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1. Weekly Markets Changes

[December 7, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
14,795.13 -402.7 -2.65%	2,633.08 -127.1 -4.60%	24,388.95 -1,149.5 -4.50%	6,969.25 -361.3 -4.93%	\$0.7519 +0.01c +0.01%	\$1,249.31 +28.79 +2.36%	\$52.61 +1.68 +3.30%

2. Why the stock market is freaking out

[December 7, 2018] Extreme fear is once again sending Wall Street into chaos. Investors are debating whether the longest bull market in American history is nearing an end or just taking a breather.

From "Tariff Man" tweets and inverting yield curves to conflicting messages from Trump advisers and the arrest of a Chinese executive, there is no shortage of headlines keeping investors awake at night.

After booking its best week since 2011, the S&P 500 plunged 3.2% Tuesday and tumbled again Thursday before staging a massive recovery. Stocks fell sharply on Friday after Trump officials Larry Kudlow and Peter Navarro contradicted each other on trade.

No matter the catalyst, the overarching fear is over just how long the economy has until the next recession strikes. Months? Quarters? Years?

"Markets are fully convinced we are in the last stages of an economic cycle," Nicholas Colas, co-founder of DataTrek Research, wrote in a note to clients. "Traders are feverishly looking for the dry tinder that will turn a simple short circuit into a full-blown conflagration."

Signs of worry abound. The Fear & Greed Index, a CNN Business gauge of market sentiment, is flashing "extreme fear." Germany's stock market is flirting with a bear market. Oil prices are already there. The VIX volatility index spiked 29% this week. And the S&P 500 is on track for its worst quarter in seven years.

"We're at a very confusing point for the economy," said Kristina Hooper, global market strategist at Invesco. "It's not as predictable as it was last year when growth seemed a lot more potent."

Enter Tariff Man

Hopes of a truce in the US-China trade war have faded into worries of an escalation. Investors only briefly celebrated the ceasefire reached by President Donald Trump and Chinese President Xi Jinping at last week's G-20 summit. Trump fueled doubt about the sustainability of trade peace on Tuesday when he called himself a "Tariff Man" in a tweet.

The Dow plummeted 799 points on Tuesday and analysts pointed to Trump's tweet as one of the catalysts.

"The president's characterization of himself as 'Tariff Man' is juvenile and unpresidential," Dennis Gartman, editor and publisher of The Gartman Letter, wrote on Thursday. "We can only shake our heads in wonder and dismay."

The president also suggested tariffs will "MAKE AMERICA RICH AGAIN," despite the fact that these levies are paid by American companies and consumers.

"The payment comes from my pocket and yours," David Kotok, chairman and chief investment officer at Cumberland Advisors, wrote to clients on Thursday. "In a trade war the guns are pointed inward. No one wins."

Is the trade war getting better or worse?

Stocks tumbled again on Thursday after the arrest in Canada of Huawei CFO Meng Wanzhou, though they rallied back later in the day. Meng is the daughter of one of founders of Huawei, a company that has been likened to the Apple of China. The arrest, at the request of the United States, opens up a new avenue in the trade war that investors had been hoping for relief from.

"This arrest suggests that as opposed to getting better, things are getting worse," said Joe Quinlan, chief market strategist at Bank of America's US Trust.

The tit-for-tat tariffs with China threaten to overshadow the tax cuts and deregulation that had been helping speed up economic growth. Not only do tariffs lift costs, they disrupt supply chains and force businesses to delay investment decisions.

Trade sensitive stocks like Boeing and Caterpillar have tumbled this week.

Concerns about the trade war prompted the IMF to recently downgrade its 2019 economic growth forecasts for both China and the United States.

"We seem to be stuck in a cul-de-sac that we just can't get out of when it comes to the trade standoff with China," said Quinlan.

Recession jitters

Meanwhile, one of Wall Street's favorite recession indicators is suddenly flashing yellow. The gap between two-year and 10-year Treasury yields has narrowed to levels unseen since just before the Great Recession.

Investors are getting nervous that the yield curve will invert, meaning short-term rates are higher than long-term ones. That has in the past been a reliable prognosticator of recessions.

At a minimum, the flattening yield curve reflects concerns over slowing growth and a Federal Reserve that could be raising borrowing costs faster than the economy can handle.

And the phenomenon makes it harder for banks to make money. The SPDR S&P Regional Banking ETF slumped 7% this week. Big banks like Citigroup and Bank of America plunged 10% apiece.

Hooper predicted the yield curve will widen soon because the Federal Reserve is likely to dial back its interest rate hikes for next year. Such an outcome could ease fears that the Fed is walking into a mistake.

Late-cycle behavior

Even though investors are watching for the next recession, the underlying fundamentals of the economy look solid, if not strong.

Friday's jobs report showed that the US unemployment rate in November remained at just 3.7% and wages grew at 3.1%. However, only 155,000 jobs were created last month, missing expectations for 200,000.

The Atlanta Federal Reserve's forecasting model is calling for fourth-quarter GDP growth of 2.7%. That's down a touch from its early November prediction of 3% growth, but still a far cry from a downturn.

"It's hard to pencil in a recession anytime soon," said Quinlan. "The US consumer is at the core of the economy -- and that core is pretty rock solid right now."

Rather than an imminent downturn, investors seem to be preparing for a more treacherous horizon. Economic and profit growth are projected to slow in 2019 and some economists have warned of a recession in 2020.

In the meantime, investors should brace for more volatility. Turbulence is par for the course in late-cycle markets.

3. Who is Meng Wanzhou, the Chinese exec wanted by the US?

[December 7, 2018] Meng Wanzhou, the CFO of Chinese tech giant Huawei, has kept a low profile for much of her career. Now she's at the center of a geopolitical drama between the world's two largest economies.

The 46-year-old executive was arrested Saturday in Canada, and faces extradition to the United States. After news of her arrest broke late Wednesday, Meng's face was splashed across the internet.

Meng is the daughter of Huawei's billionaire founder, Ren Zhangfei, and her case threatens to ramp up tensions between Washington and Beijing.

"The fact that this is Ren's daughter and a very senior official in the company sends a very strong message to China: no one is above US law and we will reach out anywhere in the world and arrest you if you break the law," said Paul Triolo, the head of global tech policy at risk consultancy Eurasia Group.

Tipped for the top?

Despite her position as a senior executive at Huawei, China's largest smartphone and telecommunications equipment maker, little is known about Meng and her rise through the ranks at the company. It's not traded on a stock exchange, and its executives are notoriously media shy.

Aside from a brief stint at state-run China Construction Bank after graduating from college in 1992, Meng has spent her entire career at her father's company.

Her brother, who is known as both Meng Ping and Ren Ping, works at a Huawei subsidiary. The siblings' roles at the company have fueled speculation that they are being groomed to take over from their father.

In March, Huawei shook up its top ranks, making the founder's daughter one of four vice chairs of the board. The promotion supported the idea she could one day lead the company.

But Huawei's founder has repeatedly denied the existence of a succession plan built around his children.

Asked about it in 2010, Ren told Chinese business news site Caixin: "This plan doesn't exist. It's too ridiculous to respond to." In a letter to employees in 2013, he reportedly said his children lacked the vision, character and ambition to lead Huawei.

According to its most recent annual report, Huawei is a private company with Ren holding 1.4% of its shares, and the rest owned by more than 80,000 company employees. Ren, 74, is worth \$3.4 billion, according to Forbes.

From answering phones to finance chief

Until recently Meng, like her father, rarely spoke to the media.

But in 2013, she gave an interview to 21st Century Business Herald, a Chinese newspaper. She said she was married with two young children and noted that her husband does not work in the telecommunications industry.

Meng also answered questions regarding her last name, saying she changed it when she was 16, taking her mother's surname.

She started working at Huawei in 1993, a year after graduating from college. Her first job, she said, was answering phones.

Meng went back to university in 1997, graduating with a master's degree in accounting. When she returned to Huawei the following year, she joined the finance department and that, she said, was when her career took off.

Meng held positions at director and executive level in the accounting and finance departments before becoming CFO.

She spent the 2000s revamping Huawei's organizational structure and financial systems as the company expanded its business around the world.

Presiding over Huawei's riches

It is unclear exactly when Meng was promoted to the C-Suite.

Founded in 1987, Huawei only began publishing the names and biographies of the people who run the company in 2011, according to Reuters. The inaugural list already identified Meng as CFO.

Over the past seven years, she has presided over a period of extraordinary financial success at Huawei. The company more than quadrupled its net profit between 2011 and 2017, when it reported 47.5 billion yuan (\$6.9 billion).

It now sells more smartphones than Apple and is the world's biggest maker of telecommunications equipment ahead of Sweden's Ericsson.

The company's global rise has brought it increasing scrutiny from the US government over the same period. And Meng has now become its focal point.

4. Surge in jobs drives unemployment rate to 40-year low of 5.6%

[December 7, 2018] A blast of 94,100 new jobs last month has knocked the country's unemployment rate down to 5.6%—its lowest level since Statistics Canada started measuring comparable data more than 40 years ago.

The overall number marked the labour force survey's largest monthly increase since March 2012 when there was a gain of 94,000 jobs, Statistics Canada said Friday.

The November employment surge was fuelled by the addition of 89,900 full-time positions. For employee work, the private sector added 78,600 positions in November, while the public sector gained 8,300 jobs.

Last month's increase pushed the jobless rate down from October's reading of 5.8%, which had been the previous low mark since comparable data first became available in 1976. The old statistical approach—prior to 1976—registered an unemployment rate reading of 5.4% in 1974.

But Friday's report also contained disappointing details.

Year-over-year average hourly wage growth for permanent employees continued its decline in November to 1.46%—to deliver its weakest reading since July 2017.

Experts have been expecting wage growth to rise thanks to the tightened labour market, but it has dropped every month since its May peak of 3.9%. It now sits well below inflation.

However, in emailed commentary, CIBC senior economist Royce Mendes noted that the wage series tends to be “very volatile.”

The Bank of Canada keeps a close watch on wages ahead of its interest-rate decisions. On Wednesday, the central bank held its benchmark rate at 1.75%, but in explaining its decision it highlighted other economic negatives such as weaker-than-expected business investment and the sharp drop in oil prices.

Statistics Canada’s report Friday also said that, compared to 12 months earlier, employment was up 1.2% following a net increase of 218,800 jobs. The addition of 227,400 full-time positions offset a small decrease in part-time work.

The November jobs report showed the goods-producing sector added 26,900 jobs following a notable gain of 14,800 construction positions. The services sector generated 67,200 jobs last month with help from the addition of 26,000 positions in professional, scientific and technical services.

By region, employment rose in six provinces and was led by gains in Quebec and Alberta.

Mendes says today’s positive jobs data will keep a January interest rate hike on the table for now, but “we’ll need to see similarly positive evidence from other indicators, and no major reversal in the next jobs report.”

5. How the BoC views the yield curve

[December 6, 2018] Bank of Canada (BoC) governor Stephen Poloz is watching the yield curve to see if its movements align with central bank policy.

The flattening yield curve is “a signal that we would ignore at our peril, because it has a very long history of telling us something important about the economy,” Poloz said Thursday, addressing the CFA Society Toronto with a year-end economic progress report.

However, the curve must be interpreted within the context of the post–Great Recession economy, he said. For example, as accommodative monetary policy ends, greater market volatility can be expected as risk moves back into the marketplace, off the balance sheets of central banks. Further, global trade

concerns add to sector volatility, mostly affecting stocks exposed to trade, he said.

Market recalibration, along with other indicators such as moderating global growth, “are exactly what I would predict from our base profile,” he said. “There’s nothing inconsistent there.”

When asked about liquidity risk in fixed income markets, he referred to the bank’s fixed income forum, through which the central bank consults regularly with major fixed income participants. He described liquidity as “OK,” and said the central bank is “alert to potential issues.”

Bank monitors mortgages, macroeconomics

In his speech, the governor highlighted updates to the central bank’s economic model, which captures how the financial system would affect the real economy and vice-versa, thus helping to inform monetary policy.

For example, the bank now uses a growth-at-risk framework, developed by the International Monetary Fund, to capture the rise in financial vulnerabilities and associated downside risks to economic growth.

The bank also upgraded its economic model to incorporate rising household debt and home prices, and mortgage data analysis to assess how higher rates affect Canadian mortgage-holders.

The governor said the overall level of risk to the Canadian financial system was about the same as it was six months ago when the bank published its financial system review.

As the central bank aims to reach a neutral policy, the governor reiterated concerns about elevated consumer debt from mortgages, which he described as “a vulnerability that will persist for many years.” At the same time, macroprudential measures are improving the quality of that debt, he said.

Though home prices are elevated in markets such as Toronto and Vancouver, he said price growth has decelerated, growing at an annual pace of about 2%—again, because of macroprudential measures along with rising rates. He added that measures to increase housing supply would be the most effective way to support housing affordability.

The governor also outlined macroeconomic risks to its inflation outlook, saying “a lot has happened” since the October monetary policy report, including the release of soft GDP and business investment data, falling prices across both heavy and light oil, and growing concerns about global growth and tariffs.

In particular, oil prices are well below forecast assumptions in the October monetary policy report, and “a painful adjustment” of Western Canada’s economic forecast will affect Canada’s macro economy, he said. However, given oil sector consolidation since 2014, net effects of lower oil prices on the

Canadian economy, dollar for dollar, should be smaller than in 2015 when oil prices dropped.

Oil and other economic developments will be assessed in new projections in January's monetary policy report, said Poloz, adding that the pace of interest rate increases to achieve the estimated neutral range of 2.5% to 3.5% would remain data-dependent.

“The persistence of the oil price shock, the evolution of business investment and our assessment of the economy's capacity will also factor importantly into our decisions about the future stance of monetary policy,” he said.

6. BoC holds interest rate with an eye on oil slump, business investment

[December 6, 2018] The Bank of Canada left its interest rate unchanged today and says the timing of future hikes will depend on factors such as how long the oil-price slump lasts, how well business investment picks up its pace and how much room the economy still has left to grow.

The central bank is holding its trend-setting rate at 1.75% in a decision that follows a quarter-point increase at its previous policy meeting in October.

The bank has been on a gradual rate-hiking path for more than a year thanks to a strengthening economy and has already raised the benchmark five times since the summer of 2017.

The bank says it will keep a close eye on the evolution of several recent developments as it considers the timing of its next rate hike—including a steep slide in oil prices that it predicts will reduce activity in Canada's energy sector. It also says recent data show that the economy has less momentum heading into the final quarter of 2018 related to factors such as a drop in business investment that the bank largely connects to trade uncertainty last summer.

The bank also notes it will be watching for positive developments such as signs the economy can still expand without stoking inflation.

The central bank can raise the interest rate to prevent inflation from climbing too high. Many market watchers had expected governor Stephen Poloz to wait until at least January before his next rate increase.

The Bank of Canada has estimated it will no longer need to increase the interest rate once it reaches a level of between 2.5% and 3.5%, but Poloz has said this destination range remains “sufficiently uncertain” and could move up or down.

In emailed commentary, CIBC chief economist Avery Shenfeld called today's message from the central bank “dovish,” and noted that the market has been pricing away rate hikes in recent weeks. A January hike depends on “better

economic data for October and an OPEC production cut that firms up oil prices,” he said.

7. UPS and FedEx plunge on Amazon Air fears

[December 6, 2018] Forget about drones and armies of people driving Amazon trucks. One big Wall Street firm thinks Amazon's plan to build up its air freight delivery service may be what really winds up hurting UPS and FedEx.

Morgan Stanley analyst Ravi Shanker said in a report Tuesday that both delivery giants could lose 10% of their revenue to Amazon Air by 2025. Shanker cut his price targets on UPS and FedEx and both stocks plunged more than 6% as a result.

It was a particularly gruesome day for transportation stocks due to worries about the broader economy and confusion about the status of US-China trade talks.

The Dow Jones Transportation Average, which includes FedEx and UPS as well as leading airlines, truckers and railroads, fell 4.4% -- its worst drop since June 2016.

But Shanker paints a picture that should be extremely worrisome to UPS and FedEx.

He notes that Amazon, which currently is leasing 40 cargo jets, could eventually have 100 planes running and estimates that the planned Amazon Air routes could overlap with more than two-thirds of the volume flown by UPS and FedEx.

That's bad news for both companies since Shanker said that UPS and FedEx each generate nearly 20% of their overall revenue from US air deliveries.

Amazon has made big investments to bulk up Amazon Air. In the past few years, it has bought stakes in two freight delivery airlines -- Air Transport Services Group and Atlas Air Worldwide Holdings.

It also announced plans to invest \$1.5 billion in order to build an Amazon Air hub on more than 900 acres of land that it is leasing near the Cincinnati/Northern Kentucky International Airport. Amazon bought an additional 210 acres earlier this year.

There's a simple reason why Amazon will want to handle more of its own air deliveries. According to Shanker, Amazon could save between \$1 billion and \$2 billion next year. That works out to about 3% to 6% of its global shipping costs.

But on a day when the broader market was tanking, investors didn't seem too enthusiastic about Shanker's thoughts on Amazon either. Shares of Amazon fell nearly 6%.

Have a nice and fruitful week!

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