Credential

Market Insights | MONTHLY

Month in Review

For the month ended January 31st, 2018

Overall Highlights

- **TSX falls.** The S&P/TSX Composite ended the month in the red as a late month sell-off, spurred on by the Federal Reserve's FOMC statement of future rate hikes in 2018, sent equity investors heading towards the exits. Of the 11 sub-indices of the TSX, only two, Information Technologies (+5.4%) and Financials (+0.3%), were in the black, while the heavyweight Energy sector suffered the largest decline falling 5.5%. The Composite closed January at 15,952, a 1.6% monthly loss.
- **Dollar higher.** Strong economic growth in November and a weakened U.S. greenback allowed our dollar to soar higher during the month. However, uncertainty on the outcome of ongoing NAFTA renegotiation talks between Canada, the U.S., and Mexico continued to place downward pressure on our currency. In January, the Loonie ended at US81.35 cents for one Canadian dollar, a monthly change of +2.1%.
- **Gold shines.** The yellow metal held its ground at a multi-month high as the U.S. dollar remained soft and the Feds left their federal funds rate unchanged at 1.25%-1.50%. This bodes well for the metal at the moment, as it typically falls when rates rise; however, we may yet see a decline in price as the likelihood of a rate hike is pushed to the March meeting. Gold closed the month at US$1,346.70, an increase of 3.2%.
- **Oil gushes.** Despite an increase in U.S. production, stronger consumer consumption for gasoline and petrol products, attributed to a colder winter season, helped pushed crude oil higher in January. Crude has more than doubled in price from two years ago, aided by high compliance by OPEC members, rising demand, and falling inventories. A March contract for a barrel of WTI crude ended trading at US$64.83, a 7.8% gain for the month.
- **GDP up.** After a flat October, Canada's economy picked up with where it left off in September as Statistics Canada reported monthly GDP growth in November at 0.4%.
- **BoC raises rates.** For the third time in seven months, the central bank raised rates by 25 basis points. The move was expected given the very strong employment data in Q4, inflation near BoC targets, and the economy operating close to capacity.
- **Inflation falls.** After briefly topping the 2% annualized level last month, the consumer price index fell 0.4% in December driven lower by gasoline prices and, surprisingly, wireless plans.
- **U.S. Q4 GDP grows less than expected.** The world's largest economy grew less than expected in Q4.
- **U.S. gains fewer jobs than expected.** The U.S. economy pumped out fewer jobs than expected in December.
- **The Fed keeps interest rate unchanged.** In Janet Yellen's final meeting as chair of the Federal Open Market Committee (FOMC), the committee decided to leave the benchmark interest rates unchanged in the 1.25%-1.5% range.
- **U.S. consumer sentiment continues to fall.** Consumer sentiment in the U.S. fell again in January according to a report by the University of Michigan.
- **Euro-zone GDP grows.** The 19-member bloc grew at its fastest pace in 10 years.
- **Euro-zone unemployment remains at nine-year low.** The 19-member bloc's unemployment rate remained at a nine-year low in December.
- **Japan's CPI increases.** Consumer prices continued to increase in Japan, inching closer to the Bank of Japan's 2% inflation target.
- **China's GDP growth accelerates.** The world's second biggest economy posted better than expected annual GDP growth in 2017.

Index/Commodity/Currency		
Close	**MonthChange**	**YTDChange**
S&P/TSX Composite		
15,951.67	-257.5	-257.5
	-1.6%	-1.6%
BMO Nesbitt Burns Small Cap		
913.11	-23.3	-23.3
	-2.5%	-2.5%
Dow Jones Industrial Average		
26,149.39	1,430.2	1,430.2
	5.8%	5.8%
S&P 500		
2,823.81	150.2	150.2
	5.6%	5.6%
NASDAQ Composite		
7,411.48	508.1	508.1
	7.4%	7.4%
MSCI-EAFE Index		
2,153.05	102.3	102.3
	5.0%	5.0%
WTI Crude Oil (per barrel, in $US)		
64.81	4.7	4.7
	7.8%	7.8%
Gold (per ounce, in US$)		
1,346.70	41.7	41.7
	3.2%	3.2%
Canadian Dollar (¢ per US$)		
81.35	1.6	1.6
	2.1%	2.1%

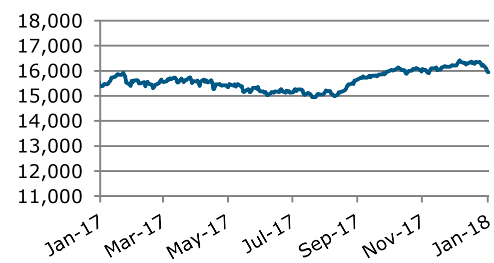
Sources: Bloomberg, PC Bond

Canadian Markets

S&P/TSX Composite Index Sector Snapshot

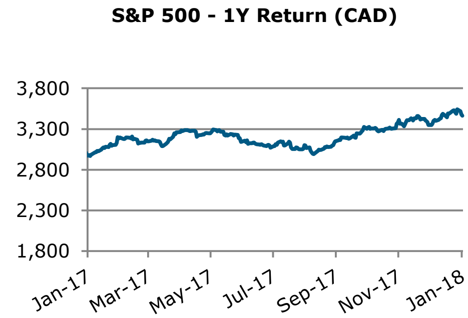
Sector	Month Return	YTD Return	Weight (%)
Energy	-5.46	-5.46	18.90
Telecoms	-4.54	-4.54	4.60
Industrials	-1.84	-1.84	9.50
Consumer Staples	-1.90	-1.90	3.60
Utilities	-4.53	-4.53	3.70
Financials	0.33	0.33	35.30
Consumer Discretionary	-0.46	-0.46	5.50
Health Care	-4.18	-4.18	1.00
Materials	-0.61	-0.61	11.60
Information Technology	5.42	5.42	3.50
Real Estate	-1.21	-1.21	2.90

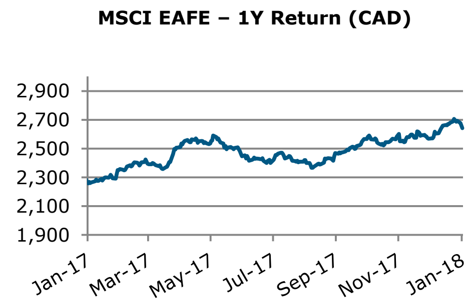
S&P/TSX Composite - 1Y Return



- **GDP up.** After a flat October, Canada's economy picked up with where it left off in September as Statistics Canada reported monthly GDP growth in November at 0.4%. Gains were seen across the majority of industries followed, with 17 of 20 sectors higher, led by Manufacturing's 1.8% surge due to vehicle production. This was the largest increase since May and revives the possibility of a Bank of Canada hike in the Spring to a 60% probability.
- **BoC raises rates.** For the third time in seven months, the central bank raised rates by 25 basis points. The move was expected given the very strong employment data in Q4, inflation near BoC targets, and the economy operating close to capacity. With the announcement, the Bank of Canada instilled a dovish outlook citing uncertainty surrounding the ongoing NAFTA renegotiations.
- **Inflation falls.** After briefly topping the 2% annualized level last month, the consumer price index fell 0.4% in December driven lower by gasoline prices and, surprisingly, wireless plans. The latter was believed to be due to a plan war between telecom companies as one slashed prices with the other rushing to catch up. Of the sectors that saw price increases, food was higher by 2% and housing costs rose 1.4%. Inflation for the 12 months ending December ended at 1.9% with core down a notch to 1.2%.
- **PPI lower.** The cost of inputs when producing goods fell in December, a reversal of November's strong reading. For the month, the Product Price Index fell 0.1%, as prices in energy and unfinished precious metals/alloys were lower. Nine of the sub-groups tracked fell while eight of the 21 sub-groups rose. On an annualized basis, PPI prices are higher by 2.2%, down from 2.7% in November.
- **Unemployment rate falls.** At a level not seen in 40 years, the nation's jobless rate fell to 5.7% from 5.9% in November. The economy added 78,600 jobs in December as employers sought additional help during the holiday season where more part-time positions (+54.9K) were filled compared to full-time (+23.7K). The participation rate, the ratio of employed and actively looking for work persons divided by the working-age population, rose a notch to 65.8%.
- **Manufacturing activity rises.** Improvements in business conditions provided the boost to push IHS Markit's Purchasing Manager's index higher in December. For the month, the PMI reading was 54.7, maintaining an expansionary sentiment in the sector since March 2016. New orders and backlogs increased as manufacturers were upbeat for the forthcoming year as global economic conditions continue to improve.
- **Manufacturing sales surge.** Increased demand for petroleum and coal products and transportation equipment led 12 of the 21 industries higher in November as factory sales spiked to their highest in two and a half years. For the month, manufacturing sales rose 3.4%, comfortable above estimates of 2%, as receipts hit a record high of $55.5B. Despite the strong numbers, economists believe that the sector was catching up as a result of weather-related weakness seen in the recent past months.
- **Wholesale sales up.** An increase in food, beverages, and tobacco helped push producer sales higher in November. For the month, sales were up 0.7% compared to previous month but were shy of forecasts of 1%. Six of the seven sectors followed by Statistics Canada rose as the auto and parts sector also provided a boost to receipts. On a volume basis, sales were up as well by 0.5%
- **Retail sales gain.** A decline in new vehicles negated gains in gasoline and electronics in November as retail sales edged higher by 0.2%, while October's reading was revised higher to 1.6%. Expectations were for a 0.7% rise during the month with six of the 11 sectors tracked seeing gains and accounted for 37% of total trade. Sales at the pumps were higher as gas prices rose and Black Friday activity drove demand for electronics ahead of the holiday season. Volume-wise, sales were higher by 0.3% in November.
- Canada Housing News:
    - **Housing starts fall.** A decline in condominiums surpassed a rise in single homes in December as the number of home starts fell to 216,980. This was above expectations, but noticeably lower than the November unit tally of 251,675, as condos fell 22% and single family homes rose 4.7%. For the year, starts were 9.2% higher compared to 2016, but is expected to slow in 2018 amidst new mortgage lending rates and likely rate hikes by the Bank of Canada.
    - **Building permits drop**. Statistics Canada reported a fall in the value of building permits issued in November as plans for commercial buildings as gains were seen in single-unit homes. For the month, permits were 7.7% lower, a 1½ year low, as non-residential structures fell 12.3% and residentials fell as well led by a 10.1% drop in multifamily dwellings.
    - **Existing home sales higher.** Sales of pre-owned homes rose in December just before new stress test rules on mortgages were set to take place at the beginning of the year. For a fifth straight month, sales increased, as reported by CREA, with December rising 4.5%. Gains were seen in the Greater Toronto region, Alberta, and the Fraser Valley in B.C. on an annual basis, with sales 4.1% higher in the Lower Mainland leading the way.
    - **New home prices rise.** Omitting condos and apartments, the price of a new home in Canada rose in November by 0.1%, half of forecasts by economists. Most of the month's activity was in the Ottawa region with 0.5% gains, while prices in Toronto and Vancouver were little changed. Nationally, 12 markets tracked by StatCan rose while 12 were flat, and three declined.

U.S. Markets





- **U.S. market rallies.** The U.S. stock market posted strong gains in the first month of 2018. All three major indices made record-highs. The broad-based S&P 500 index gained 5.6%, closing the month at 2,824. The Dow Jones Industrial Average moved up 5.8%, ending the month at 26,149. NASDAQ was the best performer of the month, surging 7.4%, wrapping up the month at 7,412.
- **U.S. Q4 GDP grows less than expected.** The world's largest economy grew less than expected in Q4. The Commerce Department reported that U.S.'s GDP grew at a 2.6% annualized rate in Q4, down from the 3.2% growth pace reported for the previous quarter. Economists were expecting Q4 GDP to grow at an annualized rate of 3%. Weak trade and slower growth in inventories were the main drag for Q4 GDP while consumer spending rose a very strong 3.8% in Q4.
- **U.S. gains fewer jobs than expected.** The U.S. economy pumped out fewer jobs than expected in December. The Labor Department reported that the world's largest economy added 148,000 jobs in December, less than economists expected gain of 190,000. Unemployment rate remained steady at 4.1%.
- **The Fed keeps interest rate unchanged.** In Janet Yellen's final meeting as chair of the Federal Open Market Committee (FOMC), the committee decided to leave the benchmark interest rates unchanged in the 1.25%-1.5% range after its two-day meeting in January. The Fed stated that the U.S. economy is growing at a solid rate, with the labor market expected to continue improving.
- **U.S. PPI falls yet CPI rises.** The Labor Department reported that the producer price index (PPI) fell in December, the first fall in 1-1/2 years. December's PPI declined 0.1% in December, the first monthly drop since August 2016; economists were expecting a rise of 0.2%. On a year-over-year basis, PPI increased by 2.6% after accelerating 3.1% in November. In contrast, the consumer price index (CPI) rose 0.1% in December, matching forecast. The core CPI, which excludes food and energy prices, went up 0.3% in December, the largest monthly increase in 11 months; economists were expecting a 0.2% rise. On a year-over-year basis, core CPI increased by 1.8%, up from November's 1.7%.
- **U.S. manufacturing sector grows faster.** Manufacturing activity in the U.S. accelerated in December. December's IHS Markit manufacturing purchasing managers' index was reported to be 55.1, rising from November's reading of 53.9 and exceeding economists' estimate of 55.0; it was the highest reading since March 2015. On the other hand, the Institute for Supply Management (ISM) manufacturing index also pointed to faster growth in the sector. The index jumped from November's reading of 58.2 to 59.7 in December, beating economists' estimate of 58.1 by a wide margin.
- **U.S. services sector slows.** The services sector growth slowed to a seven-month low in December, according to IHS Markit's services sector PMI. The services purchasing managers' index (PMI) fell to 53.7 in December, down from November's reading of 54.5. Economists were expecting an even weaker reading of 52.4. Similarly, service sector growth slowed down in December, according to the Institute of Supply Management (ISM). The ISM non-manufacturing index declined to 55.9 in December from November's reading of 57.4; economists were expecting a reading of 57.6 for December. Despite the fall, the index had been above the 50-mark for the 96th consecutive month.
- **U.S. consumer sentiment continues to fall.** Consumer sentiment in the U.S. fell again in January according to a report by the University of Michigan. January's preliminary reading of the university's consumer sentiment index was reported to be 94.4, slipping from December's final reading of 95.9 and missing economists' expected reading of 97.0. January's reading was the softest reading in the past six months.
  - **U.S. Housing News**
    - **U.S. housing starts slow.** The number of housing starts dropped sharply in December. The commerce Department reported that housing starts fell 8.2% in December to a seasonally adjusted annual pace of 1.19M units, missing economists' forecast of an annual pace of 1.28M units. It was the biggest percentage drop since November 2016. On the other hand, build permits edged down 0.1% to a pace of 1.3M units in December.
    - **U.S. pending home sales rise.** Pending home sales increased for the third straight month in December. The National Association of Realtors reported that its pending home sales index rose 0.5% to reach 110.1 in December; economists were expecting a rise of only 0.4%. On a year-over-year basis, pending home sales were up 0.5% in December.
    - **U.S. existing home sales fall.** Existing home sales in U.S. fell more than expected in December. The National Association of Realtors reported that existing home sales dropped 3.6% in December to a seasonally adjusted annual pace of 5.57M units. Economists were expecting a smaller decline of 2.2%. For the entire year of 2017, existing home sales rose 1.1% from the previous year to 5.51M units, the highest level since 2006.
    - **U.S. new home sales drop.** New home sales declined more than expected in December. The Commerce Department reported that new home sales fell 9.3% in December to a seasonally adjusted annual pace of 625,000 units. It was the largest percentage decrease since August 2016. Economists were expecting a smaller drop of 7.9%. Unseasonably cold weather was believed to be one of the main causes of the decline.
    - **U.S. home prices rise.** Home prices in U.S. continued to rise in November. The S&P CoreLogic Case-Shiller home price index increased by 0.7% in November after expanding by a similar percentage in October; economists were expecting a smaller rise of 0.6%. On a year-over-year basis, the index increased by 6.2%. Seattle, Las Vegas, and San Francisco were the cities with the largest year-over-year increase.

European Markets

- **Euro-zone GDP grows.** The 19-member bloc grew at its fastest pace in 10 years. Eurostat reported that Euro-zone's Q4 GDP grew by 0.6% quarter-over-quarter, matching economists' forecast. In 2017, Euro-zone's GDP expanded by 2.5%, the fastest growth pace since 2007.
- **Euro-zone inflation slows.** Euro-zone inflation dipped further in January. January's 'flash' harmonised index of consumer prices (HICP) fell to 1.3% from December's pace of 1.4%, on par with economists' expectations. Core inflation measure, which excludes food and energy prices, accelerated slightly from December's pace of 1.1% to 1.2%.
- **Euro-zone unemployment remains at nine-year low.** The 19-member bloc's unemployment rate remained at a nine-year low in December. Eurostat reported that the jobless rate within the region stayed steady at 8.7% in December, in line with forecasts. Germany continued to hold a very low unemployment rate at 3.6%, while Greece's unemployment rate stayed high at 20.7%.
- **ECB maintains its stance on monetary policy.** President Mario Draghi announced that the ECB would maintain the monetary stimulus in place for as long as needed and was not likely to change interest rates this year. Despite Mr. Draghi's rather dovish comments, the 19-member bloc's currency continued its recent strength, surging to a new three-year high. The euro had rallied more than 2% against the U.S. dollar since the beginning of 2018.
- **Euro-zone 'flash' composite PMI increases.** Euro-zone business activity expanded at the fastest pace in almost 12 years in January, according to the 'flash' composite PMI. January's IHS Markit 'flash' composite purchasing managers' index advanced to 58.6 from December's final reading of 58.1; economists were expecting a reading of 57.9. January's reading was the highest reading since June 2006. The service sector PMI rose to its highest level since August 2007 at 57.6 while the manufacturing PMI declined to 59.6.
- **Euro-zone consumer confidence surges.** Consumer confidence within the 19-member zone jumped in January. The European Commission reported that its 'flash' consumer confidence index jumped to 1.3 from December's final reading of 0.5; economists were expecting only a slight increase to 0.6. It was the index's highest reading since August 2000.

Asian Markets

- **Japan's CPI increases.** Consumer prices continued to increase in Japan, inching closer to the Bank of Japan's 2% inflation target. The consumer price index (CPI) rose 1% year-over-year in December, up from November's pace of 0.6%. Core inflation, which excludes fresh food prices, rose 0.9% year-over-year in December, matching November's pace and economists' estimate.
- **Japan's manufacturing PMI up.** Japan's manufacturing activity accelerated at the fastest pace in nearly four years in January, according to the Markit/Nikkei Japan manufacturing purchasing managers index (PMI). The gauge of the manufacturing sector's health came in at 54.8 in January, rising from December's reading of 54.0. It was the highest reading since February 2014.
- **China's GDP growth accelerates.** The world's second biggest economy posted better than expected annual GDP growth in 2017. The official source reported that China's GDP grew 6.9% over the full year. Not only was it better than economists' expected 6.7% expansion, but it was also the first annual acceleration since 2010. The growth pace also exceeded government's 2017 target of 6.5% growth set at the beginning of the year.
- **China's CPI accelerates while PPI slows.** Consumer prices rose faster in December. The National Bureau of Statistics reported that the consumer price index (CPI) rose 1.8% year-over-year in December, up from November's pace of 1.7%; economists were expecting a faster pace of 1.9%. On the other hand, the producer price index (PPI) rose 4.9% year-over-year, decelerating from November's pace of 5.8% but higher than economists' expected increase of 4.8%.
- **China's manufacturing activity remains in expansion mode.** China's official manufacturing purchasing managers' index (PMI) was reported to be 51.3 in January, a slight dip from December's reading of 51.6; economists were expecting a January reading of 51.6. The Caixin China manufacturing PMI, which focuses on small and mid-size enterprises, remained at 51.5, slightly better than economists' expected reading of 51.3.

Key Take-Aways

Why inflation? One of the governing factors that come into play for the Bank of Canada (BoC) at every one of their monetary policy meetings is inflation - or the price change of the cost of a basket of notional goods over time. In addition to GDP strength and unemployment, inflation helps forecast the economic health of a country. Albeit that no consumer wants to pay more for goods over time, having inflation- even a small amount- is a necessary evil for growth because of the repercussions it has on businesses and consumers. In a nutshell, as production costs rise, so too will the price of goods as well as demand as supply becomes limited. With the higher cost of goods, workers will demand higher wages, which will promote continued spending and the cycle repeats. The latest CPI data of 1.9% showed Canada's economy is following this upward trend, thereby growing, but below the BoC's preferred 2% target. Nonetheless, to keep the cycle under control, a central bank will adjust interest rates and that is what BoC did earlier in the month raising rates to 1.25%.

Third time a charm. Following their latest rate hike to 1.25%, the Bank of Canada (BoC) benchmark rate exceeded 1% for the first time in almost a decade. The realization of the 25 basis point increase was all but assured after the December employment report that saw the economy add almost 160,000 new jobs in the last two months of the year. In addition, price growth near the preferred 2% target and the strength of the economy provided reason enough for the BoC to take action. Aside from these economic metrics, the qualitative ratio of household-to-income may have also played an important part in the decision. Touching an all-time high of 173% of gross income, the debt burden of Canadians has become an increasing concern for the BoC and a rate increase serves as both a warning to consumers and a means to cool a hot economy. The effects of the 25 bps bump won't be noticed for some time, but hopefully the third hike in seven months will open the eyes of some Canadians on the state of their finances and bring forth moderate and sustainable economic growth.