Weekly Updates Issue # 736

1. Weekly Markets Changes

[October 18, 2019]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
16,377.12 -38.04 -0.23%	2,986.20 +15.93 +0.54%	26,770.20 -46.39 -0.17%	8,089.54 +32.50 +0.40%	$0.7609 +0.67c +0.89%	$1,490.05 -22.85 -1.51%	$53.78 -0.92 -1.68%

2. Brexit deal leaves uncertainty for Canadian businesses

[October 18, 2019] Experts warn that a post-Brexit United Kingdom will present Canadian business with tremendous uncertainty about billions of dollars worth of trade and investments, no matter how the British Parliament votes on Saturday.

The outcome of the unusual weekend vote in London is itself far from predictable, as British Prime Minister Boris Johnson struggles to get support for a controversial agreement that he reached Thursday with the European Union.

But observers say even a Johnson success would only provide a starting point for further rounds of difficult negotiations between London and Brussels and eventually between Canada and the United Kingdom.

Fasken partner Clifford Sosnow says the primary benefit of Johnson's plan is that it would provide for 14 months to 36 months of negotiations on a new trade deal for two of Canada's biggest export and investment markets.

“The major concern for everybody is the instability and the instability from not knowing what the business relationship will be, what the investment relationship will be,” says Sosnow, who provides strategic advice about international trade and investments at one of Canada’s largest business law firms.

He adds that open talks between the United Kingdom and Canada would be allowed only after the U.K. leaves the European Union on Oct. 31, if Johnson’s schedule is passed by the British House of Commons.

The United Kingdom by itself, represents one of Canada’s top five destinations for investments and top 10 markets for goods and services.

It has also been a gateway for Canadian companies that do business in the European Union, which is Canada’s second- or third-biggest trading partner after the United States and China, depending on the measure.

About 40% of Canadian trade in merchandise with the EU goes through United Kingdom, says Achim Hurrelmann, a political scientist and co-director of Carleton University’s Centre for European Studies in Ottawa.

Without a good free-trade deal between Brussels and London, companies may reconsider “whether they want to stay in the United Kingdom or . . . go to Dublin [Ireland], or to France or to Germany or the Netherlands.”

“To some extent, that has already happened, but my impression is that most companies have been staying put and observing and waiting [to see] what is happening,” Hurrelmann says.

He says that Johnson’s proposed deal would provide more time to sort out the U.K.’s trade relationship with the EU but also with Canada.

“Canada wants to have a trade deal with the U.K. and the U.K. wants to have one with Canada as well,” Hurrelmann says.

“But the question, of course, is will we have time to actually work that out properly or will that have to be very rushed after a no-deal Brexit.”

Mark Camilleri, a Brussels-based Canadian at the Canada EU Trade and Investment Association, says he thinks it’s fair to say “that having any deal is better than having no deal” if only to reduce uncertainty.

He says that having no U.K.-EU. deal “it would potentially be very destabilizing for businesses, including Canadian businesses that are not just based in the U.K. but also based in the EU that are trading to the U.K.”

But Camilleri noted the British Parliament has rejected Theresa May’s proposals on three occasions so “one has to hold one’s breath as to whether or not [Johnson’s deal] will get through. “

3. What to watch as geopolitical risk rises

[October 18, 2019] The outcome of ongoing global trade tensions can't be predicted, yet that outcome is key to accurately forecasting the world's economic growth and market effects.

As such, the U.S-China trade war is the wild card in Stéfane Marion's economic outlook. The chief economist and strategist at National Bank spoke about his outlook on Thursday at the National Bank Independent Network Annual Conference 2019 in Toronto.

"This is no time for complacency," Marion said, referring to geopolitical risk. With persistent trade tensions and the trend toward less globalization, "we are changing the global supply chain in a way that we haven't seen in over a generation."

The potential result is a global regime change in which growth is slower, companies have less leverage and inflation is stickier.

While inflation might not rear its head in the short term, he expects it to appear within three to five years as consumer prices begin to reflect the effects of de-globalization, as well as the fight against climate change, which will be costly for businesses.

Markets would also be affected by the regime change. A continued trend toward de-globalization "forces you to rethink what the fair value of the stock market will be," Marion said, noting the importance of foreign sales for many S&P 500 companies. "It's not cruise control with your investments anymore."

Further, given the current price-earnings ratio expansion with accommodative monetary policy, the stock market is "even more vulnerable" to geopolitics, he said. (The corporate earnings outlook for 2020 would be boosted by one more potential rate cut by the Fed, he said.)

Despite geopolitical risk, Marion doesn't forecast a recession for 2020, mainly because of the recent U.S. decision not to impose new tariffs on China. Also, accommodative monetary policy has helped offset some of the negative effects of the trade war, and higher oil prices reflect growth, he said.

While the U.S. and China have called a trade truce for now, National Bank thinks the two countries will eventually divorce, though the break-up would likely be amicable, not acrimonious, Marion said. As a result, economic growth would be slower but a recession would be avoided.

He forecasted global growth of about 3.2% this year and next, with China's GDP at about 6%.

The Canadian economy, which has outperformed its global peers so far this year with nominal GDP of about 4%, is expected to remain resilient, supported by strong population growth and less leveraged companies relative to the U.S. Growth for the whole year is expected to be lower, however, at 1.6%. With the economy hitting the Bank of Canada's inflation target of 2%, Marion isn't expecting rate cuts from the central bank, but that could change if the U.S.-China trade war takes a turn for the worse.

Commenting on next week's election, Marion said Canada's new government must adapt its foreign policy to respond to the changing geopolitical environment, where global allies will be fewer. That means being pragmatic, not dogmatic, he said.

4. FAIR Canada unable to secure matching funding

[October 18, 2019] Already facing a serious funding crisis, the Canadian Foundation for the Advancement of Investor Rights (a.k.a. FAIR Canada), an independent investor advocacy group, has found itself in deeper financial turmoil.

The group announced today that it has returned $2.4 million to the Jarislowsky Foundation, which provided it with $2 million in 2012 for an endowment fund to support its mission. The founder of the Jarislowsky Foundation, Stephen Jarislowsky, has also resigned as a board member of FAIR Canada.

Unless it receives additional financial support, "the board will have to make a decision to [either] continue operating until the end of next year with a full complement of staff, or to continue operating with a reduced staff," said Ermanno Pascutto, executive director of FAIR Canada in Toronto.

"We still have the $2 million provided by the Ontario Securities Commission (OSC) in the endowment fund," Pascutto added. To cover FAIR Canada's operating expenses, "we will have to draw down on it."

The 2012 Jarislowsky donation came with the condition that FAIR Canada had to find $4 million in matching donations. The initial deadline to do so was Sept. 30, 2014, but was extended several times over the past five years, with a final deadline of Sept. 30, 2019.

In 2014, FAIR Canada obtained $2 million in endowment funding from the OSC, but has been unsuccessful in securing the remaining $2 million.

In a release, FAIR Canada said it "has applied to governments, regulators and SROs over the years to support its mission of enhancing the interests and rights of the everyday Canadians" but that "governments, securities regulators and self-regulatory organizations have been generally unwilling to provide adequate support.

"Most regulatory or governmental organizations offered no support at all."

In 2012, the OSC provided $1 million in funding for operations over two years, and an additional $500,000 in funding for operations in 2014.

The predecessor organizations to the Investment Industry Regulatory Organization of Canada (IIROC) had provided the initial funding for the creation of FAIR Canada in 2008, and IIROC made further donations for total funding of $4.65 million.

Recently, however, "IIROC has generally advised FAIR Canada to seek sustainable funding elsewhere," the release stated. Last year, FAIR Canada applied to IIROC "as a last resort" for the $2 million in endowment funding, but the application was rejected, although IIROC agreed to provide $250,000 in operational funding after a reapplication.

The release noted that the MFDA "has never offered financial support and has in excess of $5 million in its restricted funds based on the most recent published information."

In the release, Jarislowsky said, "It is my view that the governments, regulators and the financial industry do not want FAIR Canada to fulfill its mission as a positive force to make the financial consumer better protected and informed. Corporations prefer to keep retail investors dependent and underinformed."

Jarislowsky added that while he still supports FAIR Canada's mission, "We do not feel that we should lend out more to an organization to advance a mission that is a governmental and regulator responsibility which governments and regulators refuse to fulfill."

5. Foresters announces sale of New York-domiciled life insurance company

[October 17, 2019] Toronto-based Foresters Financial is selling Foresters Financial Holding Company, Inc. and its New York-domiciled subsidiary Foresters Life Insurance and Annuity Company (FLIAC) to Nassau Life Insurance Company, also based in New York.

In a release issued Thursday, Foresters said the transaction marks the final stage in its strategy to exit its North American asset management business, which began earlier this year with the sale of some of its U.S. asset management and broker dealer businesses.

Foresters Financial Holding Company, formerly known as First Investors, includes a registered broker-dealer, two investment advisers, a life insurance company and a transfer agent.

Foresters said the sale solidifies its strategy to focus on fixed life insurance in North America.

The transaction is subject to regulatory approval by the New York State Department of Financial Services. It is expected to close in the first quarter 2020.

6. Low gas prices continue to weigh on inflation

[October 16, 2019] The annual inflation rate was 1.9% in September for a second-straight month, keeping the indicator close to the Bank of Canada's ideal 2% target.

The new numbers released Wednesday in Statistics Canada's latest consumer price index report showed that price growth was once again held back by lower gas prices.

Inflation has now stayed at 1.9% or higher for seven consecutive months.

The country's price picture, on its own, is not applying pressure on the inflation-targeting Bank of Canada to adjust interest rates. The central bank's next rate announcement is scheduled for Oct. 30.

The average of Canada's three measures for core inflation, which are considered better gauges of underlying price pressures by omitting volatile items like gasoline, moved up slightly to 2.1% last month from 2% in August. The core readings are closely monitored by the Bank of Canada.

Royce Mendes, senior economist for CIBC Capital Markets, said with all the inflation data so close to target they're unlikely to change the timing of the Bank of Canada's next policy move.

"I think, at this point, the Bank of Canada is really looking at how the slowing in global growth and the trade tensions between the U.S. and China are affecting Canada," said Mendes, who predicts the central bank's next move — a cut — to come in January.

Statistics Canada said a 10% drop in gasoline prices compared with last year continued to weigh on the overall inflation rate. Gas prices, year-over-year, were down 10.2% in August and 6.9% in July.

Excluding pump prices, the inflation reading for September was 2.4% for a third-straight month.

Upward momentum in price growth was also held back in September by lower costs, year-over-year, for internet access services, tuition fees and telephone services. On a month-to-month basis, airfares saw a big drop, falling 19.5%.

Canadians did, however, pay more for mortgage interest costs, vehicle insurance and auto purchases last month compared to the previous year.

Shoppers shelled out 3.4% more for passenger vehicles last month than they did a year earlier as price growth in the category exceeded 2.5% for a seventh-straight month, the report said. Statistics Canada called it the "strongest continuous stretch of growth" in the category since early 2017.

Year-over-year mortgage interest costs have increased through 2019 and were up another 7.5% in September. The report said the growth has followed a series of interest rate hikes by the Bank of Canada between July 2017 and October 2018.

In terms of downward forces, the report said tuition fees decreased 3.6% last month for the category's first year-over-year decline since its creation in 1973.

The drop was driven by an 8.9% decrease in Ontario, where the provincial government cut tuition for the 2019-20 academic year.

Overall, economists on average had expected inflation of 2.1% for September, according to financial markets data firm Refinitiv.

Looking ahead, Stephen Brown of Capital Economics wrote in a research note Wednesday that he expects headline inflation to gradually drift down towards 1.5% by early 2020.

Brown, a senior Canada economist, predicted that signs of lower inflation and below-potential economic growth in the coming months will encourage the Bank of Canada to cut interest rates in December.

7. Mergers and acquisitions slow in third quarter: report

[October 16, 2019] The Canadian M&A market pulled back a bit in the third quarter after several quarters of historically strong deal flow, according to the latest data from Toronto's Crosbie & Co.

There were 776 deals announced in the third quarter of 2019, down from 886 deals in the previous quarter, and 881 transactions in the same quarter last year.

The deal activity in Q3 was at its lowest level since the third quarter of 2017.

In terms of deal value, the third quarter generated about $45 billion, which was also down from $71 billion in the previous quarter.

Quarterly deal value hasn't been this low since the first quarter of 2015.

"Canadian M&A activity softened somewhat in Q3 following an extended period of strong deal activity in recent quarters," said Sam Sivarajan, managing director at Crosbie & Co.

There were nine so-called "mega-deals" — transactions worth at least $1 billion — announced in the third quarter, accounting for over half ($25.0 billion) of the quarterly deal value.

Crosbie notes that mid-market M&A (which includes transactions of less than $250 million) activity also softened in Q3, with 287 deals worth a combined $8.7 billion.

The real estate sector was the most active last quarter, with 112 announced deals for $19.0 billion, which represents 42% of deal value.

Crosbie reports that the tech sector saw the greatest increase in deal activity in Q3, with 102 transactions, up by 32% from the same quarter in 2018. The industrial sector also generated 102 transactions in the quarter.

The firm also notes that seven of the nine mega-deals in Q3 involved financial sponsors, such as private equity groups, investment managers and pension funds.

"Even though we may be in the late innings of the longest bull market in history, there is reason to believe in the continued strength of the M&A market," said Sivarajan.

"Strong balance sheets, relatively easy access to capital, aging business owners looking to monetize at current high valuations and buyers seeking to boost weak organic growth all suggest that the strong M&A activity trend will continue into Q4," he added.

8. Surge in leveraged lending not a risk to Canadian financial system: report

[October 15, 2019] The volume of leveraged lending has grown substantially since the financial crisis but shouldn't pose a major risk to the Canadian financial system, suggests a new report from DBRS Morningstar.

Globally, the total value of leveraged loan origination has almost tripled since 2008, according to the report. In Canada, volumes are up almost five times their level in 2008.

"The origination of these loans is dominated by the large banks and is predominantly focused on a few sectors," the report stated. "However, the banks do not retain all the loans that they originate, so they form a small, albeit riskier, portion of these banks' overall commercial loan portfolios."

The report noted that leveraged loans remain relatively small in Canada, compared to the overall size of the credit market. And, at this level, leveraged lending doesn't represent a major risk to the Canadian financial sector, DBRS Morningstar concluded.

"Given the size of the market in Canada, in DBRS Morningstar's view, leveraged loans do not pose a major risk, but they could exacerbate the impact of a downturn," the report said.

For instance, it said that "a significant market dislocation" that continues for an extended period "could cause implications for the banks."

9. Next government to face declining demand for manufacturing, energy: report

[October 15, 2019] As federal parties dig in for the final week of campaigning before the Oct. 21 vote, a new report outlines the economic headwinds the next government will face.

The quarterly economic report from RSM Canada LLP said the country's GDP performance is "deceptive," with global geopolitical tensions and the U.S.-China trade war set to affect spending and growth.

Canada is also starting to feel the side effects of the global slowdown in manufacturing, and demand for Canadian energy resources is declining, the report said.

Canada's economy surpassed expectations in the second quarter, growing at 3.7%. Growth was flat in July and is expected to be slower in the third and fourth quarters.

The International Monetary Fund projects Canadian economic growth of 1.5% this year and 1.8% in 2020.

RSM recommended boosting the economy by adjusting employment insurance, providing individual tax relief as well as business tax incentives, and increasing government spending through infrastructure projects.

Moving ahead with the Trans Mountain Pipeline project would boost short- and long-term productivity, the report said, creating jobs for large and small corporations.

10. Home sales were up 15.5% in September: CREA

[October 15, 2019] The Canadian Real Estate Association says the number of home sales in September was up 15.5% compared with a year ago as sales in the country's big cities climbed higher.

The association says sales compared with a year ago were up in Canada's large urban markets, including B.C.'s Lower Mainland, Calgary, Edmonton, Winnipeg, the Greater Toronto Area, Hamilton-Burlington, Ottawa and Montreal.

On a month-over-month basis, home sales through the Canadian Multiple Listing Service were up 0.6% in September.

Home sales in Canada have been rising since hitting a six-year low in February.

The national average price for homes sold in September 2019 was about $515,500, up 5.3% from the same month last year.

Excluding the Greater Vancouver and Greater Toronto regions, the average price was less than $397,000 and amounting to a year-over-year gain of 3.3%.

11. Global conflicts could lead to weakest growth since 2008: IMF

[October 15, 2019] The International Monetary Fund is further downgrading its outlook for the world economy, predicting that growth this year will be the weakest since the 2008 financial crisis primarily because of widening global conflicts.

The IMF's latest World Economic Outlook foresees a slight rebound in 2020 but warns of threats ranging from heightened political tensions in the Middle East to the threat that the United States and China will fail to prevent their trade war from escalating.

The updated forecast released Tuesday was prepared for the fall meetings this week of the 189-nation IMF and its sister lending organization, the World Bank. Those meetings and a gathering Friday of finance ministers and central bankers of the world's 20 biggest economies are expected to be dominated by efforts to de-escalate trade wars.

The new forecast predicts global growth of 3% this year, down 0.2 percentage point from its previous forecast in July and sharply below the 3.6% growth of 2018. For the United States this year, the IMF projects a modest 2.4% gain, down from 2.9% in 2018.

Next year, the fund foresees a rebound for the world economy to 3.4% growth but a further slowdown in the United States to 2.1%, far below the 3% growth the Trump administration projects.

IMF economists cautioned that that even its projected modest gains might not be realized.

"With a synchronized slowdown and uncertain recovery, there is no room for policy mistakes, and an urgent need for policymakers to co-operatively de-escalate trade and geopolitical tensions," Gita Gopinath, the IMF's chief economist, said in the report.

Last week, the United States and China reached a temporary cease-fire in their trade fight when President Donald Trump agreed to suspend a tariff hike on $250 billion of Chinese products that was to take effect this week. But with no formal agreement reached and many issues yet to resolved, further talks will be needed to achieve any meaningful breakthrough. The Trump administration's threat to raise tariffs on an additional $160 billion in Chinese imports on Dec. 15 remains in effect.

The IMF's forecast predicted that about half the increase in growth expected next year will result from recoveries in countries where economies slowed significantly this year, as in Mexico, India, Russia and Saudi Arabia.

This year's slowdown, the IMF said, was caused largely by trade disputes, which resulted in higher tariffs being imposed on many goods. Growth in trade in the first half of this year slowed to 1%, the weakest annual pace since 2012.

Kristalina Georgieva, who will preside over her first IMF meetings after succeeding Christine Lagarde this month as the fund's managing director, said last week that the various trade disputes could produce a loss of around $700 billion in output by the end of next year or about 0.8% of world output.

IMF economists said one worrisome development is that the slowdown this year has occurred even as the Federal Reserve and other central banks have been cutting interest rates and deploying other means to bolster economies.

The IMF estimated that global growth would have been about one-half percentage point lower this year and in 2020 without the central banks' efforts to ease borrowing rates.

"With central banks having to spend limited ammunition to offset policy mistakes, they may have little left when the economy is in a tougher spot," Gopinath said.

In addition to trade and geopolitical risks, the IMF envisions threats arising from a potentially disruptive exit by Britain from the European Union on Oct. 31. The IMF urged policymakers to intensify their efforts to avoid economically damaging mistakes.

"As policy priorities go, undoing the trade barriers put in place with durable agreements and reining in geopolitical tensions top the list," Gopinath said. "Such actions can significantly boost confidence, rejuvenate investment, halt the slide in trade and manufacturing and raise world growth."

The IMF projected that growth in the 19-nation euro area will slow to 1.2% this year, after a 1.9% gain in 2018. It expects the pace to recover only slightly to 1.4% next year.

Growth in Germany, Europe's biggest economy, is expected to be a modest 0.5% this year before rising to 1.2% next year.

China's growth is projected to dip to 6.1% this year and 5.8% next year. These would be the slowest rates since 1990, when China was hit by sanctions after the brutal crackdown on pro-democracy demonstrators in Beijing's Tiananmen Square.

For Japan, the IMF expects growth of just 0.5% next year. It foresees an expansion in Russia of 1.9%, up from 1.1% this year.

And Mexico is forecast to experience growth of 1.3% next year, far better than the lacklustre 0.4% gain envisioned for this year.

Have a nice and fruitful week!