Weekly Updates Issue # 753

1. Weekly Markets Changes

[February 28, 2020]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
16,263.03 -1,580.5 -8.9%	2,954.22 -383.5 -11.5%	25,409.36 -3,583.1 -12.4%	8,567.37 -1,009.2 -10.5%	$0.7447 -1.15c -1.52%	$1,585.69 -57.72 -3.51%	$44.76 -8.70 -16.27%

2. Canada’s economy slowed to 0.3% in Q4

[February 28, 2020] Economic growth in Canada slowed over the last three months of 2019 for its worst quarter in three years, limping into 2020 and facing headwinds from trade uncertainty and the novel coronavirus outbreak.
Statistics Canada said Friday growth in the fourth quarter came in at an annualized rate of 0.3%, its worst showing since the second quarter of 2016 when the economy contracted.
The federal agency also revised its reading for the third quarter down to an annual rate of 1.1% compared with its initial report of 1.3%.
Economists had expected annualized growth of 0.3% in the fourth quarter, according to financial markets data firm Refinitiv.
The stumble through the final part of 2019 meant the economy grew by 1.6% for the year, down from the 2% mark it hit in 2018.
The GDP report comes amid worries about the novel coronavirus outbreak that began in China and its impact on the global economy ahead of an interest rate announcement by the Bank of Canada next week.
The central bank kept its key interest rate on hold in January, but left the door open to the possibility of rate cuts in the future if weakness in the economy was more persistent than it expected.

There's a chance the bank may cut its trendsetting rate next week—a move aimed to make it more attractive for households to spend rather than save—if the COVID-19 outbreak worsens, CIBC chief economist Avery Shenfeld said.

A rate cut is "by no means a cure," Shenfeld said in an interview.

"It would be a small Band-Aid on a major short-term problem, but nevertheless why not use the Band-Aid you have?"

Business investment contracted again, which may be a symptom of bigger concerns about the broader economic outlook around things like trade, said Brian DePratto, senior economist with TD Economics.

"You look into this year, we're seeing a lot of headwinds—the coronavirus is the obvious one," DePratto said in an interview.

"We definitely could be in a stronger place as we look to some of those challenges."

Statistics Canada said the softness in the fourth quarter of 2019 was a result of pipeline shutdowns, tough harvest conditions for farmers, an eight-day strike in November at CN Rail and an unrelated strike by auto workers in the U.S., as well as ongoing global trade tensions.

Offsetting the declines was an increase in household spending.

The Canadian Chamber of Commerce said in a release that the figures confirm the economy is in a slump, and used the release to urge the federal government for a better economic plan.

"The Canadian economy already entered 2020 in a soft spot before taking into account the significant impact of rail disruptions, Teck's withdrawal from its Frontier Mine project, and the looming global economic impacts of coronavirus," Trevin Stratton, the group's chief economist, said in a statement.

3. Trailer fee class action against TD to proceed

[February 28, 2020] A proposed class action against TD Asset Management Inc. (TDAM) over trailer fees paid to discount brokers has been given the go-ahead by an Ontario court.

Justice Edward Belobaba of the Superior Court of Justice certified the class action on behalf of investors who purchased TD mutual funds from a discount broker. The suit alleges that investors suffered tens of millions of dollars in losses because the funds paid trailers to firms in part for advice the firms don't provide.

While trailing commission to full-service firms "made sense" because those firms "were legally permitted to provide investment advice to their clients and have done so," the ruling said, paying trailing commissions to the discount brokers "made less sense because they were prohibited by provincial securities law from providing investment advice."

It also noted that securities regulators have recently declared that there's "no justifiable rationale" for the practice of funds paying trailers to discounters, and that the Canadian Securities Administrators (CSA) are planning to introduce measures to outlaw it.

In the meantime, the investor class action will be allowed to proceed. The allegations have not been proven.

The court said TDAM basically argued that the plaintiff doesn't have standing to bring the class action. It argued that the fund manager is obliged to act in the best interests of the fund, not its unitholders.

However, the court rejected the argument, at least at the certification stage.

It said that TDAM may succeed with this argument during a trial but that on a certification motion, it's not clear that this is the case.

"In my view, it is not at all plain and obvious on the facts as pleaded that the plaintiff as unitholder and beneficiary has no right to sue the defendant trustee in respect of the alleged breaches of the prescribed standard and duty of care," the ruling said.

Ultimately, the court found that the plaintiff has a viable claim for breach of trust and fiduciary duty. Several other claims — for knowing assistance, knowing receipt and unjust enrichment — were ordered struck.

A claim of prospectus misrepresentation is also a viable cause of action, the court said, noting that TDAM's "Fund Facts documents have consistently stated that trailing commissions are paid for the 'services and advice' provided by dealers to their clients."

It certified the action to proceed on the claims that it deemed to be viable.

This is the first to be certified in a number of similar class actions against asset managers over trailing commissions to discount brokers.

4. Despite Q4 growth, U.S. economists downgrade forecasts

[February 27, 2020] The U.S. economy grew at an annual rate of 2.1% in the final quarter of last year, but damage from the spreading coronavirus is likely depressing growth in the current quarter and for 2020 as a whole.

The Commerce Department said Thursday that the overall pace of growth in the October-December quarter was unchanged from its initial estimate a month ago, though the components were slightly altered. A slowdown in business restocking was less severe than first believed. But a cutback in business investment in new equipment was more of a drag on growth than initially estimated.

Economists have been downgrading their forecasts for the first quarter of this year as fears of the virus' impact have escalated. Stock markets have plunged this week on news that the number of coronavirus cases worldwide has now topped 81,000. The virus, which started in Wuhan, China, has spread to more than 30 countries, including the United States, Italy and South Korea.

Vital supply chains from China that companies in the United States and elsewhere depend on have been disrupted, and that problem is expected to worsen.

That fears have inflicted the worst losses on U.S. stocks in two years, less than a week after Wall Street was hitting record highs. To try to demonstrate the government's resolve to deal with the spread of the virus, President Donald Trump announced Wednesday that he was appointing Vice-President Mike Pence to take the lead in co-ordinating U.S. actions.

But economists are warning that if the virus turns into a global pandemic, the impact could be severe enough to push the global economy and the U.S. economy into recessions.

"The global economy was already very weak because of the trade war, and it would not take much to shove it on its heels," said Mark Zandi, chief economist at Moody's Analytics.

Zandi said his baseline forecast, which optimistically assumes that the outbreak remains largely contained in China and dissipates by spring, projects that global growth will slow to 2.4% this year — 0.4 percentage point lower because of the virus.

He expects the annual pace of U.S. growth to slow to 1.3% in the current quarter, down by 0.6 percentage point because of the virus. He said for the year, he is forecasting U.S. growth of 1.7%. That would be the slowest annual growth of the Trump presidency and far below the 3%-plus growth that Trump had promised to deliver during the 2016 campaign.

Because of the market turbulence and the rising potential of adverse effects from the virus, expectation of interest rate cuts by the Federal Reserve have risen. The CME Group tracker of investment sentiment has put the possibility of a quarter-point cut as early as March at 37%, up from just 7% a week ago.

Diane Swonk, chief economist at Grant Thornton, said the possibility of two rate cuts this year "has gone up dramatically" because of the virus threats."

Until recently, many economists had expected that the Fed could keep rates unchanged the whole year after three rate cuts last year, when it was struggling to cushion the impact of Trump's trade war with China and a slowing global economy.

The estimated 2.1% annual growth pace in the October-December quarter followed an identical gain in the third quarter. For 2019, as a whole, the economy grew by 2.3%, the slowest pace since a 1.6% increase in 2016.

Trump is counting on a strong economy to propel him to re-election in November. But for each year of his presidency, economic expansion has fallen below the levels he had promised to deliver during the campaign, when he derided the growth rates achieved under President Barack Obama.

While growth did jump to 2.9% in 2018, propelled by the 2017 tax cut and increased government spending, it returned last year to near the average achieved by Obama.

Thursday's report from the Commerce Department was its second of three estimates of economic growth for the October-December quarter. It showed that consumer spending, which accounts for 70 per cent of economic growth, grew at a 1.7% annual rate in the fourth quarter, down from an initial estimate of 1.8% growth.

Business investment on new plants and equipment was also lower, falling at a 2.3% rate, worse than the initial estimate of a 1.5% drop. These weaker numbers were offset by more business restocking of store shelves and upward revisions to residential investment and federal government spending.

5. Drabinsky transferred house title to dodge creditors, court finds

[February 27, 2020] An Ontario court has ruled that former theatre impresario Garth Drabinsky transferred the title on his $2.6 million house in Toronto to his wife to avoid creditors, including a lawyer who represented him before the Ontario Securities Commission (OSC).

The Ontario Superior Court of Justice ruled this week that when Drabinsky transferred the title for the house to his wife for $2 in 2015, the transaction was intended to hide the house from Drabinsky's creditors.

The decision came in response to a legal action from securities lawyer Phil Anisman, who was seeking to reverse the title transfer.

Drabinsky was convicted in 2009 of fraud and forgery in connection with misrepresentations made in the financial statements of his company, Livent Inc. In 2017, he was permanently banned by the OSC.

According to the decision released this week, Drabinsky owed Anisman about $50,000 for representing him in an OSC enforcement proceeding between April 2013 and June 2014. The legal bill was to be paid in monthly instalments. However, only two payments were made in 2015.

Ultimately, Drabinsky was sued over the debt, and in 2018, a court awarded $47,727 plus $14,000 in costs against him.

"That judgment has not been paid, and the plaintiff remains a judgment creditor of Mr. Drabinsky's," the court said.

In 2019, Anisman brought legal action to reverse the title transfer that took place in 2015.

According to the decision, Drabinsky claimed that he transferred title to his wife at the request of a bank when he refinanced the property in 2015.

However, the court didn't buy that explanation, saying, "It makes no sense that CIBC would ask for the transfer, as Mr. Drabinsky insists, since Ms. Winford-Drabinsky did not have the financial wherewithal to carry the mortgage. At the risk of stating the obvious, banks typically want financially capable mortgagors, not financially incapable ones."

Ultimately, the court concluded that the transfer was designed to avoid creditors.

"To all appearances, the transfer can only be explained as an effort to put the property beyond the reach of Mr. Drabinsky's creditors. The transaction is replete with the badges of this kind of surreptitious creditor-proofing," the court said.

"Mr. Drabinsky offers no other explanation that makes sense. While he insists under oath that he had not turned his mind to the effect of the transfer on his creditors, the objective indicia are such that he could hardly have been thinking of anything else," the court found.

The court granted judgement in favour of Anisman, and ruled that the transfer "is void as against the plaintiff and other creditors of Mr. Drabinsky."

The court also ordered costs of $13,000.

6. Corporate profits in Canada hit record level in 2019

[February 25, 2020] Canadian corporate profits finished 2019 at an all-time high, according to the latest data from Statistics Canada.

StatsCan reported that operating profits rose by 3.6% in the fourth quarter, to $112.3 billion. This marked the third consecutive quarterly increase for corporate earnings.

The financial sector led the way, with profits jumping by 10.6% in Q4, to $37.2 billion.

Within the sector, the insurance business powered profits higher, while the banking segment saw its operating earnings decline by 2.5% due to lower non-interest revenue.

Credit union profits also jumped by 21.6% in the quarter, to $1.3 billion, StatsCan said.

In a research note, National Bank Financial Inc. (NBF) said that operating profits for non-financial corporations hit an all-time high of $297.6 billion in 2019.

While recent headlines about rail blockades and regulatory burdens focus on the challenges faced by corporate Canada, “business can still be profitable,” NBF said.

“The $4.7-billion advance from the prior year came courtesy of higher commodity prices which boosted mining (highest profits in eight years) and oil & gas (highest profits in five years),” it said.

Profit gains were also “decent” in services-producing industries such as transportation/warehousing, real estate/leasing, education/healthcare and arts/entertainment, it noted.

At the same time, NBF said that slower growth and the global trade war cut profits in cyclical sectors, such as construction and manufacturing.

StatsCan reported that operating profit in the manufacturing sector was down 2.7% in the fourth quarter, to $13.5 billion.

7. What the stress test change means for homebuyers

[February 24, 2020] Last week, the federal government said it was changing the stress test for insured mortgages, effective April 6, to make the test more dynamic.

Right now, the minimum qualifying rate is currently the greater of the borrower’s contract rate or the Bank of Canada’s five-year benchmark mortgage rate (which in turn is based on the Big Six banks’ posted mortgage rates).

Once the change is implemented, the test will be based on the contract rates on all insured mortgages. Thus, the new minimum qualifying rate will be the greater of the borrower’s contract rate or the weekly median five-year fixed insured mortgage rate from mortgage insurance applications, plus 2%.

The change makes the stress test more dynamic, because contract rates are set weekly, said Benjamin Tal, managing director and deputy chief economist at CIBC Economics, in a weekly report.

Considering current rates and housing prices, the change would allow clients to take on a slightly bigger mortgage: the difference between the old rate and the contract rate, plus 200 basis points, is currently about 30 basis points.

“For the average household in Toronto with an income around $100,000, this would increase how much they can borrow by about $13,000,” said RBC economist Colin Guldimann in a report. "Borrowers with higher incomes or larger down payments would see their maximum loan sizes move up somewhat more."

The increased amount roughly translates to less than a 3% improvement in purchasing power, Tal said in the CIBC report. "The modifications […] are not a game-changer," he said.

Also, because market conditions pass through to the new qualifying rate more quickly, new homebuyers could be subject to volatility.

For example, "While the new test may lower the bar as of April, it may make qualifying a bit more difficult if rates start to rise, as they did in 2018," Guldimann said in the RBC report.

Potential volatility would be more concerning in the spring, when Canadian homebuyers are most active in the housing market.

"[G]iven the quick response of the new test to changes in rates, a short-lived change in the five-year rate, say, in February, will have a less significant impact on the number of qualifying borrowers than a similar rate change in April," Tal said in the report.

In the near term, clients who are home-shopping will likely see little rate volatility. "Given the current low level of rates and with markets fully priced for a cut [by the central bank] in July, there is limited scope for market rates to move significantly," Guldimann said.

While the change so far applies to insured mortgages, it's expected to apply to uninsured mortgages as well (the Office of the Superintendent of Financial Institutions is in consultations concerning uninsured mortgages).

8. Canada's banks capable of withstanding an economic shock: report

[February 24, 2020] The big Canadian banks have improved their funding and liquidity positions since the financial crisis and are capable of absorbing a severe economic shock, DBRS Ltd. says in a new report.

The rating agency's assessment of the Big Six banks found that they already meet or exceed the new global liquidity standards, which were bolstered in response to the financial crisis.

DBRS also reported that the big banks are poised to meet the new net stable funding ratio requirements in 2021.

"Since the financial crisis of 2007–08, the large Canadian banks have improved their funding and liquidity profiles by increasing their holdings of unencumbered liquid assets and ensuring that their mix of funding is well diversified," the report said.

DBRS noted that almost half of the banks' funding comes from stable deposits, coupled with various forms of wholesale funding.

DBRS also found that the banks have enhanced their access to liquid assets and have done a better job of matching the maturities of their assets and liabilities.

"As a result, we view the large Canadian banks as well positioned to deal with any unforeseen shock in wholesale funding markets or a severe economic downturn," the report concluded.

Any weakening in banks' liquidity positions could lead to negative rating pressure, DBRS said.

9. Virus outbreak chills markets, outlook for global economy

[February 24, 2020] The widening coronavirus outbreak threatens to seriously disrupt the global economy, just as it was steadying itself against headwinds from the U.S.-China trade dispute.

Amid concerns that global output could decline for the first time since the global financial crisis a little more than a decade ago, stock markets sank Monday. In one sign of how sentiment has been negatively hit, gold spiked 1.8% to $1,688 an ounce, its highest level in seven years, as traders sought out financial assets some consider safer in times of stress.

On Wall Street, the Dow Jones was down more than 900 points during early afternoon Monday trading, while in Europe, the pan-European Stoxx 600 slid 3.6% after an eruption of cases in Italy. Cases were also reported in new countries in the Middle East.

"Compounded with the already dramatic interruptions to global supply chains in China, traders fear that a rapid spread of the disease to other major economies could be enough to temporarily tip global economic growth into contraction in the first half of the year," said Matt Weller, global head of market research at GAIN Capital.

China, the epicenter of the outbreak, faces the most acute near-term difficulties as factories lie idle and people remain homebound. But the ripple effects are being felt all around the world, as China is both a major importer of goods as well as a source of parts through intricate supply chains. Growth estimates for China are already being cut.

Concerns are growing in the 19-country eurozone, whose three biggest economies — Germany, France and Italy — are stalling. Concerns over the knock-on effects on Germany, Europe's export powerhouse, are particularly

acute. Germany’s main DAX stock market closed a whopping 4% lower Monday.
“Given the latest developments, one has inevitably to talk about downside risks for German exporters,” said Andreas Rees, chief German economist at UniCredit.
Rees cited figures showing car sales in China fell 92% in the first two weeks of February and pointed out that of the 21 million cars sold in China last year, about 1 in 5 was made either in Germany or through German investment in China. Most Chinese auto showrooms are closed.
Meanwhile Italy’s FTSE MIB slumped 5.4% as Italian civil protection officials said at least 222 people had tested positive for the virus in the country and that six people had died.
Jack Allen-Reynolds, senior Europe economist at Capital Economics, said the virus “makes another recession in Italy more likely than not.”
Europeans had been hoping for a modest upturn this year after major economies staggered through a rough patch at the end of the year. Germany showed zero growth in the fourth quarter, while the No. 2 and No. 3 economies, France and Italy, shrank slightly. Two straight quarters of falling growth is one definition of a recession.
The global economy was just stabilizing after wobbles caused by the trade war between the U.S. and China and fears of a disorderly British exit from the European Union. The coronavirus hit just as a U.S.-China preliminary deal and a Brexit withdrawal divorce agreement had boosted hopes for a modest upswing, particularly in Europe.
Now the world economy could see its first quarterly fall in seasonally adjusted output since the global financial crisis of more than a decade ago, says Ben May, director of global macro research at Oxford Economics.
Frequent business and tourism destinations for people from China are already being hit hard, confirming that this will be a key way that the pain will spread to other Asian economies, with Singapore and Hong Kong feeling the effects.
Comparisons to the 2003 SARS epidemic, another deadly outbreak that originated in China, aren’t reassuring because China’s share of the global economy is much bigger than it was back then, and supply chains moving raw materials, parts and products snake through the global economy more than ever.
Stock markets may have been slow to appreciate the risk posed by the outbreak because they hoped central banks could step in with more stimulus.
Individual companies have already reported trouble, most notably Apple, which said it will miss its sales target. But it could take until April or May

before hard data on production and sales gives a clear picture of the impact on a regional or global level, Oxford Economics' May said.

Markets are now pricing in a bigger chance for a rate cut by the European Central Bank by July, even though the ECB has already cut rates into unprecedented negative territory. Its key benchmark deposit rate is minus0.5%.

Kristalina Georgieva, the head of the International Monetary Fund, said that the fund's baseline scenario is that China's economy slows but returns to normal in the second quarter.

"But we are looking at more dire scenarios, where the spread of the virus continues for longer and more globally, and the growth consequences are more protracted," she said.

Testifying to Congress on Feb. 11, Fed Chairman Jerome Powell said that it was too early to assess the scope of the impact the virus poses to the U.S. economy. He noted that at the moment the economy "is in a very good place "with strong job creation and steady growth.

Powell indicated that he saw no need to change the Fed's benchmark interest rate, which is in a range of 1.5% to 1.75% after three rate cuts in 2019.

Raphael Bostic, head of the Fed's Atlanta regional bank, said Friday that he expected the coronavirus to "be a short-time hit; we'll get the economy back to its usual level" after the adverse effects pass.

The U.S. economy still looks resilient, growing at a solid 2.1% annual rate the last three months of 2019. American consumers are driving the record-breaking expansion, now in its 11th year.

Business investment has been weak, partly because President Donald Trump's trade wars have generated uncertainty about where companies should locate factories and buy supplies. Investment could get weaker if the virus continues to disrupt the supply chains American businesses rely on.

10. StatsCan reports median household income was flat in 2018

[February 24, 2020] The median after-tax income was stagnant for the majority of Canadians in 2018, according to data released by Statistics Canada on Monday.

For Canadian families, median after-tax income was $61,400, up only slightly from $59,800 in 2017. The median after-tax income of senior families and unattached individuals remained virtually unchanged as well, at $63,500 and $30,700, respectively.

For non-senior families, the median after-tax income increased by $2,300 to $91,600 in 2018. Within this group, couples with children saw an increase of $2,700 to $101,900.

Statistics Canada attributed the growth in after-tax income to gains in market income — which includes employment income, retirement income and income from investments — led by couples with children, whose median market income rose by $4,400 to $108,700 in 2018.

Geographically, the median after-tax income of families and unattached individuals remained relatively stable in every province except Ontario, where it increased by 3.3% to $66,200 due to growth in market income.

Alberta families and unattached individuals had the highest after-tax income, at $72,700, while those in Nova Scotia had the lowest, at $52,200.

StatsCan also found that the proportion of Canadians living below the official poverty line declined to 8.7% in 2018, down from 9.5% in 2017. There were 216,000 seniors living in poverty, down from 238,000 in 2017.

Have a nice and fruitful week!