Weekly Updates Issue # 698

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1. Weekly Markets Changes

[January 25, 2019]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,366.05 +62.22 +0.41%	2,664.76 -5.95 -0.22%	24,737.20 +30.85 +0.12%	7,164.86 +7.63 +0.11%	$0.7544 +0.03c +0.04%	$1,305.25 +23.14 +1.80%	$53.69 -0.11 -0.21%

2. Higher revenue keeps federal deficit to $2.1B from April to November

[January 25, 2019] The federal government ran a deficit of $2.1 billion through the first eight months of its 2018-19 fiscal year compared with a deficit of $9.5 billion in the same period a year earlier.

In its monthly fiscal monitor, the Finance Department says revenue in the April-to-November period was up $16.7 billion, or 8.6%, boosted by increases in tax revenues, EI premium revenues and other revenues.

Program expenses were up $8.0 billion, or 4.2%, due to increases in major transfers to persons and other levels of government and direct program expenses.

Public debt charges increased by $1.4 billion, or 9.8%.

The government’s February budget predicted a deficit of $18.1 billion for the 2018-19 fiscal year, which ends in March.

For November, the government posted a deficit of $2.2 billion compared with a deficit of $2.9 billion in November 2017.

3. OSFI calls on banks, insurers to report cybersecurity incidents

[January 25, 2019] The Office of the Superintendent of Financial Institutions (OSFI) has issued a new advisory that sets out obligations for banks and insurers to report technology and cybersecurity incidents, the federal regulator announced Thursday.

"Cybersecurity threats and incidents are increasing in sophistication, frequency and persistence. They have the potential to disrupt interconnected global financial systems and financial institutions," OSFI states in a letter to federally regulated financial institutions.

The advisory describes characteristics of incidents that should be reported to OSFI, in addition to initial notification and subsequent reporting requirements.

Specifically, firms **must notify OSFI no later than 72 hours after an incident.** Additionally, they must meet ongoing reporting obligations for incidents that "materially impact" normal operations "including confidentiality, integrity or availability of its systems and information," the advisory states.

Regulatory reporting of security incidents can help both individual firms and the industry at large identify measures that they can take to prevent similar incidents, OSFI says, and improve their resiliency when breaches do occur.

Effective March 31, the advisory supersedes any prior instructions for technology and cybersecurity incident reporting, OSFI says.

4. Hedge funds assets plunged by $88 billion in 2018

[January 25, 2019] The hedge fund industry suffered a brutal 2018 as nervous clients yanked tens of billions of dollars from their portfolios. Hundreds of funds shut down and bets on tech stocks and oil blew up.

Hedge fund assets under management plummeted by $88 billion last year, according to research by eVestment, a firm that provides software to institutional investors. It was easily the deepest decline in assets for the industry since the financial crisis a decade ago, eVestment said in a report published Thursday.

Extreme turbulence across financial markets exposed glaring performance issues that have dogged hedge funds for years.

"Investors were again reminded that the industry is not necessarily full of exceptional managers," wrote Peter Laurelli, eVestment's global head of research. "There is no disputing the numbers."

That realization hit a crescendo last month, when the S&P 500 suffered its steepest December decline since the Great Depression.

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Jittery clients pulled $19.6 billion out of hedge funds that month alone, lifting annual withdrawals to $35.3 billion, eVestment said.

Hundreds of hedge funds shut down

The withdrawals were punctuated by several large funds deciding to liquidate or convert to family firms early in the fourth quarter. When those funds closed, they returned capital to investors.

More than 400 hedge funds were liquidated through the first three quarters of 2018, according to HFR.

"We have been in a bull market for the last 11 years, so now that this is ending, the wheat is being separated from the chaff," said Ole Rollag, managing principal of Murano Connect, a firm that connects fund managers to allocators. "There are many fund managers, but only some of them are good."

It's not a new trend. Nearly 3,000 hedge funds were shut down since the beginning of 2015, HFR said. And hedge fund assets plunged by $112 billion in 2016.

The problem is that the performance of many hedge funds has not lived up to the expensive fees that they charge.

For many years, most hedge funds charged a flat fee of 2% on total assets and an extra 20% on any profits earned. But poor performance has forced hedge funds to rethink the pricey "two and twenty" fee structure that eats into client returns.

EVestment said the hedge fund aggregate index fell by 5.2% in 2018, narrowly trailing the S&P 500's 4.4% decline. Hedge funds did beat the S&P 500 in the fourth quarter, though they still lost money.

"In theory, hedge funds are supposed to be able to make money in up or down markets," said Ian Winer, a former hedge fund executive who is now an advisory board member at Drexel Hamilton.

Tech, oil trades implode

Performance issues were exposed by the fact that hedge funds piled into crowded stocks like Facebook, Amazon and Alphabet. Crowded positioning can exacerbate losses when everyone decides to sell at the same time. The tech trade blew up last year when the Nasdaq careened into a bear market.

Equity hedge funds tumbled by nearly 8% in 2018, including a 4% loss in December, eVestment said.

Hedge funds were also hurt by the extreme turbulence in the oil patch. Oil prices shot higher most of the year before plunging into a bear market in the fall, dealing heavy losses to some hedge funds.

Commodity hedge funds fell by 6% last year, eVestment said.

Brenham Capital, a Dallas hedge fund that bet on energy stocks, closed its doors in late November. Founder John Labanowski blamed the "gut-wrenching" decision to liquidate on the boom-bust nature of oil.

"The cycle continues to get shorter and more violent," Labanowski wrote in a letter to clients.

"Our team fought the good fight and had great success at times but the difficult environment finally took its toll on the Fund's returns and me personally."

$3.2 trillion of hedge fund assets

Don't feel too badly for hedge funds though. The industry still manages a stunning $3.2 trillion. And 42% of hedge fund managers were able to raise net capital last year, eVestment said.

Some firms, especially ones using macro strategies, adeptly navigated the challenging market conditions.

For instance, the flagship fund at Citadel, the nearly $30 billion multi-strategy hedge fund run by billionaire Ken Griffin, was up 9.1% last year, a person familiar with the matter told CNN Business.

Earlier this week Griffin closed on the $238 million purchase of a Manhattan property at 220 Central Park South. It marks the most expensive price ever paid for a home in the United States.

Still, the winning funds were hard to find in 2018.

Winer said that too many firms are "masquerading" as hedge funds. They don't adequately hedge themselves, essentially making them leveraged long funds.

"When the market is up, they do okay. But when the market's down, they get killed," Winer said. "Investors have finally said, 'Why am I paying two and twenty for a fund that isn't too different from buying the S&P for nothing?"4.

5. Canadian retail sales fell in November

[January 23, 2019] Statistics Canada says retail sales fell 0.9% to $50.4 billion in November. The data is the latest sign of weakness in the Canadian economy after the agency reported Tuesday that both wholesale and manufacturing sales also fell in November.

Economists had expected a retail sales drop of 0.6%, according to Thomson Reuters Eikon.

Statistics Canada says the move lower came as sales at gasoline stations and motor vehicle and parts dealers dropped.

Excluding these two subsectors, retail sales increased 0.2%.

Overall, sales were down in six of 11 subsectors, representing 75% of retail trade.

Retail sales in volume terms fell 0.4%.

Royce Mendes, director and senior economist at CIBC World Markets, said in a research note that cautious consumers pose another challenge for the economy.

After Tuesday's manufacturing and wholesale numbers, Mendes said CIBC is now tracking a decline in GDP for November and has lowered its Q4 forecast to 1% growth.

"Households were in no mood to spend the gains from increasing job totals nor the savings from falling gasoline prices during the month of November," he said.

"While the latter will be temporary, slower growth in consumption has been one of the main reasons we don't see the Bank of Canada as being able to raise rates much higher than current levels."

6. Liberals to prioritize affordable homes for millennials

[January 22, 2019] The Trudeau government wants to make home-buying more affordable for millennials, Finance Minister Bill Morneau said Tuesday as he held pre-budget public events in the Toronto suburbs.

Following a speech in Aurora, Ont., Morneau made the comment when he was asked if Ottawa has any plans to help first-time buyers enter the housing market at a time of rising interest rates, which make mortgages more expensive.

Housing is expected to be a prominent campaign issue ahead of October's federal election—and major parties have already begun to position themselves.

Real estate in Aurora, about 50 kilometres north of Toronto, has shot up in price about as quickly as it has anywhere. According to the Toronto Real Estate Board, the average price for all types of housing there was $810,000 in December. Detached homes were going for more than $918,000.

Morneau told the business audience that the Liberal government has focused on three housing-related issues since coming to office in 2015: Canada's shortage of affordable housing, a run-up in real-estate prices in some markets and ensuring millennials can afford homes.

The federal government, he said, has already tried to increase the supply of affordable housing and to cool the hottest markets—such as Toronto and Vancouver—by introducing stress tests that limit some people's ability to take out big mortgages.

"The middle part—the big middle part—is the affordable housing for millennials," said Morneau, who will release his election-year budget in the coming weeks that will also lay out Liberal platform commitments.

"That's a real challenge and there's multiple things we're looking at in order to think about how we can help in that regard."

Morneau didn't elaborate on what options are on the table.

Conservative MP Karen Vecchio argued in a statement Tuesday that Trudeau government policies, including its carbon tax, have made housing less affordable.

"Justin Trudeau's policies are making life more expensive for Canadians, pushing their dream of owning a home further and further away," Vecchio said.

On Monday, NDP Leader Jagmeet Singh proposed measures he insisted will help build 500,000 new affordable housing units across Canada over the next 10 years.

Singh only offered a few details, but said Ottawa should stop applying GST to the cost of building new affordable units, provide a subsidy to renters who spend more than 30% of their incomes on housing and double a tax credit for first-time homebuyers to $1,500 from $750.

7. Latest economic data fall below expectations

[January 22, 2019] The Canadian economy showed signs of weakness in November as both wholesale and manufacturing sales fell.

Statistics Canada said Tuesday wholesale trade fell 1% in November to $63.0 billion, more than offsetting the 0.7% increase in October.

Meanwhile, manufacturing sales fell 1.4% to $57.3 billion in November, the second consecutive monthly decrease.

Economists had expected no change in wholesale sales and a drop of 0.9% in manufacturing sales, according to Thomson Reuters Eikon.

TD Bank economist Omar Abdelrahman said the data confirm the moderating growth narrative.

"Sub-par manufacturing performance is still expected in the near-term, as Alberta's production curtailment plan starts to reflect in manufacturing sales volumes," Abdelrahman wrote in a note to clients.

"It is important, however, to note that these are temporary shocks. As these shocks fade, manufacturing sales should receive support from strong economic performance south of the border, a weaker loonie and expectations of increases in investment spending in the face of elevated capacity constraints."

Royal Bank senior economist Nathan Janzen noted that labour markets still look solid and, notwithstanding recent market volatility, the U.S. industrial sector is continuing to expand.

“We still expect a ‘data-dependent’ Bank of Canada will ultimately view more gradual rate hikes as appropriate this year—but very likely not until confirmation emerges that the expected slow patch over the next couple of quarters is temporary,” Janzen wrote.
In emailed commentary, Royce Mendes, director and senior economist at CIBC World Markets, said today’s data could indicate GDP for November will sink below CIBC’s flat forecast. Retail sales for the month, to be published tomorrow, will provide a clearer view of monthly growth, he said.
Data details
Manufacturing sales were down in 13 of 21 industries, representing 45.3% of total manufacturing sales. In volume terms, manufacturing sales fell 0.9%.
The petroleum and coal product industry fell 13.8% due to lower prices for petroleum and coal products, as well as maintenance and turnaround work at some refineries and lower production at other others.
Partially offsetting the decline was a 1.3% increase in the transportation equipment industry and a 1.5% increase in the food industry.
Meanwhile, wholesale sales were down in five of seven subsectors. In volume terms, wholesale sales fell 1.2%.
The machinery, equipment and supplies subsector fell 2.3%, while sales in the building material and supplies subsector dropped 1.9%.

8. The US is moving ahead with its extradition request for the Huawei CFO

[January 22, 2019] The United States will soon make a formal request for the extradition of Huawei's chief financial officer, marking the next step in a case that has set off a geopolitical storm.
The US Department of Justice said in a statement Tuesday that it will meet a deadline next week to file the request with Canadian authorities.
The arrest of the Chinese executive, Meng Wanzhou, in Vancouver last month has strained relations between Canada, the United States and China. It has also raised questions about how far the US government may go in its efforts to clamp down on Huawei, a top Chinese tech company that it regards as a national security threat.
China's Ministry of Foreign Affairs on Monday reiterated its request for Meng to be released, claiming the United States and Canada had abused their extradition treaty.
Ministry spokeswoman Hua Chunying told reporters at a regular briefing that Canada "made a serious mistake at the beginning" and Meng's case is not a "regular judicial case."

"We also urge the US to correct their mistakes and withdraw the arrest warrant for Meng Wanzhou," Hua said.

Meng, the daughter of Huawei's founder, was arrested by Canadian authorities acting on behalf of the United States. The US government alleges that she helped Huawei dodge US sanctions on Iran.

Meng and Huawei have denied any wrongdoing.

A spokesperson from Canada's Justice Ministry said Monday that it hasn't yet received the full extradition request from the United States. The deadline for filing the formal request is January 30 and a court hearing has been scheduled for February 6.

"We greatly appreciate Canada's continuing support in our mutual efforts to enforce the rule of law," US Department of Justice Spokesman Marc Raimondi said Tuesday.

Canada under pressure

The US statement followed comments Monday about Meng's case by David MacNaughton, the Canadian Ambassador to the United States.

He stressed that despite pressure from China, the Canadian government is following national laws and international obligations. "I have not ever asked the Americans to withdraw their request," he told CNN.

US President Donald Trump complicated the situation last month by suggesting he may intervene in the legal saga if it would help his pursuit of a trade deal with China. That helped fuel the widely held view in China that Meng's arrest was a political move by the Trump administration to gain leverage in the clash between the two countries over trade and technology rather than a law enforcement matter.

MacNaughton said he has "sought clarification that this is a legal matter and not a chip in a trade dispute."

"There are Canadians being detained and one sentenced to death," he added. "This is serious stuff."

Since Meng's arrest, China has detained two Canadians on suspicion of "activities that endangered China's national security." Last week, another Canadian was sentenced to death after a Chinese court convicted him of drug smuggling, prompting Canada to issue a travel warning to its citizens over "the risk of arbitrary enforcement of local laws" in China.

MacNaughton first made remarks about the case Monday in an interview with Canadian Newspaper The Globe and Mail.

Have a nice and fruitful week!