Weekly Updates Issue # 686

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1. Weekly Markets Changes

[October 19, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,470.10 +55.81 +0.36%	2,767.78 +0.65 +0.02%	25,444.34 +104.35 +0.41%	7,449.03 -47.87 -0.64%	$0.7631 -0.99c -1.28%	$1,226.49 +9.44 +0.78%	$69.12 -2.39 -3.34%

2. Rate of inflation slows to 2.2% in September: StatsCan

[October 19, 2018] The rate of inflation slowed in September on the back of easing gas prices—a result that could weigh on the pacing of Canada's monetary policy.

Specifically, the consumer price index (CPI) rose 2.2% on a year-over-year basis in September, reports StatsCan, compared to a 2.8% increase in August. Consensus was for an increase of 2.7%.

Month over month, CPI decreased 0.4%, due to easing transitory pressures from the gasoline, air transportation and travel tours indexes, says StatsCan.

Though prices were up in all eight major components in the 12 months to September, the transportation index increased at a slower pace in September (+3.9%) than in August (+7.2%). Still, it remained the largest contributor to the year-over-year increase in CPI, says StatsCan.

In emailed commentary, CIBC senior economist Andrew Grantham notes September's drop-off in airline fares.

"Those prices had spiked strangely at the start of the summer, in part thanks to a change of methodology," he says. As such, "the pullback isn't a sign of anything worrisome within the Canadian economy," he says.

After next week's expected rate hike by the Bank of Canada, expectations for follow-up hikes will be pared back, he adds.
A decline in retail sales offers support for that view. In a separate report, StatsCan says retail sales for August declined 0.1%, following a 0.2% increase in July.
Weakness was broad, with sales down in seven of 11 subsectors for the month. Lower sales at gas stations more than offset gains at motor vehicle and parts dealers, says StatsCan.
In volume terms, retail sales decreased 0.3%.
In emailed commentary, CIBC director and senior economist Royce Mendes says retail sales data will "raise red flags for those who believed the central bank could accelerate the pace of monetary tightening."

3. Client-focused reforms too focused on cost, industry associations say

[October 19, 2018] Regulators are too focused on investor costs, unclear on how to act in a client's best interest and off the mark with disclosure, industry associations said in submissions to CSA's client-focused reforms.
Comments on CSA's proposed amendments to rules around KYP, KYC, suitability, conflicts of interest and relationship disclosure were due Friday.
Advocis calls out regulators for emphasizing low cost such that it becomes the "de facto proxy" in determining whether a product is in a client's best interest. Such a focus ignores advisors' skill to make qualitative judgments, it says. Focusing on low cost also contributes to a race to the bottom, whereby firms cut services not tied to cost.
Instead, regulators should focus on value, says Advocis in its letter. The appropriate question is; how does the value investors receive from advice compare with the associated cost?
"The best investor outcomes occur when [clients] achieve their personal financial objectives, whether that means saving for retirement, buying a home or being financially protected from life's unexpected shocks," says Advocis.
Similarly, IFIC says in its letter that the proposals' focus on cost implicitly suggests client outcomes aren't achieved through savings and wealth accumulation. "The overemphasis on costs does not ascribe value to the advice clients receive and may have the unintended outcome of reducing investor choice" by indiscriminately focusing on only low-cost products, it says.

Likewise, IIAC recommends in its letter that cost considerations be balanced with other factors such as consistent returns, diversification of holdings, stable fund management and the potential benefits of a more expensive managed account.

Further, regulatory emphasis on cost is inconsistent, since the cost of implementing CSA's reforms will be passed on to clients—as regulators have acknowledged. As a way forward, IFIC suggests the proposals "achieve a better balance between the valuable advisory services provided by registrants, who must remain profitable, and the desire for lower-cost products and services."

Best be clear about best interest

The reforms require advisors put clients' interests first when making a suitability determination and also when addressing conflicts. The industry associations critiqued what they consider ambiguous in the proposed reforms.

For example, while IFIC mostly supports suitability enhancements, it notes a lack of guidance on how advisors demonstrate that an investment decision puts the client's interest first.

To address this lack, it recommends introducing a regulatory safe harbour for advisors as a way to provide regulatory certainty on compliance. Safe harbour would protect advisors who meet suitability obligations and manage material conflicts of interest, it says.

IIAC makes the same suggestion, and strongly supports the litmus test of the reasonable advisor. Its letter suggests a clearly articulated and defined best interest standard be included in the proposals, and that the proposals make explicit that best interest is not a fiduciary duty.

IIAC also takes exception to the reforms' focus on proprietary product sales as an example of a conflict. For example, a client account heavily weighted to proprietary products could indicate a firm has developed products well suited to its clients, it says.

The only way to make the client-focused reforms' best interest principles workable is to professionalize advice, says Advocis. It suggests establishing a professional college of advisors that would judge its peers' actions.

"We are opposed to a best interest duty that is interpreted and enforced by existing regulators that are not connected with the client-facing work of advisors and are therefore not positioned to understand the nuances of an advisor's real-world practice," says Advocis in its letter.

Advisors can also judge when to make appropriate disclosures, it adds. Excessive information overwhelms investors, it says.

Sometimes, disclosure alone is sufficient, says IFIC, such as for fees and referral arrangements. Like Advocis, it says advisors must exercise their

professional judgment to determine which conflicts can't be addressed through disclosure alone and then implement appropriate controls.

Industry associations further say disclosure should be limited to material conflicts, not all conflicts. "Where a conflict is not material, by definition, it would not negatively impact investors," says IIAC.

Along with information overload, IFIC says disclosing all conflicts would serve to dilute disclosure related to material conflicts.

Other highlights

Concern with KYP reforms centres on a narrowing of dealers' shelves and the challenges these reforms present for smaller independent firms. "It is not realistic to expect dealers to complete a review of literally thousands of products on the market," says Advocis.

Further, the reforms would likely favour prioritizing products for high-net-worth clients or the greatest number of clients, so unique client needs would go unmet. The reforms could also serve to limit the addition of new products to shelves, like liquid alts, says Advocis. It suggests advisor proficiency, not a blanket KYP policy on dealers, could help avoid costs and obligations arising from KYP reforms.

IIAC notes the prescriptive nature of some the reforms, including for KYC and KYP. For example, the prescriptive list of factors to analyze products doesn't suggest flexibility, which is needed for product shelves to remain "vibrant." Without clarifying language, firms will interpret regulatory suggestions as mandatory, and will develop policies and procedures to comply, it says.

IFIC says changes and clarifications to the reforms are required to make implementation costs more manageable.

While Advocis is overall supportive of the client-focused reforms, it says they're "necessarily incomplete" because they're layered atop a "product-based framework that doesn't reflect modern advice-giving or the way that modern consumers see their advisors, or access financial advice, today."

Instead, Advocis calls for professional recognition of advisors— "detached from product sales, with higher proficiency standards."

4. China's growth slows as officials try to reassure investors

[October 19, 2018] China reported economic growth sank to a post-global crisis low as finance officials launched a media blitz Friday to shore up confidence in its sagging stock market.

Growth in the quarter that ended in September slipped to 6.5% over a year earlier from the previous quarter's 6.7%, official data showed. It was the slowest rate since early 2009.
The world's second-largest economy already was cooling before a tariff war between Beijing and President Donald Trump erupted.
Beijing tightened controls on lending last year to rein in a debt boom. That has weighed on housing sales and consumer spending. Car buyers are steering clear of dealerships.
Credit controls and trade tensions are "taking a bite out of economic momentum," said Bill Adams of PNC Financial Services Group in a report.
The impact of Trump's penalty tariffs of up to 25% on Chinese goods in a dispute over Beijing's technology policy has been limited. But with the rest of their $12 trillion-a-year economy slowing, the communist leaderships has reversed course and ordered banks to lend.
"Downward pressure has increased," a government spokesman, Mao Shengyong, said at a news conference.
Officials led by China's economic czar, Vice Premier Liu He, tried Friday to reassure investors about a stock market that has sagged 30% since January.
The decline is "creating good investment opportunities," Liu said in comments carried by the official Xinhua News Agency and business newspapers and websites.
"China's current economic fundamentals are good," the central bank's governor, Yi Gang, said on its website.
The benchmark Shanghai Composite Index ended the day up 2.6%.
The government also said insurers will be allowed to create products to help stabilize the market by reducing "liquidity risk." That refers to fears lenders that accepted stock as collateral for loans might sell, flooding the market and driving a new price collapse.
Retail sales, factory output and investment in factories and equipment—bigger drivers of growth than exports—all weakened in the latest quarter.
The conflict with Washington has prompted Chinese leaders to step up a marathon effort to encourage self-sustaining growth driven by domestic consumption and reduce reliance on exports and investment.
Beijing has cut tariffs, promised to lift curbs on foreign ownership of auto producers and taken other steps to rev up growth.
But leaders have refused to scrap plans such as "Made in China 2025," which calls for state-led creation of Chinese champions in robotics and other technologies.

The United States, Europe and other trading partners say those violate Beijing's market-opening commitments. But Chinese leaders see them as a path to prosperity and global influence.

Regulators have ordered banks to step up lending, especially to entrepreneurs who create most of China's new jobs and wealth. Forecasters say it will take time for results to show.

Government support is "starting to gain traction," but more will be needed to stabilize growth, Julian Evans-Pritchard of Capital Economics said in a report.

Washington has raised tariffs on $250 billion of Chinese goods and Trump says he might extend penalties to almost all imports from China. Beijing responded with its own tariff hikes on $110 billion of American imports. But it is running out of goods for retaliation due to their lopsided trade balance.

Forecasters say that if all the tariff hikes both sides have threatened are imposed, that could cut China's 2019 growth by up to 0.3 percentage points.

The Trump administration argues that China has more to lose in a trade war—and will face pressure to reach a truce because it exports more than it buys from the United States and because its economy is decelerating while the U.S. economy looks strong.

But Claude Barfield, scholar at the conservative American Enterprise Institute, noted that China's growth rate "doesn't seem to be anything close to a crisis."

Exports to the United States rose 13% in September despite the tariff hikes, down slightly from August's 13.4%, helping push China's politically volatile trade surplus with the United States to a record $34.1 billion.

Exporters of clothes and other lower-value goods say American orders began falling in April as trade tensions worsened. But makers of less price-sensitive exports such as factory equipment and medical technology are confident they can keep their market share.

Trade has shrunk as a share of the economy but still supports millions of jobs. The government is promising to help struggling exporters.

"In general, the impact is limited," a Commerce Ministry spokesman, Gao Feng, said Friday. "Governments at all levels will also take active measures to help enterprises and employees cope with possible difficulties."

5. Canadian economy no longer as vulnerable to oil prices: Desjardins

[October 18, 2018] The recent drop in the price of Canadian oil will have a limited economic effect, a Desjardins report says.

The price for Western Canadian Select (WCS) dropped this week to US$20 per barrel. The price decline of 63.8% so far this year is similar to the price drop of 64.5% in 2014, Desjardins says.

Desjardins is forecasting this latest decline will only have a limited impact on the Canadian economy, though. Investment in the oil extraction sector only represents 14% of total non-residential capital spending, compared to 28% in 2014, when "the oil industry was running full throttle and was one of the main drivers of Canada's economic growth," the report says.

While in 2014, the Bank of Canada lowered interest rates twice after the price of oil dropped, Desjardins expects the central bank to raise interest rates on Oct. 24.

Business investment in other sectors is growing, the report says, and the easing of trade tensions with the U.S. adds to the positive economic outlook.

"Ongoing extremely low prices for Canadian oil could represent, nevertheless, one more reason for the BoC to continue to act with caution," the report says.

Pipeline capacity problems

While world oil prices have risen recently to four-year highs due to concerns including possible U.S. sanctions on Iran, Canadian oil prices have gone in the opposite direction as new production floods pipelines and U.S. demand drops temporarily due to fall refinery maintenance outages.

The difference last week between (WCS) prices and the New York benchmark West Texas Intermediate (WTI) was more than US$52 per barrel. According to Net Energy Group, the difference between WCS and WTI for November delivery has averaged US$45.50 per barrel this month. The difference between Edmonton Sweet and WTI has been about US$27.

"Canada is facing an unprecedented epic pipeline problem," said Jon Morrison, analyst at CIBC, in a report. "And while we have known that this issue has been on the horizon for years, the pressure in the system is building and it's set to remain ugly for some time."

Western Canada will remain short of pipeline capacity even if Enbridge Inc.'s Line 3 replacement pipeline is completed by 2020, thus adding 370,000 barrels per day of capacity, CIBC notes.

The short-term situation will improve but not enough to allow growth in activity if crude-by-rail exports double as expected to a record 450,000 barrels per day by the end of this year, the report says.

6. How far can the loonie upswing go?

[October 17, 2018] Luc de la Durantaye expects the Canadian dollar to appreciate in the coming months, possibly returning to early-2018 highs of around US$0.81 on the back of a bolder Bank of Canada.

The head of asset allocation and currency management at CIBC Asset Management cautioned about getting too excited about the loonie, though. "We don't want to overplay that," he said in an early October interview.

Still, his outlook is positive for the Canadian dollar, as investors have "more confidence from the Bank of Canada (BoC) that they will continue on the path of raising interest rates."

The central bank is widely expected to hike interest rates at its Oct. 24 announcement. Following the release of an upbeat Business Outlook Survey for the fall, several bank analysts said now is the time to hike based on economic strength and improving executive forecasts.

While the BoC won't quite match the pace of the Federal Reserve when it comes to raising rates, said de la Durantaye, "at least there's a recalibration […] which will support the Canadian dollar."

On Oct. 16, the loonie was worth US$0.77, around its one-year average (the low over that period was US$0.75 and the high was US$0.81).

Once the loonie regains the ground it lost this year—and possibly hits US$0.82—it may face headwinds, said de la Durantaye, who manages the Renaissance Optimal Inflation Opportunities Portfolio.

"We can't afford to have too strong a dollar, and certainly not an overvalued [loonie] versus a U.S. dollar, given the fact that we have a current account deficit," he said.

Canada also trails the U.S. in productivity, he added, which "will limit the appreciation of the Canadian dollar."

Economic outlook

From low unemployment to a positive investment outlook, the domestic economy is performing well, said de la Durantaye, who also highlighted wage growth as a factor benefiting consumers.

Canada's unemployment fell to 5.9% in September as the country added 63,000 jobs.

The tight labour market is contributing to a decline in household debt and, as a result, is reducing risk to the Canadian economy from the consumer side, said de la Durantaye.

The level of household debt relative to income fell slightly in Q2 from the previous year, Statistics Canada reported. Demand for consumer credit rose but that was offset by a drop in both mortgage and non-mortgage loans. Canadians owed $1.69 for every dollar of household disposable income for the quarter.

From the investment side, the new trade agreement between the United States, Mexico and Canada will bring in investment that was likely put on hold due to uncertainty, said de la Durantaye.
High oil prices are also helping maintain a decent economic outlook for Canada, de la Durantaye said. The price of Brent crude rose above US$81 on Oct. 16, compared to around US$57 a year earlier. The price of WTI crude has increased over the last year, from around US$51 last fall to more than US$71 on Oct. 16.

7. Fed officials debated hiking rates to 'restrictive' level

[October 17, 2018] Federal Reserve officials last month debated how high they should raise interest rates to achieve their economic goals, with some arguing that they may need to lift rates to a level that would modestly restrain growth.
The discussion, revealed in minutes of the Sept. 25-26 meeting released Wednesday, shows that a few participants believed that the Fed's key interest rate would need to "become modestly restrictive for a time" to guard against inflation climbing too high.
However, other officials argued that they would not favour adopting a restrictive policy "in the absence of clear signs of an overheating economy and rising inflation."
The minutes did not indicate that officials had reached a conclusion, but they did show that all Fed officials favoured gradual rate hikes in response to a strong economy and low unemployment.
At the September meeting, the Fed boosted its key policy rate for a third time this year. The move was immediately criticized by President Donald Trump, who said he was not happy with the continued rate hikes.
The president has stepped up those attacks in recent weeks, going so far in an interview Tuesday as calling the Fed's rate hikes "my biggest threat."
Trump's criticism intensified after last week's big stock market tumble, which has been partially reversed this week. Analysts have pointed to rising interest rates, which can make stocks a less attractive investment.
The Fed minutes did not include any discussion of Trump's attacks. Powell, who was tapped as Fed chairman by Trump after he decided not to offer Janet Yellen a second term, has said the central bank will not be influenced by outside criticism but will continue to do its job of managing the economy to promote maximum employment and stable prices.
The Fed released an updated economic forecast at the September meeting. The median view of all Fed officials was that rates should be increased one more

time this year and three times next year and a final quarter-point rate hike in 2020. At that point, the policy rate would be at 3.4%, according to the median of Fed officials' individual forecasts. That would put it above the 3% level that the Fed currently pegs as its "neutral rate." The 3% level is the point where officials believe Fed policy is neither boosting growth or holding it back.

The minutes showed that officials were generally pleased with how the economy is unfolding this year, with strong job growth and inflation hovering near the Fed's 2% goal. The minutes noted that the tax cuts Trump had pushed through Congress late last year along with the spending increases Congress approved at the beginning of this year were boosting economic activity.

The minutes did note concerns about the impact of Trump's get-tough trade policies, citing business contacts who expressed worries about lost markets and rising prices for steel and aluminum.

8. Canada underwhelms on global competitiveness

[October 17, 2018] Canada places 12th in the World Economic Forum's latest global competitiveness report—down two places from last year. To move up the rankings will require specific investment by the federal government, suggests a report by National Bank.

The U.S. holds the top spot, followed by Singapore and Germany.

"Compared to the U.S.—our main export market and the home of our main competitor—Canada doesn't fare very well," says senior economist Krishen Rangasamy in the National Bank report.

As part of the solution, the feds could increase investment in research and development. The global competitiveness report says Canada spends only 1.6% of GDP on R&D, below the average of 2% among countries in the Organization for Economic Cooperation and Development.

The competitiveness report also notes that Canada's adoption of information and communications technology is low—the weakest aspect of Canada's performance measured by the report's index.

Infrastructure spending is also lacking, accounting for only 4% of last year's GDP, says the National Bank report.

The feds could also lower trade barriers and more aggressively court skilled foreign workers, says the bank. Labour shortages and available skills often mismatch. "There must be a way of better integrating immigrants, perhaps by facilitating training and recognizing foreign qualifications," says Rangasamy in the report.

As Canadian businesses struggle to compete with U.S. firms that have benefited from tax reform, the federal government's fall economic statement will be the most anticipated in years, he adds.

9. Half of homeowners say using cannabis would lower property values: poll

[October 16, 2018] More than half of Canadian homeowners recently surveyed say they would be less likely to consider a property if they knew cannabis had been grown inside, according to a poll released Tuesday.

Real estate listings company Zoocasa, which commissioned the study, found that 52% of homeowners would think twice about buying a home that had been used to grow even a legal amount of marijuana.

Set to go into effect on Wednesday, the new federal Cannabis Act will permit the consumption and purchase of the previously-illicit plant. It also allows Canadians to grow up to four plants for personal use inside their homes.

But Zoocasa said those involved in their survey generally expressed negative sentiments towards consuming, cultivating and living in close proximity to cannabis use.

Fifty-seven percent of those polled believe even growing the legal amount would devalue property.

Meanwhile, only 15% of all respondents indicated they would consider growing cannabis in their homes.

Nearly two-thirds (64%) of homeowners polled say smoking marijuana inside a home would harm a property's value, while 21% disagreed and 15% were neutral.

Penelope Graham, the managing editor at Zoocasa, says these are still early days and there are still a lot of unanswered questions about how cannabis legalization will impact property values.

"A lot of the negative sentiment in our findings is stemming from this uncertainty among homeowners," she said. "[Your home is] your largest financial investment. The last thing that you want to do is accidentally devalue it doing something you think is legal."

Among condo and apartment dwellers, a majority (61%) of those polled say that people who live in these properties should not be able to smoke inside their units, while 64% say condo boards and property managers should have the right to ban residents from using the drugs in their units.

The survey also found that nearly half of respondents don't want to live near a cannabis dispensary either.

Forty-two percent of those polled say that having this type of business in their neighbourhood would harm nearby property values, while 48% of respondents say the presence of a dispensary nearby would reduce their desire to purchase a specific property.

10. Home prices to rise by 1.5% in Q4: Royal LePage

[October 16, 2018] After a third-quarter increase, Canadian home prices are expected to keep rising in Q4, a survey from Royal LePage says.

Home prices are forecasted to increase by 1.5% over the next three months, the survey says.

"Positive economic fundamentals, supported by a new agreement on trade, should bolster consumer confidence across Canada and stoke demand in the nation's real estate market," said Phil Soper, president and CEO of Royal LePage, in a statement.

"Dangerously overheated regions have cooled considerably this year, while home prices have remained remarkably resilient. This is the soft landing that policy makers were hoping for."

National home prices rose by 2.2% to an average of $625,499 in Q3 mainly because of an increase from the Greater Vancouver Area (up 3.9%), the survey compiled from proprietary property data in 63 large markets says.

The Canadian Real Estate Association said Monday that the national average price for a home sold in September was just under $487,000, up 0.2% compared with a year ago.

The Greater Montreal Area saw prices rise 5.4% year over year in Q3, the highest increase among Canada's three largest metropolitan areas, Royal LePage says.

Prices were almost flat in the Greater Toronto Area from the previous year with aggregate prices falling 0.4%, led by declines in suburban prices. Prices in the City of Toronto rose by 5.2% while prices fell in almost every suburb except for Mississauga.

By the end of the year, Royal LePage expects the aggregate price of a GTA home to rise to $853,097, up 2% from the third quarter.

Soper said the GTA is emerging from a housing correction, with new mortgage stress tests bringing down suburban prices, in particular.

"Quarter-over-quarter trends are pointing to the end of this correctional cycle and the beginning of a modest recovery in the region," he said.

Median home prices in Canada rose in Q3 year over year to:

- 1.4% for a two-storey home to $736,337;
- 1.5% for bungalows to $519,886; and

- 6.7% for condos to $441,240.

Royal LePage forecasts prices to increase by 0.7% in the Greater Montreal Area to $399,679 in Q4. In B.C., it says double-digit price increases will no longer be the norm because of the mortgage stress test and provincial tax policy.

Have a nice and fruitful week!

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