients of job growth, there's a major downside for recent college graduates. Obtaining a degree has increasingly coincided with ever-higher student debt loads. Since 2004 total student debt has climbed 540% to $1.4 trillion, according to the New York Federal Reserve. About 60% of college graduates from 2016 held debt, with an average of $28,400, according to the College Board. That figure doesn't include any graduate school debt. The Urban Institute found that advanced degree students borrowed an average of $18,210 in 2015—about triple what undergraduates borrowed that academic year.

Mounting student debt could hinder the buying of homes and formation of families that helped growth in previous decades. A survey last year by the National Association of Realtors found that student debt was delaying homeownership by seven years among millennials, a generation it defined as people born between 1980 and 1998.

Payers of childcare

Children are immensely expensive. For nearly a third of families, the costs of childcare swallowed at least 20% of their income, according to a survey posted in March by the caregiver jobs site Care.com. Nearly a third of parents said they went into debt to cover childcare expenses.

When Care.com assessed how much its members were spending on daycare centres for infants yearly, the average cost was $10,486, and it ranged as high as $20,209. Nannies were even pricier.

Research also suggests that some women remain outside the workforce because of the comparatively weak family leave and childcare policies in the U.S. relative to those in other developed economies. A result is that families are forgoing income that would otherwise benefit them and the economy.

When the unemployment rate was last around 3.8% in 2000, the proportion of women who either had a job or were looking for one was peaking. For women ages 25 to 54, that proportion—called the labour force participation rate—was roughly 77% in 2000. It's now 74.8%.

If women's labour force participation were to return to 77%, there would be 1.4 million more women in the work force.

7. Advisors concerned about volatility, rising rates: survey

[June 18, 2018] Following lacklustre returns in the Canadian stock market in 2017, financial advisors are concerned that higher levels of market volatility, interest rate hikes and possible asset bubbles threaten investment returns for 2018, finds a survey by Natixis Investment Managers. This environment can also lead investors to make costly mistakes—and managing the emotional reactions of clients could be advisors' greatest challenge this year, notes the firm.

In fact, 94% of advisors say that preventing clients from making investment decisions based on their feelings is important to their success, according to the survey. In addition, 34% report that their clients reacted emotionally to recent market movements; 43% believe investors are prepared for a market downturn.

Financial advisors also have their work cut out as they navigate through the market's choppy waters. As survey respondents strive to grow assets under management by an average of 14% over the next 12 months, they see several potential roadblocks.

- **Threats to investment performance:** Advisors see rising volatility as the biggest potential threat to the markets—73% say it would negatively affect overall investment performance. Trailing perils are asset bubbles (63%), geopolitical events (57%) unwinding of quantitative easing (57%), interest rate increases (56%), the low yield environment (55%), regulation (43%) and currency fluctuations (41%).
- **Impact of short-term rate increase:** Advisors say an increase in central bank short-term interest rates is expected to adversely affect the housing market (75%), credit market (71%), bond volatility (68%), overall market volatility (65%) consumer spending (62%) and economic growth (53%).
- **Portfolio risks:** Advisors' top risk concerns are interest rate hikes (51%), asset price volatility spikes (45%) and low yields (38%).
- **Concerns about bubbles:** Advisors believe there are asset bubbles in the real estate market (49%), the tech sector (23%), the stock market (23%) and bond market (22%). They show the most concern for cryptocurrencies. After those currencies experienced a considerable run

up in 2017, 69% of respondents see them as a potential bubble that could burst in 2018.

“Advisors have an important role to play in all markets, helping investors to be aware of the harm emotionally driven investing can cause and assisting them in dispassionately examining their goals, risk tolerance and timeframe,” says Abe Goenka, CEO of Natixis Investment Managers Canada, in a release. “Our research shows they are increasingly turning to active managers for the tools and flexibility to diversify their clients’ portfolios and reduce risk.”

Active management

According to the survey, advisors are turning to active managers and deploying alternative investments to manage new and numerous risks facing their clients.

In fact, 86% say the risks in the market add up to an environment that favours active management. These professionals demonstrate a clear preference for actively managed investments and continue to allocate the majority of assets to these strategies.

Advisors who responded to Natixis’ 2016 survey reported that 68% of the assets they manage were allocated to active strategies and 32% to passive. They projected that within three years they would moderate their active allocations to 62% and increase passive allocations to 38%. Instead, allocations to active have increased in the past two years. Respondents in this year’s survey now say they have 72% of assets allocated to active management.

Greater sentiment toward active management could generate a further shift to active strategies, which have become essential in recent years as advisors seek opportunities to generate alpha. Advisors say that passive strategies, in contrast, are used mainly for their lower fees (56%). Notably, 75% of advisors believe individual investors are unaware of the risks of passive investing, and the same number has a false sense of security about this type of investing.

Alternatives regaining momentum

Financial advisors also believe it’s important to invest in alternatives to obtain benefits, such as moderating volatility, producing alpha and generating stable income. Survey results show that 66% recommend alternative investments to clients today. Their strategies include real estate/REITS (35%), infrastructure (33%), real assets (29%), commodities (19%), hedge fund strategies (17%) and private equity (15%). Further, 47% give an alternative strategy more than three years to prove itself.

Among those who recommend alternative investments, advisors see a number of liquid alternative strategies playing distinct roles in their portfolios.

- **Diversification:** Advisors most commonly cite global tactical asset allocation (40%) and multi alternatives (37%) as best for diversification.
- **Fixed-income replacement:** Top choices for providing a source of stable income include option writing (34%) and real estate (17%).
- **Volatility management:** Advisors cite market-neutral (48%) and long-short equity (24%) as best suited to manage volatility risk.
- **Enhanced returns:** One-quarter (25%) cite global tactical asset allocation as their top choice for enhancing returns. They also see long-short equity (20%) as useful in meeting this objective.
- **Inflation hedge:** Advisors view real estate (18%) as best for inflation hedging strategies.
- **Reduced risk:** Top choices for risk mitigation include long-short equity (25%), long-short credit (21%) and market neutral (18%).

Clients need practical education

Investors need to know themselves and the markets to make sound decisions, especially during growing volatility. Yet, just 53% of advisors believe investors understand the risks of the current market environment, and an even smaller number (43%) believe that investors are prepared for a market downturn. Further, 81% say the extended period of higher markets has made investors complacent about risk, and 82% say risk awareness often comes too late, with investors not recognizing risk until bad outcomes have occurred.

According to the survey, other than giving investment advice, financial advisors describe their role with clients as:

- guiding clients through emotional decisions (86%);
- providing ongoing financial education (71%);
- helping navigating life events (70%);
- providing guidance on identifying and achieving life goals (65%); and
- helping mediate family financial affairs (42%).

“To be successful, advisors will need to be in close communication with their clients, and their advice will need to come from both the right side and the left side of the brain,” says David Goodsell, executive director of Natixis Investment Managers’ Center for Investor Insight, in the release.

About the survey: *Conducted in March 2018, the survey included 2,775 financial professionals, with $113.7 billion in assets, in 16 countries and territories in Asia, Europe, Latin America, the U.K. and the Americas. In Canada, CoreData surveyed 150 financial professionals.*

Have a nice and fruitful week!

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