# Weekly Updates Issue # 683

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## 1. Weekly Markets Changes

**[September 28, 2018]**

| S&P TSX | S&P 500 | Dow Jones | NASDAQ | CAD/USD | Gold | WTI Crude |
|---|---|---|---|---|---|---|
| 16,073.14<br>-151.0 -0.93% | 2,913.98<br>-15.7 -0.54% | 26,458.31<br>-285.19 -1.07% | 8,046.35<br>+59.39 +0.74% | $0.7725<br>-0.17c +0.22% | $1,190.88<br>-9.16 -0.76% | $73.25<br>+2.47 +3.49% |

## 2. Canadian GDP beat expectations in July with boost from manufacturing

**[September 28, 2018]** Strength in the manufacturing sector helped the Canadian economy grow more than expected in July and boost expectations the Bank of Canada will raise its key interest rate next month.

Statistics Canada said Friday real gross domestic product grew by 0.2% in July, an increase that followed essentially no change in June.

Economists had expected an increase of 0.1% for July, according to Thomson Reuters Eikon.

Stephen Brown, senior Canada economist at Capital Economics, said the overall economy is on track for annualized growth of around 2% in the second quarter.

“That would be stronger than the 1.5% expected by the Bank of Canada in its July monetary policy report and is another reason to expect the bank to raise interest rates next month,” Brown wrote in a report.

The stronger-than-expected GDP figure follows signs of growing price pressures that have also raised expectations of higher interest rates. The annual inflation rate was 2.8% in August, down from 3.0% in July, but still at the top end of the Bank of Canada’s target range of 1% to 3%.

The central bank kept its key interest rate target on hold at its rate announcement earlier this month, but most economists expect the central bank to raise the rate at its announcement on Oct. 24.

The Bank of Canada's trend-setting interest rate sits at 1.5% after four increases since the middle of last year.
"On balance, the Canadian economy looks to have had a wee bit more underlying momentum than expected through the summer, and the ding from the Syncrude outage was not as deep as feared," Bank of Montreal chief economist Doug Porter said.
"As we opined in the wake of last week's solid core CPI (2.1% on average), the ducks are in a row for an October rate hike, barring a shock on the NAFTA front."
The Bank of Canada has said it is closely watching the NAFTA talks and other trade policy developments, which could hurt the Canadian economy.
Bank governor Stephen Poloz has said uncertainty over NAFTA has resulted in less business investment in Canada than there otherwise should be.
In its report Friday, Statistics Canada said goods-producing industries grew 0.3%, while services-producing industries increased 0.2%.
The agency said 12 of 20 sectors gained ground as the manufacturing sector grew 1.2% in the month, its strongest showing since November 2017.
Wholesale trade grew 1.4%, while transportation and warehousing services grew 0.9%.
Meanwhile, the construction sector fell for the third time in four months as it moved down 0.6% in the month.

## 3. Housing affordability in Canada at worst levels since 1990: RBC

**[September 28, 2018]** Homes in Canada reached their worst affordability level since 1990 in the second quarter of this year, an RBC report says.
Anyone who bought a home in the second quarter would have needed to spend 53.9% of their household income on the home ownership costs, such as mortgage payments, utilities and property taxes, the report says.
This aggregate housing affordability measure is up from 43.2% three years ago.
Rising interest rates are the main reason why houses became less affordable. Increases to mortgage rates, since the Bank of Canada started to raise interest rates in July 2017, have kept "ownership costs on a steep upward trajectory despite home prices stabilizing," the report says.
Higher borrowing costs accounted for the 2.6 percentage-point increase in the affordability measure in the last year and the 1.1 percentage-point rise in Q2.
Vancouver has the least affordable housing in Canada, where it would take 88.4% of a household's income to pay for the ownership costs. Toronto ranks

second for affordability with a measure of 75.9%. Victoria is the third most unaffordable city, where it would take 65% of a household income to cover the ownership costs.
“The grim outlook for prospective home-buyers will likely continue in the near term,” said Craig Wright, chief economist at RBC, in a release. “We anticipate the Bank of Canada will proceed with further interest rate hikes well into 2019. This will keep mortgage rates under upward pressure and boost ownership costs even more across Canada.”
A UBS study released yesterday ranks Toronto and Vancouver among the top cities worldwide for overvalued property markets facing the risk of a housing bubble.

## 4. Sears is now a penny stock

**[September 28, 2018]** In the latest indignity for a once-grand retailer, the share price fell below $1 on Friday for the first time in the company's history, dropping as much as 15% to 85 cents in midday trading.
Falling into loose-change territory is more than embarrassing. Nasdaq, the exchange where Sears stock trades, could delist the company. That's a long process and would happen next year at the earliest.
Shares of Sears Holdings had already plunged 88% in the past year. They took another blow Monday, when CEO and primary shareholder Eddie Lampert warned the board that the company was running out of time and cash. He said Sears must restructure and cut its debt "without delay."
Lampert pointed to a $134 million debt payment due on October 15, and said the company must demonstrate to lenders by Monday that it has required levels of cash in reserve, which could itself prove difficult.
Sears' market value has fallen to less than $100 million. Lampert recently offered to buy the Kenmore appliance line through his hedge fund for $400 million, suggesting that the Kenmore brand on its own is worth more than four times as much as the whole company.
All of which is a stunning reversal for a company that was once not only the nation's largest retailer, but also its largest employer.
In its heyday, Sears was both the Walmart and Amazon of its time. In the late 19th century and early decades of the 20th century, many Americans bought mass-produced goods for the first time through the Sears catalog. Most lived on farms and in small towns, and had previously made many of the goods they needed, such as clothes and furniture, themselves.
Sears stores helped reshape America itself, drawing shoppers away from traditional Main Street merchants and into malls, contributing to the

suburbanization of the country after World War II. And its appliances introduced many American homes to labor-saving devices that changed family dynamics.

But long before the rise of Amazon and online shopping, Sears struggled to keep up with changing shopping habits.

Big box retailers such as Walmart beat it on both price and selection. In 1999, Sears was booted out of the Dow Jones industrial average, where it had been for 75 years. Home Depot took its place.

In more recent years, Sears has struggled just to stay alive.

It told investors last year that there was "substantial doubt" it could stay in business. Lampert's latest warning to the board raised a similar warning. He said it was in the best interest of creditors and shareholders to restructure the company "as a going concern."

Sears has lost $11.7 billion since 2010, its last profitable year, and sales have plunged 60% in that time. It has fewer than 900 stores, down from a combined 3,500 US stores when Sears and Kmart merged in 2005.

In July, the company closed the last Sears store in Chicago, its former hometown. And the company recently announced that 46 more stores will close just before the holiday shopping season.

## 5. SEC sues Elon Musk for his allegedly misleading tweets

**[September 28, 2018]** Elon Musk has tweeted himself into serious trouble.

The Securities and Exchange Commission sued Tesla's CEO on Thursday for making "false and misleading" statements to investors. It's asking a federal judge to prevent Musk from serving as an officer or a director of a public company, among other penalties.

The complaint hinges on a tweet Musk sent on August 7 about taking Tesla private.

"Am considering taking Tesla private at $420," Musk said. "Funding secured."

The SEC said he had not actually secured the funding.

"In truth and in fact, Musk had not even discussed, much less confirmed, key deal terms, including price, with any potential funding source," the SEC said in its complaint.

That tweet, and subsequent tweets from Musk over the next three hours, caused "significant confusion and disruption in the market for Tesla's stock," as well as harm to investors, the SEC said. On the day of Musk's tweet, Tesla's stock shot up nearly 9%. It has declined substantially since then.

Tesla's stock dropped more than 11% in after-hours trading Thursday.
"This unjustified action by the SEC leaves me deeply saddened and disappointed," Musk said in a statement. "I have always taken action in the best interests of truth, transparency and investors. Integrity is the most important value in my life and the facts will show I never compromised this in any way."
Tesla and its board of directors said in a joint statement that they are "are fully confident in Elon, his integrity, and his leadership of the company."
"Our focus remains on the continued ramp of Model 3 production and delivering for our customers, shareholders and employees," the statement said.
Stephanie Avakian, co-director of the SEC's enforcement division, said at a press conference Thursday that the agency is committed to holding people accountable despite "celebrity status or reputation as a technological innovator."
The complaint alleged that Musk rounded up the go-private price to $420 per share "because he had recently learned about the number's significance in marijuana culture" and thought his girlfriend would find it funny. He was dating the musician Grimes.
Musk did not consult with any board members, employees or outside advisers before he sent the tweets, according to the SEC.
"This is serious. This is what you go after insider traders and market manipulators on," said Charles Whitehead, professor at Cornell Law School. "This is a serious allegation."
Musk abandoned the plan to take Tesla private less than three weeks after he first tweeted about it. He later said his "funding secured" comment was based on talks with Saudi Arabia's sovereign wealth fund, which he said had urged him to take the company private and offered to increase its investment in Tesla.
The Justice Department is also investigating comments made by Musk, Tesla said last week. The company said it had received a voluntary request for documents and is cooperating. Tesla said it had not been subpoenaed.
Shareholders have also filed lawsuits charging that Musk made the claim to manipulate the stock price.
Musk has brought a string of bad headlines down on himself with erratic behavior. He has fired off tweets late at night and brushed off analysts on corporate earnings calls. He disparaged a man who was working to rescue boys trapped in a cave in Thailand, and sparred with journalists and investors he believed were unfair to him. Musk vowed to launch a website called Pravda to critique the media.

## 6. Toronto and Vancouver make top 5 bubble list

**[September 27, 2018]** Toronto and Vancouver rank among the top cities worldwide for overvalued property markets facing the risk of a housing bubble, a UBS study says.

Hong Kong, Munich, Toronto, Vancouver and Amsterdam face the greatest risk of seeing their property values collapse, the UBS Global Real Estate Index says.

The study notes the term bubble "refers to a substantial and sustained mispricing of an asset, the existence of which cannot be proved unless it bursts." An index score of 1.5 or greater indicates a bubble. Toronto has a score of 1.95 while Vancouver scores 1.92. Hong Kong has a score of 2.03.

Despite the high index score, house prices in Toronto have stabilized over the last year, the study says. Still, prices are 50% higher than five years ago when adjusted for inflation. It would take six years of income for a "skilled service worker" to buy a 650-square-foot apartment near downtown Toronto.

The index score for the city dropped slightly over the last four quarters. Taxes on foreign buyers, vacant houses and expansion of rent controls in Ontario likely contributed to a cooling in prices, the study says. It forecasts that a short-term decline in the Canadian dollar could attract foreign buyers again to Toronto.

Prices in Vancouver, however, rose by more than 10% last year and the city has "a ballooning index score," the study says. Real prices have doubled in 12 years.

Higher taxes on foreign investors didn't stop the rise in prices, the report says. A skilled service worker would need nine years of their salary to buy a 650-square-foot-apartment near downtown Vancouver.

Overall for Toronto and Vancouver, tighter mortgage lending rules, rising interest rates or an economic downturn "could turn the lights out on the party given the high valuations and strained affordability," the study says.

## 7. Fed raises rates for 3rd time this year with one more expected

**[September 26, 2018]** The Federal Reserve has modestly raised a key interest rate for the third time this year in response to a strong U.S. economy, and signalled that it foresees another rate hike before the year ends.

The Fed on Wednesday lifted its short-term rate—a benchmark for many consumer and business loans—by a quarter-point to a range of 2% to 2.25%. It was its eighth hike since late 2015, and the Fed indicated that it expects to

continue gradual increases. It also stuck with its previous forecast for three more rate hikes in 2019.
In a statement after its latest policy meeting, the Fed dropped phrasing it had long used that characterized its policy as “accommodative”—that is, favouring low rates. The Fed had used variations of that pledge in the seven years that it kept its key rate at a record low near zero and over the past nearly three years in which it’s gradually tightened credit. In removing that language, the Fed may be signalling its resolve to keep raising rates.
In an updated economic outlook, the Fed foresees one final rate hike after 2019—in 2020—which would leave its benchmark at 3.4%. At that point, it would regard its policy as modestly restraining growth. The Fed seeks to slow the economy when it reaches full employment to prevent a tight job market from raising inflation too high.
In emailed commentary, CIBC senior economist Andrew Grantham noted that markets appear to be paying more attention to the dropping of policy remaining “accommodative” than to the longer-term benchmark: the U.S. dollar and bond yields fell slightly on today’s announcement.
President Donald Trump has argued publicly against higher rates, complaining that they would blunt his efforts to boost growth through tax cuts and deregulation.
The Fed’s latest forecast predicts that the unemployment rate, now 3.9%, will reach 3.7% by the end of this year and then 3.5% next year. Not since the late 1960s has unemployment fallen that low.
The central bank expects unemployment to begin rising to 3.7% in 2021. It foresees the economy, as measured by the gross domestic product, growing 3.1% this year before slowing to 2.5% in 2019, 2% in 2020 and 1.8% in 2021. The Fed sees the economy’s long-run growth at a 1.8% annual rate—far below the Trump administration’s projections for a sustained rate of 3%.
Many analysts think the economy could weaken next year, in part from the effects of the trade conflicts Trump has pursued with China, Canada, Europe and other trading partners. The tariffs and counter-tariffs that have been imposed on imports and exports are having the effect of raising prices for some goods and supplies and potentially slowing growth.
Compounding the effects of the tariffs and retaliatory tariffs resulting from Trump’s trade war, other factors could slow growth next year. The benefits of tax cuts that took effect this year, along with increased government spending, for example, are widely expected to fade.
Still, some analysts hold to a more optimistic scenario: that momentum already built up from the government’s economic stimulus will keep strengthening the job market and lowering unemployment, already near a 50-

year low. A tight employment market, in this scenario, will accelerate wages and inflation and prod the Fed to keep tightening credit to ensure that the economy doesn't overheat.

The robust job market has helped make consumers, the main drivers of growth, more confident than they've been in nearly 18 years. Business investment is up. Americans are spending freely on cars, clothes and restaurant meals.

All the good news has helped fuel a stock market rally. Household wealth is up, too. It reached a record in the April-June quarter, although the gain is concentrated largely among the most affluent.

Many economists worry, though, that Trump's combative trade policies could slow the economy. Trump insists that the tariffs he is imposing on Chinese imports, to which Beijing has retaliated, are needed to force China to halt unfair trading practices. But concern is growing that China won't change its practices, the higher tariffs on U.S. and Chinese goods will become permanent and both economies—the world's two largest—will suffer.

Fed Chairman Jerome Powell has so far been circumspect in reflecting on Trump's trade war. Powell has suggested that while higher tariffs are generally harmful, they could serve a healthy purpose if they eventually force Beijing to liberalize its trade practices.

## Have a nice and fruitful week!

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