Weekly Updates Issue # 626

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1. Weekly Markets Changes

[August 11, 2017]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,033.38 -224.6 -1.47%	2,441.32 -35.51 -1.43%	21,858.32 -234.5 -1.06%	6,256.56 -95.01 -1.50%	$0.7889 -0.17c -0.22%	$1,295.00 +30.70 +2.43%	$48.79 -0.73 -1.47%

2. Ontario’s Q1 finances show province on track to balance

[August 11, 2017] Ontario’s first-quarter finances show the government is still on track to balance this year’s budget.

A bilateral agreement between Ontario and the federal government on early learning and childcare gives the government both $145 million in new revenue and expenses.

Other new spending includes $85 million to clean up the mercury-contaminated English-Wabigoon River system in northern Ontario, nearly $15 million in compensation for flooding of Lac des Mille Lacs First Nation reserve land, as well spending on famine relief efforts in Yemen, South Sudan, Somalia and Nigeria.

That funding is coming out of contingency funds.

The spending on interest on debt is $11.6 billion, which is what was projected in the budget.

As of July, private-sector forecasters on average, projected Ontario’s real GDP will increase by 2.7 per cent this year, up from the 2.4 per cent projected in the budget.

3. Lack of U.S. consumer price gains could stall the Fed

[August 11, 2017] Consumer prices posted a slight gain in July, with higher costs for medical care and clothing offsetting declines for hotel stays and consumer cellphone plans.

The U.S. Labor Department said Friday that its consumer price index edged up 0.1% last month after no gain in June and a 0.1% fall in May. Core inflation, which excludes volatile energy and food changes, was also up a slight 0.1% in July.

Both overall inflation and core inflation have risen an identical 1.7% over the past 12 months. That shows that inflation pressures remain well under control. In fact, a separate inflation gauge favoured by the Federal Reserve has been slowing this year, raising concerns that inflation is falling farther from the Fed's 2% goal.

"The story remained the same for the American economy in July: a healthy job market, but no new momentum in inflation pressures," says Leslie Preston, senior economist at TD Economics in a data release.

Preston notes "one-off price drops in specific categories" led to lack of momentum but adds that "doesn't explain the entire weakening seen in measures of inflation that strip out such volatility (trimmed mean or median CPI). Inflation has weakened across many advanced economies, suggesting that a broader phenomenon – such as persistent economic slack globally – may be playing a role."

It's Preston's view that inflation pressures will keep building "through the remainder of the year, but the process is proving slower than expected," adding risk to the pace of U.S. Federal Reserve hikes over the rest of this year and next year.

So far in 2017, the Fed has raised its benchmark interest rate in March and June, and has signalled it plans a third rate hike before year's end. But private economists say the Fed may stand pat for the rest of 2017 unless inflation accelerates in coming months. The Fed's preferred inflation gauge showed a 12-month price gain of 2.2% in February, but its latest reading has slowed to a gain of just 1.4%.

Fed Chair Janet Yellen has blamed the slowdown on temporary factors such as a price war in the cellular phone industry that has pushed monthly mobile phone charges down. But she has also indicated that if her view is proven wrong, she is ready to support a change in the Fed's plans for rate hikes. The Fed meets again in September.

Analysts believe it will keep rates unchanged and may not hike again until December.

Avery Shenfeld of CIBC Capital Markets says in a research note, "Lately, core PCE hasn't been tracking as much below core CPI as it had earlier, so we're not necessarily miles below the 2% core PCE objective. But we're going to need a few 0.2% monthly gains in core prices to stay on track for our projected Fed hike in December."

For July, the CPI report showed that monthly wireless phone charges dropped 0.3%. They are now down 13.3% over the past 12 months, the biggest 12-month decline in cellphone charges in 16 years.

The costs of hotel and motel stays plunged a record 4.9% in July, the biggest one-month on records that go back to 1997.

Clothing costs, which had been falling, rose 0.3% in July. Medical costs showed a 0.3% increase in medical services and an even bigger 1% jump in medical products such as drugs.

Energy costs dipped a slight 0.1% in July with the cost of gasoline unchanged. Food costs were up a modest 0.2%.

4. Reasons to close your currency hedge

[August 9, 2017] The loonie has been a star performer recently, but in the longer term, that performance likely won't continue.

That's because of potential cracks in housing, fluctuating oil prices, gaining momentum for U.S. economic data and uncertainty about NAFTA, says Craig Basinger, CFA, in a Richardson GMP Market Ethos report. Further, "Expectations for U.S. tax reform [are] now very low, opening the door for a potential positive surprise" for the U.S. dollar, he says.

BMO senior economist Sal Guatieri agrees. "We suspect the Canuck buck will struggle to make further headway," he says in a North American outlook report. "The best economic news is likely priced in, the current account deficit is near 3% of GDP […] and the Bank of Canada likely won't ignore a further sharp appreciation. We see the loonie trading below 78 cents U.S. in the year ahead."

Basinger puts the loonie a bit higher, at US$0.79 to US$0.80, and says he thus sees greater value in U.S. exposure. "We closed our currency hedge in the Redwood Core Income Equity Fund," he says, explaining that last April the firm hedged one-quarter of the fund's U.S. holdings from a currency perspective.

His reasoning: economic data are changing momentum, and the number of speculators who moved from shorting the loonie to being long appears overdone. "The Canadian dollar moved too far, too fast," he says.

Comparing returns from the S&P and MSCI EAFE, he shows that, over the longer term of 20 years, local-currency returns and Canadian-dollar returns

are very close for both indexes — only a few basis points difference, he says, which probably isn't worth the trouble of hedging in the long term.
Another reason for Canadian investors to embrace the U.S. dollar is as a diversifier, says Basinger — yes, really.
That's because, as a resource-rich country, Canadian markets do well when global growth is healthy, and, in such an environment, "your Canadian investments are thriving, but your U.S. holdings are a bit of a drag due to the currency," he says. "Think of this as insurance."
Further, if global growth slows or global markets experience a shock, the U.S. dollar is viewed as a safe haven. Thus, the U.S. dollar "is a good diversifier for Canadians, and generally we believe investors should be unhedged," says Basinger.

5. OSC accepts $11-million Home Capital settlement

[August 9, 2017] Ontario's securities watchdog has approved a settlement with Home Capital Group Inc. and three former executives who have agreed they failed to tell investors quickly and completely about fraudulent activity by some mortgage brokers associated with the alternative lender.
As a result of the settlement, about $11 million could flow through the OSC to shareholders covered by a related class-action suit that's awaiting court approval.
The OSC settlement is conditional on the Ontario Superior Court accepting a settlement worth about $29.5 million including the money collected through the OSC process.
An OSC lawyer told a hearing in Toronto that the commission needed to send a clear message that public companies are legally obligated to disclose important information within required time frames and in a form reasonable investors could use.
The OSC's announcement of its allegations in March contributed to a sudden exodus of Home Capital depositors in April that pushed the Toronto-based company to borrow about $2 billion — at crushingly high interest rates — to stay in business.
Home Capital shares and prospects have improved since famed billionaire investor Warren Buffett agreed to support the lender through an equity investment and loans by Berkshire Hathaway, his main company.

6. Retail apocalypse continues at department stores

[August 10, 2017] It should be easier to find a parking spot at the mall these days, because consumers continue to shun department stores.

Macy's, Kohl's and Dillard's all reported drops in same store sales in their latest earnings reports Thursday. Same store sales are a key measure of health for retailers that look at how well locations open for at least one year are doing. Stocks for each retailer plunged on the news.
Macy's is now down more than 40% this year. Kohl's has dropped nearly 25% so far in 2017. Dillard's plummeted 15% on Thursday alone, and has now given up nearly all its gains for the year in the process.
It's yet another sign that the rise of Amazon and resurgence of Walmart have taken a toll on many traditional retailers.
Shares of Nordstrom, which will report its latest results after the closing bell Thursday, also fell. So did J.C. Penney, which will release its earnings Friday morning. Sears Holdings and Target got whacked too.
All of these old-school retailers are grappling with how to get customers in the door. Many have resorted to big discounts and promotions -- and that has hurt their profits.
Dillard's CEO William Dillard said in the company's earnings release that "significant markdowns led to a disappointing loss" in the quarter, adding that sales of shoes, cosmetics and furniture were disappointing.
Retailers have had a tough time managing the transition to e-commerce while also making sure their brick-and-mortar stores keep foot traffic moving.
Macy's CEO Jeff Gennette, who replaced longtime CEO Terry Lundgren earlier this year, stressed in the earnings release that Macy's is continuing to invest in "accelerated growth in digital and mobile." But he added "there is still work ahead of us."
Simply put, retailers have to do a better job of offering products consumers want at affordable prices.
But Antony Karabus, CEO of consulting firm HRC Retail Advisory, said in a recent report that's easier said than done.
"Significant market share becoming available as a result of bankruptcies and store closures should have produced sales growth for traditional retailers -- but sadly this hasn't occurred," Karabus noted in his report.
That's because along with Amazon, discounters like Walmart and fast-fashion apparel brands such as H&M and Zara are stealing more market share. And that trend is unlikely to change anytime soon.
E*TRADE senior manager David Russell referred to the problems facing traditional stores as "the retail ice age" in a report Thursday. Sounds about right.

7. Streaming wars: Here's why Disney won't kill Netflix

[August 9, 2017] Disney has arguably the top library of content in the media world, much of which it will eventually take away from Netflix.

So you'd think Disney would have the best chance of any entertainment giant out there at poaching a big chunk of Netflix's more than 100 million subscribers when it launches its own streaming service in 2019.

The threat from Disney is the reason Netflix stock fell more than 2% on Wednesday.

But should investors really be worried that Netflix will lose the streaming media crown (see what I did for you fans of the drama about Queen Elizabeth II?) to the House of Mouse?

Netflix's stock is still up 40% this year. And it's not as if Disney is the first company to emerge as a potential threat.

There's Hulu, which includes content from Disney as well as media rivals Fox, Comcast's NBCUniversal and Time Warner, the parent company of CNN.

These four also own stakes in Hulu. And another TV titan, CBS, now offers programming to Hulu, too.

Amazon is another big player in streaming media, offering movies and shows to its army of Prime subscribers. Time Warner's HBO has a subscription streaming service, as does CBS-owned Showtime.

But here's the thing. For many couch potatoes, a subscription to several of these services -- if not all of them -- might still be necessary because they all churn out original, exclusive content.

That's especially the case with Netflix. Disney won't have "House of Cards," "Orange is the New Black" or "Stranger Things."

You won't find David Letterman's new show on Hulu. He just signed with Netflix. (I hope Stupid Buffering Tricks becomes a regular segment.) Even Jerry Seinfeld is moving his buzzy "Comedians in Cars Getting Coffee" from Sony's Crackle to Netflix.

It's important to remember that Netflix also has original shows that are produced by other big media companies. And Hollywood studios may decide they would rather put their content on their own platforms than on Netflix.

For example, Disney owns Marvel comics, and it's not clear whether "Daredevil," "Jessica Jones," "Luke Cage" and "Iron Fist," all based on Marvel characters, will stay on Netflix or move to the new Disney service.

"The Defenders," a new show that brings these four together, will premiere on Netflix on August 18.

The other streaming companies also realize they need their own hits to attract subscribers. Want to watch the dystopian nightmare that is "The Handmaid's Tale?" You need Hulu.

Amazon is home to the award-winning "Transparent" as well as "Sneaky Pete" and "Mozart in the Jungle."
And you won't find "Game of Thrones" streaming anywhere but HBO Go or the Internet-only subscription service HBO Now.
But Netflix also might be hedging its bets. It made its first acquisition this week, buying comic book publisher Millarworld.
That's why Bruce Springsteen might need to update his 1992 song about the lack of good shows on TV. Forget about "57 Channels (And Nothin' On.)"
These days, the Boss could sing about how there are 57 streaming services -- and that there's too much to watch.

8. What to buy and avoid in Canada

[August 8, 2017] The Bank of Canada hiked its key rate in mid-July – and even hinted at its move – but afterwards, David Picton wasn't convinced by the Bank's bullish outlook.
Picton, president and portfolio manager for Canadian equities at Picton Mahoney Asset Management in Toronto, finds domestic fundamentals aren't as strong as a rate hike typically implies. As a result, he says, "[The] traditional playbook of playing the BoC hike […] is not to be implemented this time around."
Despite this summer's recovery of the Canadian dollar from a "heavily shorted global standpoint," he also hasn't moved to increase his positions in the financial or real estate sectors, even following the BoC hike. Picton, whose firm is one of three managers of the Renaissance Canadian Growth Fund, says, "Normally, in a more robust environment with Canadian interest rates going higher, we would be very much favouring financials and housing-related mortgage companies in Canada."
But given the advanced state of the cycle, he adds, he doesn't favour a lot of mortgage-weighted holdings. Instead, he's looking at companies like Air Canada, which are "prime beneficiaries of a higher [Canadian dollar] and oil prices falling. That is a significant position within portfolios."
Since the end of July, the loonie has started to weaken against the greenback, going from a close of US$0.8043 on July 28 to a close of $0.7913 on August 4 – but that compares to a 2017 low of US$0.7288 on May 8. As of August 7, oil prices were rebounding but still below January's 2017 highs, with Brent crude nearing $53 and WTI at nearly $50.
Still, there are some benefits to the July rate hike, Picton notes. "We're in a bit of a cyclical uptick for the Canadian currency and monetary policy, and I think some of that's necessary." Further, "We need to get more tightening

within the system to squeeze out the heavy reliance we have on real estate in the Canadian landscape," he says.

A few reasons are "we have consumers that are elevated in their borrowings, prices that are elevated in the housing market and employment trends that are highly elevated in housing," says Picton.

And that's why "it makes sense to increase rates to hopefully put a bit of a lid on that. But one has to be careful – if we go too far we do run the risk of a Canadian recession, especially if we're to see more of a slowdown around the rest of the world."

What not to buy

Currently, Picton is avoiding names that he refers to as over-owned and "very interest rate-sensitive." He's avoiding assets that are "expensive relative to history, or that don't have maybe as much earnings growth as you would have had in the past. A couple areas that come to mind are the utilities sector and telecom sector."

Over the past several years both sectors have received high inflows of cash, he says, but "the underlying fundamentals of the actual businesses haven't really done much to improve, especially if you justify the higher relative valuations that those stocks have." Going forward, Picton says, "we can see them being used as a source of stability if we get into a rockier climate down the road."

Picton is cautious on mortgage-related securities. At the Canadian bank level, he says he's not as concerned when he sees diversified operations, noting, "The ones we like – TD, RBC and BMO, for example – have U.S. operations to offset [risk]. But once you get into mortgage lenders or alt-A mortgage companies, we need a bit of a shake up in the real estate sector before we move back to those things."

Have a nice and fruitful week!