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1. Weekly Markets Changes

[August 17, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
16,323.71	2,850.13	25,669.32	7,816.33	\$0.7626	\$1,184.25	\$65.91
-2.80 -0.02%	+16.85 +0.59%	+356.18 +1.41%	-22.8 -0.29%	+0.19c +0.25%	-26.32 -2.17%	-1.72 -2.54%

2. Inflation hits 3% in July, upper end of BoC target

[August 17, 2018] Higher gasoline prices helped push the country's annual inflation rate in July to its highest reading since September 2011, Statistics Canada said Friday.

The federal agency said the consumer price index for July was up 3% on a year-over-year basis, up from a 2.5% increase in June.

Economists had expected a year-over-year inflation rate of 2.5%, according to Thomson Reuters Eikon.

The result put inflation at the upper end of the Bank of Canada's target range of 1 to 3%.

Earlier this summer, the Bank of Canada predicted inflation to move as high as 2.5%—due to temporary factors like higher gas prices—before it settles back down to 2% late next year.

The Bank of Canada can use interest rate hikes as a tool to help prevent inflation from climbing too high. The central bank raised its trend-setting interest rate to 1.5% earlier this summer.

Some of the gains in prices in July (food prices, for example) may prove temporary, said Andrew Grantham, senior economist at CIBC Capital Markets, in Friday commentary.

“Today's figures will likely support the [loonie] and result in increased speculation that the Bank [of Canada] could hike again as early as September, [but] we continue to lean toward October for the next move,” he said.

The Canadian dollar rose more than half a cent to US\$76.50 Friday morning after the inflation report was released.

The average of Canada's three measures of core inflation, which leave out more-volatile data like pump prices and are closely watched by the central bank, rose last month to 2% compared with 1.96% in June.

All eight major components of the consumer price index rose on a year-over-year basis in July with the transportation index being the largest contributor with an 8.1% increase.

A 25.4% increase in the price of gasoline and a 28.2% increase in the cost of air transportation compared with a year ago helped push overall prices higher. Food purchased from restaurants also gained 4.4%, while mortgage interest costs rose 5.2%.

On the flip side, telephone service costs were down 5.1% and traveller accommodations slipped 4.1% compared with a year ago.

James Marple, senior economist at TD, also expects little from the BoC until October. "The relative stability of core inflation measures may give the Bank of Canada some solace," he said in commentary. "Still, with an economy beating expectations and a range of indicators pointing to limited excess capacity, maintaining stable inflation is likely to require further rate hikes by the central bank [...]."

BMO strategist and expert Benjamin Reitzes also noted in his Friday report that core inflation remained at 2% and that one month does not make a trend. "Overall, this report barely moves the needle for the September policy meeting (if at all), as there's no need to shift away from the gradual tightening stance noted in July," he said.

3. Why binary options remain a 'systematic risk' for Canadians: OBSI

[August 17, 2018] Despite CSA's binary options ban in 2017—it's currently illegal to advertise, offer, sell or otherwise trade binary options that are shorter than 30 days—the instruments are still a risk to investors.

As the Ombudsman for Banking Services and Investments (OBSI) explained in an Aug. 15 bulletin, MasterCard and Visa blocked binary options payments, but "investors in Canada are still able to purchase these offerings using other means and through other jurisdictions," which "leaves consumers with few opportunities to recover their money if something goes wrong."

The contracts or instruments allow investors to bet on the performance of an underlying asset, often a currency, commodity, stock index or share. In its 2017 notice, CSA said it found that, "however named, marketed or sold," the instruments are risky and resulted in a "significant number of the complaints and inquiries" leading to the ban.

Binary options are referred to by many names, CSA said, including but not limited to all-or-nothing options, asset-or-nothing options and bet options.

In OBSI's warning, the organization suggested investors be "very cautious about purchasing investments based solely on online or telephone marketing."

"Binary options are a very high-risk investment that Canadians should avoid. [...] At best, they are a high-risk investment strategy suitable only for sophisticated investors who are willing to lose their entire investment," it said. "At worst, the investments may be frauds designed to take advantage of unwary investors."

Its warning was released this week, OBSI said, because it has "received multiple complaints from investors who used their credit card to purchase binary options. These investors later disputed credit card charges related to these transactions."

OBSI said that, while investors believed the charges should be reversed "because they did not receive the promised services (such as the ability to withdraw their investment capital)," it found that the banks it investigated were not at fault since the institutions had followed "normal chargeback policies and procedures."

Given investors typically have no recourse for falling victim to binary options fraud, OBSI has identified the continued selling and buying of the instruments "as a systemic risk and reported it to the Financial Consumer Agency of Canada."

To help protect clients, make sure they understand what binary options are and why they've been banned. Also, if an investor is unsure whether a company is licensed to sell products in Canada, OBSI suggested they use CSA's national registration database.

Under current regulations, "The companies offering binary options are not licensed to sell investments to Canadians, they are not regulated in Canada and they are not within OBSI's jurisdiction to investigate," OBSI said.

4. Tesla's stock falls sharply after Elon Musk's tearful interview

[August 17, 2018] Tesla's stock tumbled after CEO Elon Musk said he's working himself to the bone and relies on Ambien to sleep.

In an tearful interview with The New York Times, Musk said this has been "the most difficult and painful year" of his career. He said he works 120 hours some weeks and has trouble sleeping. Musk is also CEO of SpaceX and The Boring Company.

Investors weren't sympathetic.

The stock closed down 9% on Friday, and it's down 21% since the day Musk tweeted he had secured funding for a private takeover of Tesla.

Musk hasn't exactly given investors confidence that he's on the ball.

He admitted in the Times interview that he hadn't cleared his tweet with anyone at Tesla before firing it off midday August 7.

He also said that the price he chose — \$420 a share — was somewhat arbitrary. He wanted it to be a 20% premium, which would have been around \$419. So he tweeted \$420 because it was "better karma."

Musk explained himself in a blog post this week, and he left the impression that he hadn't exactly secured the funding.

He said he left a July 31 meeting with the Saudi sovereign wealth fund "with no question that a deal with the Saudi sovereign fund could be closed, and that it was just a matter of getting the process moving."

That is far more preliminary than his tweet led investors to believe. The board also said it hasn't even fully explored whether to go private.

That's one of the reasons the stock has fallen so much after soaring 11% on the day of his tweet.

But Musk's tweet has also opened Tesla to increased scrutiny and lawsuits. The SEC is reportedly investigating Musk's tweet and had already been looking into Tesla's Model 3 production troubles.

The Times reported that some Tesla board members are concerned about Musk's frequent use of Ambien as well as his occasional use of recreational drugs.

"We would like to make clear that Elon's commitment and dedication to Tesla is obvious," Tesla said in a statement. "Over the past 15 years, Elon's leadership of the Tesla team has caused Tesla to grow from a small startup to having hundreds of thousands of cars on the road that customers love, employing tens of thousands of people around the world, and creating significant shareholder value in the process."

5. Manufacturing sales rise 1.1% in June, boosted by oil and coal

[August 16, 2018] Canadian manufacturing sales rose more than expected in June, boosted by a 16% surge in oil and coal shipments.

Statistics Canada said Thursday manufacturing sales were up 1.1% to \$58.1 billion in June, following a 1.5% increase in May.

Economists had expected an increase of 0.9% in June, according to Thomson Reuters Eikon.

In constant dollars, manufacturing sales were up 0.7% in June.

“Coupled with other better recent economic data—and absent an unexpected shock—the economic backdrop still looks strong enough to warrant further gradual interest rate hikes from the Bank of Canada,” Royal Bank senior economist Nathan Janzen wrote in a brief note to clients.

Last week, Statistics Canada reported the economy generated 54,100 net new jobs in July and saw its unemployment rate fall back to its four-decade low of 5.8%. And earlier this month, data showed surging exports led by higher-priced energy products allowed Canada to shrug off new U.S. steel and aluminum tariffs in June to post the lowest monthly merchandise trade deficit with the world in 17 months.

Many economists expect Canada’s central bank to raise interest rates at least one more time this year.

The Bank of Canada raised its trend-setting interest rate by a quarter of a percentage point to 1.5% earlier this summer. Its key interest rate target is now at its highest point since December 2008.

The increase in factory sales came as the petroleum and coal products industry sales increased 15.9% in June.

Statistics Canada said several major refineries ramped up production levels following temporary shutdowns and spring maintenance that began in April and continued into May.

Capacity utilization rates for the industry rose from 69.8% in May to 89.8% in June.

The gains in the petroleum and coal group was offset in part by a drop in chemical products, which fell 4.5% in June as sales of pesticides, fertilizers and other agricultural chemical products dropped.

Sales of food products fell 1.7% in June following four consecutive monthly gains.

Omar Abdelrahman, economist at TD Economics, said in a research note Thursday that the surge in petroleum and coal would not be repeated. While the June sales numbers are “a solid handoff to the third quarter,” he noted “mixed signs” that could indicate decelerating momentum.

6. Big Oil is racing to pump all the oil out of Texas

[August 15, 2018] The gold rush is on in Texas, and Big Oil is scrambling for a piece of the action.

The oil industry is shelling out billions of dollars in a series of acquisitions in the Permian Basin, the hottest oilfield in the world.

The latest deal came on Tuesday when Diamondback Energy agreed to purchase shale producer Energen for \$9.2 billion, forming one of the largest players in the Permian.

Late last month, BP inked a \$10.5 billion deal to buy oil assets in Texas. It was BP's biggest acquisition in two decades and first major investment in the United States since the Deepwater Horizon disaster in 2010.

And Concho Resources recently completed a \$9.5 billion purchase of RSP Permian that created the largest shale producer in the Permian.

The rush of deals underscores how eager companies are to get a foothold in the region.

Rapid technological advances have dramatically slashed the cost to frack in the Permian. Production is spiking so much that Texas is on track to surpass Iran and Iraq, both OPEC members. That would make Texas No. 3 in the world if it were a country.

"It's the most desired region in the United States, if not globally," said Michael Tran, director of global energy strategy at RBC Capital Markets.

Permian could rival legendary Saudi field

RBC estimates that Permian production will more than double over the next seven to 10 years, to about 6.5 million barrels per day. That's more than the entire United States produced in early 2012.

"From a price perspective, the Permian Basin is extremely attractive," Tran said. "Nobody doubts the rock."

The Permian boasts unique geology that allows oil companies to drill more than one layer of the earth at the same time. Wells can be profitable below \$40 a barrel. That's well below today's price of about \$65 a barrel. And some executives believe the amount of Permian oil rivals Saudi Arabia's legendary Ghawar Field, the world's largest conventional oilfield.

By spending \$9.2 billion in stock, Alabama-based Diamondback is nearly doubling its acreage in core parts of the Permian Basin.

"They're as good as some of the assets we've seen anywhere," Michael Hollis, president of Diamondback Energy, told analysts on Wednesday. "We were really impressed once we got under the hood."

Wall Street was less impressed. Diamondback shares plunged nearly 11% on Wednesday.

Just days earlier, Diamondback swept in with a \$1.25 billion deal to buy private Permian oil producer Ajax Resources.

Even some of the biggest oil companies are getting into the game. Long before BP's big bet on shale, ExxonMobil announced a \$5.6 billion deal in January 2017 to double its assets in the Permian Basin. It was Exxon's biggest purchase since the 2010 takeover of natural gas producer XTO Energy. That

\$41 billion acquisition proved to be badly timed as natural gas prices later crashed.

Victim of its own success

But major obstacles loom in the booming Permian Basin, at least in the short run. Because of hyper growth, the Permian is quickly running out of pipelines to move oil out of the region.

"The pipeline constraints are real, but they are transitory," said Vincent Piazza, senior energy analyst at Bloomberg Intelligence. "The infrastructure has had a difficult time keeping up with the explosive growth.

More pipelines are coming, but they will take time. Clay Seigle, managing director of oil at research firm Genscape, warned of "significant challenges" for transporting oil out of the Permian until the second half of next year.

At the same time, Permian producers are feeling sticker shock as prices spike for talent, supplies and services.

Oil executives are betting they can maximize their chances of success by working together.

The recent deals "signal a clear shift in the US shale industry towards consolidation as players seek operational and capital efficiencies," analysts at research firm Rystad Energy wrote in a report on Wednesday.

The boom in the Permian has sparked some concerns that the shale industry could be overextending itself once again. It was just a few years ago that excessive shale production caused oil prices to crash around the world. Dozens of US oil companies filed for bankruptcy.

Big Oil is betting this time will be different because the oil glut has largely disappeared, demand is strong and OPEC has less firepower to respond to price shocks. US crude prices plunged 3.5% on Wednesday, but they have nearly tripled since early 2016.

"The market is going to need more barrels," RBC's Tran said. "OPEC and the Saudis can only do so much."

7. Corporate America is raking in fat profits. Will it last?

[August 13, 2018] Corporate America is growing practically nonstop thanks to massive tax cuts and a booming economy.

Already fat profits at S&P 500 companies are on track to spike by nearly 25% during the second quarter. That would tie the first quarter for the fastest growth since 2010, according to FactSet.

The across-the-board success includes everyone from Apple and Amazon to Chevron and JPMorgan Chase.

Blockbuster earnings growth has offset rising concern on Wall Street about President Trump's trade wars and crises in emerging markets, such as Turkey. "Earnings season was terrific -- and I think we have at least three more terrific quarters ahead of us," said Jeffrey Saut, chief investment strategist at Raymond James.

Goldman Sachs called the "stellar" results the "best earnings season since 2010." BlackRock cheered Corporate America's "unmatched earnings momentum."

Crushing expectations

It's tough to argue with the euphoric reviews. Ten of the 11 S&P 500 sectors increased profits by double-digits during the second quarter, led by surging growth from energy companies thanks to vastly higher oil prices.

The earnings results have been better than anticipated: 79% of S&P 500 companies have beaten Wall Street's expectations. That would be the highest percentage since FactSet started tracking the stat in 2008, taking out the first quarter's record.

The success has been driven in part by the corporate tax cut, which lowered the rate from 35% to 21%. A big chunk of those tax savings have gone to the bottom line and to stock buybacks, which boost per-share earnings. Stock buybacks could exceed \$1 trillion this year for the first time ever.

But companies aren't just raking in monster profits because they're paying Uncle Sam less. Sales, often a better measure of overall health, are also jumping, as the economy grew at the fastest pace since 2014. S&P 500 revenue is on track to rise by nearly 10% in the second quarter, the most since 2011, according to FactSet.

"There's a very favorable backdrop for companies, small, medium and large. It's pretty impressive," said Joe Quinlan, head of market strategy at Bank of America's US Trust.

Strong earnings helped Apple become the first company to achieve a \$1 trillion valuation. During the first quarter, JPMorgan reported the biggest ever profit for an American bank. It nearly topped that record last quarter.

Wage hikes wiped out by inflation

Although companies are minting money, there's a reason workers may not be feeling a bump in their paychecks: Inflation is heating up.

Real average hourly earnings -- which factors in inflation -- dropped by 0.2% in July from last year, according to the Labor Department. That's because consumer prices, excluding volatile food and energy expenses, jumped in July by the most since September 2008.

It's surprising that the low unemployment rate -- it fell to 3.9% in July -- hasn't translated to meaningful wage hikes, outside of select industries like trucking and oil workers.

Analysts said companies have navigated the worker shortage by relying on technology and hiring people who have dropped out of the workforce at lower wages. That strategy helped push S&P 500 profit margins to a record high last quarter, according to Goldman Sachs.

Trade war not dinging overall profits -- yet

So will the incredible profit growth continue?

One obvious threat is the explosion of tariffs during the trade fights with China, the European Union and other trading partners. Some iconic American companies, including Harley-Davidson, General Motors and Whirlpool, have warned they are getting squeezed by higher raw material prices.

However, the trade wars have not yet had a dramatic impact on actual results nor on the outlook for future profits.

"A lot of these costs are going to be passed on to the consumer. There hasn't been a big margin squeeze yet," said Quinlan.

Much will depend on whether trade tensions deepen. Goldman Sachs warned in a recent note that earnings growth will vanish in 2019 if a 25% tariff is levied against all imports from China. Under that negative scenario, Goldman said the S&P 500 could plunge by 17% from current levels.

Of course, if trade tensions with China ease, the stock market could be in store for a relief rally.

Another major question is whether the American economy can continue to grow at a rapid pace as the worker shortage worsens and interest rates rise.

Goldman Sachs believes earnings growth will "decelerate sharply" in 2019 as the US economy slows and the sugar rush from tax cuts fades.

If that happens, investors may look back on this period as the peak of earnings growth.

Have a nice and fruitful week!

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