Credential

Market Insights | MONTHLY

Month in Review

For the month ended December 31st, 2016

Overall Highlights

- **S&P/TSX gains.** Canada's main equity index rose on mediocre economic data reported during the month, buoyed primarily by the rise in crude prices. In December, the Composite gained 1.4% to close at 15,288. The rally that sent U.S. markets toward record highs continues to spill over onto the TSX as the index edges closer to its all-time high of 15,625 set in 2014.
- **Loonie unchanged.** The Loonie was flat in December as economic news at home helped our currency keep pace with the strength of the U.S. dollar. At month's end, one Canadian dollar was worth US74.47 cents, no change from the previous month end.
- **Gold drops.** Despite the expected interest rate hike by the U.S. Federal Reserve as a result of the improving economy, investors continued to sell off the yellow metal in favour of the equity markets. For the month of December, gold was down 1.5% to end the year at US$1,150.90 per ounce.
- **Oil pops.** West Texas Intermediate (WTI) crude continued to benefit from accords reached amongst OPEC members and between OPEC and non-OPEC members to help ease the global supply glut. On the close, oil rose to US$53.83 a barrel, a gain of 9.5%.
- **Economy slows.** Canada's GDP unexpectedly contracted in October suffering its worst monthly decline since December 2013.
- **Unemployment rate falls.** The economy added 10,700 jobs in November sending the jobless rate down to 6.8%.
- **Inflation falls.** Weaker inflation in November was a setback for the Bank of Canada as the economy continued to have difficulties sustaining growth. Led by lower food costs, monthly inflation fell by 0.4%, dropping annualized CPI to 1.2%.
- **Retail sale rise.** For a third month in a row, retail sales rose in October by 1.1% to $45B, driven by higher gasoline and general merchandise sales.
- **U.S. Q3 GDP revised up.** The U.S. economy grew faster than initially thought. The Commerce Department released its final estimate of Q3 economic growth, revising it to 3.5%, from the second estimate of 3.2%.
- **Fed raises interest rates.** In one of the most anticipated moves for the market, the U.S. Federal Reserve announced its first rate hike since December 2015. The target federal funds rate was raised by 25 basis points to range between 0.50% and 0.75%.
- **U.S. industrial production declines.** The Federal Reserve reported that industrial production in November declined 0.4% from October, larger than the 0.2% drop estimated by economists.
- **ECB extends bond purchase but reduces the pace.** As many market participants expected, ECB extended its bond purchase program, but surprised some by cutting the size of the purchase.
- **Euro-zone inflation down.** Euro-zone inflation remained subdued despite ECB's continuous monetary stimulus. Eurostat reported that consumer prices within the 19-member bloc fell 0.1% in November; year-over-year, prices increased by 0.6%.
- **Italians say no to reform.** The constitutional reform proposed by Italian Prime Minister Matteo Renzi was rejected by its people. Italians rejected the proposed reforms by 60 to 40 percent, adding more uncertainties around Italy's future in the Euro-zone.
- **BOJ leaves monetary policies unchanged.** The Bank of Japan (BOJ) announced that it will maintain its current stimulus program, at the same time upgrading its economic assessment.

Index/Commodity/Currency		
Close	**Month Change**	**YTD Change**
S&P/TSX Composite		
15,287.59	204.7	2,277.6
	1.4%	17.5%
BMO Nesbitt Burns Small Cap		
880.27	27.7	230.1
	3.2%	35.4%
Dow Jones Industrial Average		
19,762.60	639.0	2,337.6
	3.3%	13.4%
S&P 500		
2,238.83	40.0	194.9
	1.8%	9.5%
NASDAQ Composite		
5,383.12	59.4	375.7
	1.1%	7.5%
MSCI-EAFE Index		
1,684.00	54.3	-32.3
	3.3%	-1.9%
WTI Crude Oil (per barrel, in $US)		
53.83	4.7	16.8
	9.50%	45.2%
Gold (per ounce, in US$)		
1,150.90	-17.7	90.4
	-1.5%	8.5%
Canadian Dollar (¢ per US$)		
74.47	0.0	2.3
	0.0%	3.2%

Sources: Bloomberg, PC Bond

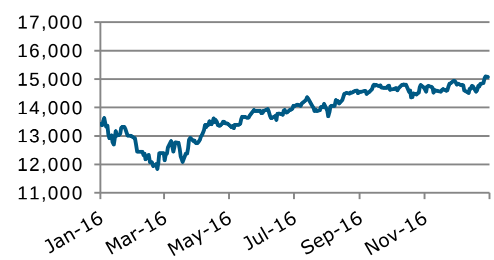
Canadian Markets

- **Economy slows.** Canada's GDP unexpectedly contracted in October suffering its worst monthly decline since December 2013. Output fell 0.3% as the manufacturing sector declined 2%, placing a damper on the efforts of the Bank of Canada to jumpstart a stubborn economy. Forecasts had called for a flat growth during the month after four straight months of growth and a strong third quarter.
- **No change in interest rates.** Canada's central bank held its benchmark rate at 0.5%, on par with expectations, as the economy recovered slightly in the third quarter. However, inflation was below the Bank of Canada's liking due to lower food costs, and because the economy remains susceptible to negative global factors resulting in muted growth. The Bank's December rate announcement was the last for 2016 with new economic projections and its next decision slated for January 2017.
- **Unemployment rate falls.** The economy added 10,700 jobs in November sending the jobless rate down to 6.8%. However, despite the decline, fewer people were actively seeking employment, causing the structure of the labour market to tilt more towards part-time hirings, likely attributed to the upcoming holiday season, than the more stable, full-time positions.
- **Inflation falls.** Weaker inflation in November was a setback for the Bank of Canada as the economy continued to have difficulties sustaining growth. Led by lower food costs, monthly inflation fell by 0.4%, dropping annualized CPI to 1.2%. Price increases in autos and utilities were not enough to offset declines in meat products and travel costs. Core inflation was also lower falling to 1.5% from 1.7% in October.
- **Wholesale sales climb.** Motor vehicles and food and drink pushed wholesale sales higher by 1.1% in October, firmly besting economist forecasts of 0.4%. Five of the seven sectors tracked rose with monthly receipts tallying $56.6B, while on a volume basis, inventories rose 0.8% to $72.9B, a third straight month of increases.
- **Retail sale rise.** For a third month in a row, retail sales rose in October by 1.1% to $45B, driven by higher gasoline and general merchandise sales. Expectations called for a 0.3% increase and the month's gains were the quickest in nearly a year, as nine of the 11 sectors rose. On an annualized basis, retail sales are up 3.8% from the same period last year.
- **Manufacturing sales slip.** General weakness in the sector sent factory sales lower in October by 0.8%. Expectations called for a monthly gain of 0.4%, but sales fell in 15 of the 21 industries tracked, led by metal, petroleum, and coal products. This was the largest decline since March when sales fell 0.9% suggesting slower GDP growth in the fourth quarter.
- **Manufacturing PMI higher.** The manufacturing sector saw an uptick in November as new orders rose to a seven month high. The RBC Manufacturing PMI rose to a seasonally adjusted 51.5 from 51.1 signaling continued expansion in the sector that has had difficulties maintaining gains during the year.
- Canada Housing News:
    - **Housing starts fall.** Fewer homes broke ground in November as the number of starts declined 4.3% to just below 184,000 units. Construction of multi-unit buildings rose in BC but was offset by a decline in Ontario, which was blamed on new mortgage tightening rules introduced by Ottawa.
    - **Building permits jump.** New changes to Alberta's building codes sent the value of building permits in October higher by 8.7%, far above analysts' estimates of a -0.7% change. Residential permits rose 7.7% during the month as both single and multi-unit dwellings saw increases, and non-residentials increased 10.7%.
    - **New home prices rise.** StatCan's New Housing Price Index saw a 0.4% increase in October with 13 metropolitans rising and five unchanged amongst the 21 cities tracked. Toronto and Oshawa combined was the largest gainer, rising 1.3% during the month. Annualized, home prices have risen 3% as market conditions, increased construction costs, and lack of developable land was to blame.

S&P / TSX Composite Index
Sector Snapshot

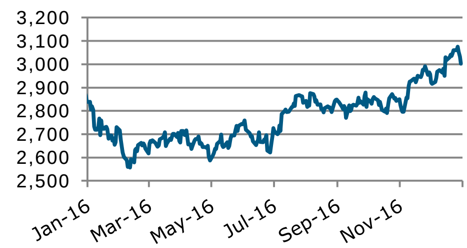
Sector	Month Return	YTD Return	Weight (%)
Energy	1.08	31.19	21.40
Telecoms	0.62	9.85	4.80
Industrials	-0.93	20.73	8.90
Consumer Staples	-0.39	6.15	3.80
Utilities	-5.25	9.74	2.80
Financials	3.19	19.33	35.00
Consumer Discretionary	1.65	8.20	5.00
Health Care	-5.23	-78.65	0.60
Materials	-0.81	39.00	11.80
Information Technology	-1.19	4.36	2.70

S&P / TSX Composite - 1Y Return

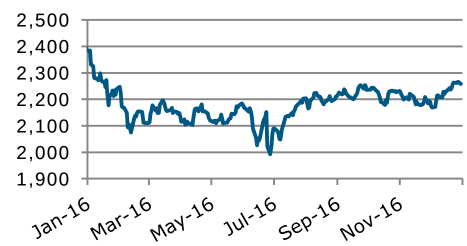


U.S. Markets

S&P 500 - 1Y Return (CAD)



MSCI EAFE – 1Y Return (CAD)



- **U.S. market continues to rally.** The U.S. stock markets continued their post-election rally in December where all three major indices recorded positive gains. The broad-based S&P 500 gained 1.8% for the month, closing at 2,239. The Dow Jones Industrial Average moved up the most among the three indices, gaining 3.3%, and wrapping up the month at 19,763. The tech-heavy Nasdaq went up 1.1%, ending the month at 5,383.
- **U.S. Q3 GDP revised up.** The U.S. economy grew faster than initially thought. The Commerce Department released its final estimate of Q3 economic growth, revising it to 3.5%, from the second estimate of 3.2%. Economists were expecting a smaller upward revision to 3.3%. It was the strongest growth rate in two years.
- **Fed raises interest rates.** In one of the most anticipated moves for the market, the U.S. Federal Reserve announced its first rate hike since December 2015. The target federal funds rate was raised by 25 basis points to range between 0.50% and 0.75%. The Fed increased its forecasted number of 2017 rate hikes from two (its own forecast in September) to three, due to job market strength, evidence of faster inflation, and the expected impact from Donald Trump's policies.
- **Inflation rises.** Consumer inflation in U.S. rose in line with expectations in November. The Labor Department reported that the Consumer Price Index (CPI) increased 0.2% last month, matching economists' forecast. Year-over-year, CPI rose 1.7% in November, the biggest increase since October 2014. Core CPI, which excludes food and energy costs, rose 0.2% after rising 0.1% on October. Year-over-year, core CPI moved up 2.1%.
- **U.S. PPI surges.** Producer prices recorded their largest gain in five months in November. The Labor Department reported that its producer price index (PPI) moved up 0.4% in November, the largest monthly increase since June. Economists were expecting a gain of 0.1% only. Year-over-year, PPI rose 1.3%. Core PPI, which excludes food and energy prices, advanced 0.2%; year-over-year, core PPI increased by 1.8%, the largest increase since August 2014.
- **Durable goods orders decline.** Durable goods orders fell for the first time in five months in November. The Commerce Department reported that demand for products designed to last longer than three years dropped 4.6% in November to a seasonally adjusted $228 billion. Economists were expecting a drop of 5%. Core capital goods orders, which excludes orders for aircraft and is a proxy of business spending plan, rose 0.9%, the second monthly rise in a row.
- **U.S. industrial production declines.** The Federal Reserve reported that industrial production in November declined 0.4% from October, larger than the 0.2% drop estimated by economists. Utilities output fell 4.4% last month due to warmer weather, reducing demand on electricity. A 1.1% increase in the mining sector offset some of the decline from utilities. Year-over-year, industrial production fell 0.6%.
- **Retail sales cool down.** After consecutive months of gains, retail sales slowed down in November. The Commerce Department reported that November's retail sales increased by 0.1% from October, weaker than the 0.3% rise economists were expecting. Sales in September and October were up 1% and 0.6% respectively. Year-over-year, retail sales were 3.8% higher than a year earlier.
- **U.S. service sector grows at a faster pace.** America's service industry expanded at its fastest pace in 13 months, according to the ISM non-manufacturing index. The gauge of U.S.'s service sector activity published by the Institute for Supply (ISM) rose to 57.2 from October's 54.8. Economists were expecting a reading of 55.5. It was the highest reading since October last year.
- **U.S. consumers' sentiment surge.** Americans seemed to be optimistic about their country's future. The Index of Consumer Sentiment tracked by University of Michigan advanced to 98.2 in December, up from November's final reading of 93.8. Economists were expecting a reading of 98.0.
- U.S. housing news:
  - **Housing starts fall.** Housing starts tumbled from its nine-year high recorded in the previous month. The Commerce Department reported that groundbreaking fell 18.7% in November to a seasonally adjusted annual pace of 1.09M units; October housing starts reached an annual pace of 1.34M units, the highest level since July 2007. Economists were expecting housing starts to slip to 1.23M unit rate in November. Building permits also fell in November, dropping 4.7% to a 1.20M unit annual pace.
  - **Existing home sales increase.** Existing home sales rose unexpectedly in November. Sales of previously owned homes advanced 0.7% to a 5.61M unit annual pace, higher than economists estimated 5.50M unit pace. It was the fastest pace since February 2007. Year-over-year, sales climbed up 18.2%.
  - **New home sales rises.** New home sales increased more than expected in November. The Commerce Department reported that new home sales climbed up 5.2% to a seasonally adjusted annual rate of 592,000 units, higher than economists' expectation of 575,000-unit pace. It was the highest level of new home sales in four months.
  - **Home prices continue to rise.** U.S. home prices reached a new peak in October. The S&P/Case-Shiller U.S. National Home Price Index rose 5.6% in October year-over-year, extending the new high reached in the previous month. Seattle, Portland, and Denver remained the hottest market nationwide, recording the largest percentage increases.

European Markets

- **Euro-zone inflation down.** Euro-zone inflation remained subdued despite ECB's continuous monetary stimulus. Eurostat reported that consumer prices within the 19-member bloc fell 0.1% in November; year-over-year, prices increased by 0.6%. Cheap energy cost was one of the main contributors to softness in prices as energy prices fell 0.2% during November and 1.1% year-over-year. Core inflation, which excludes volatile food and energy costs, eased 0.1% in November; year-over-year, core inflation rose 0.8%.
- **ECB extends bond purchase but reduces the pace.** As many market participants expected, ECB extended its bond purchase program, but surprised some by cutting the size of the purchase. The ECB announced that it will extend its bond purchase program by nine months to December 2017. In addition to that, it also said it will purchase at a €60B monthly pace beginning in April 2017 instead of the current pace of €80B. The Euro saw its biggest one-day decline against the dollar since June after the announcement.
- **Euro-zone 'flash' PMI remains at high level.** Business conditions within the Euro-zone ended the year on an upbeat note. The 'flash' IHS Markit's composite purchasing managers' index (PMI) was reported to be 53.9 in December, matching November's final reading and in line with economists' forecast. The 'flash' manufacturing PMI was reported to be 54.9, up from November's reading of 53.7. The region's dominant service sector saw some regression, with the 'flash' service PMI dipping to 53.1 from 53.8, but remaining well above the critical 50-mark separating expansion and contraction.
- **Euro-zone industrial production dips.** Industrial output dropped for the second consecutive month in October. Eurostat reported that industrial production within the 19-member bloc slid 0.1% in October, weaker than the 0.2% rise predicted by economists. Year-over-year, output was up 0.6%, also weaker than the 0.8% gain estimated.
- **U.K. inflation rises to two-year-high.** Inflation in U.K. rose to a two-year high due to a falling pound. The Office for National Statistics reported that consumer prices rose 1.2% year-over-year, higher than economists' expectations for a 1.1% increase. The deep depreciation of pounds this year against the U.S. dollar and euro, especially after the Brexit vote, has caused imported goods to be more expensive.
- **Italians say no to reform.** The constitutional reform proposed by Italian Prime Minister Matteo Renzi was rejected by its people. Italians rejected the proposed reforms by 60 to 40 percent, adding more uncertainties around Italy's future in the Euro-zone. Renzi resigned right after the defeat. Unlike Brexit, the consequences from this event were less clear and the down-the-road effect is harder to predict. In reaction to the result, the Euro fell to 20-month low.

Asian Markets

- **Producer inflation climbs in China.** Producer price level surged in November, improving the chance that the Central Bank may have to raise interest rates to contain inflation. The producer price index in China moved up 3.3% year-over-year in November after rising 1.2% in October, according to the National Bureau of Statistic. Price increases in coal, oil, and steel were among the major contributors to the increase. In comparison, consumer inflation increased by 2.3% in November.
- **BOJ leaves monetary policies unchanged.** The Bank of Japan (BOJ) announced that it will maintain its current stimulus program, at the same time upgrading its economic assessment. At the conclusion of its two-day policy meeting, BOJ decided to maintain the -0.1% interest rate imposed on some of the banks' excess reserves, leave the 10-year Japanese government bond (JGB) yield at around 0%, and keep its annual purchase of JGB at the current pace of 80T yen. It also raised its assessment of the economy claiming that the economy "has continued its moderate recovery trend." It was the first upgrade by the central bank since May 2015.
- **Japan's consumer inflation slumps.** Core consumer prices in Japan posted its ninth straight month of declines in November. Core consumer prices, which includes oil products but excludes fresh food prices, fell 0.4% in November year-over-year, bigger than the 0.3% fall estimated by economists. It was the largest annual drop since February 2013.

Key Take-away:

Farewell to 2016. This year was one for the books, beginning with a sharp sell-off in China that had ripple effects on all global markets. Next, the U.K. Brexit referendum in June ended with the "Leave" side winning 52% of the vote, and sending equity markets lower by 3-4% the next day. The markets recovered (and then some) leading up to the November U.S. presidential election battle between Hillary Clinton and Donald Trump. Clinton lost the Electoral College, conceding victory to Mr. Trump and the Republicans. All signs pointed to a steep market decline but instead, the day ended with gains. Since the election, markets have been on a tear, reaching multiple new all-time highs as the year drew to a close. Though markets ended on a high note, key events in 2017, namely general elections in Germany and France, the U.K.'s formal notice to exit the EU, and a new U.S. administration, will test the bull market resilience in 2017.

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