

14th June 2015

America's jobs report released last Friday was strong across the board and certainly took us by surprise. We had thought that announced job losses in the energy sector and by multi-nationals suffering from a strong greenback would have begun to show up in the official data, however that did not occur.

Average hourly earnings have reversed; December's harsh weather was a setback. Weekly hours worked have remained the highest since the financial crisis, and the participation rate is rising. Earnings increases were healthy for the month of May at 0.3%, up from 0.1% for the month of April, and -0.2% for the month of March. Quite a turn around.

This jobs report may bring about speculation that the American Federal Reserve will raise interest rates sooner than later. Corporate America is impacted from dramatically reduced spending in the energy sector and lower inventory buildup. Additionally, both energy sector profits and a strong American dollar will start to impact earnings. The positive news out of the jobs data report is that wage inflation in America is starting to take hold on a broader national level. Chances are low for the American economy to roll back on itself. A much more interesting development is the IMF's (International Monetary Fund) statement urging the American Federal Reserve not to raise interest rates till late 2016.

Here is why we believe in our focused North American recovery strategy:

For companies to increase output they either need to invest in new plant and equipment, or they need to hire more workers. Simple, invest capital or spend more on labor. In the post 2009 cycle, corporations have not been interested in ramping up capital investment and instead have been employing more workers to meet increased demand. Without any meaningful pressure on wages to rise as a result of cheap foreign labor and low inflation, growth to profit margins is expanding to record high levels.

Corporate leaders are incentivized to work at boosting share prices, which means using any measure they can to boost earnings. One obvious ploy has been to borrow money to buy back shares to boost both the share price and earnings per share. Corporations have reached a tipping point in order to keep share earnings high. Companies need to shift gears as productivity gains through labor alone will reach its limits quickly, which in turn will only lead to further wage inflation and shedding of the lowest denominator jobs as upgraders in machinery drive productivity.

Nearly every central bank (except America's) is either applying QE or has no desire to raise future interest rate. If the Federal Reserve maintains its desire to raise rates, the dollar will make more gains. The greenback has already risen by nearly 20% last year alone. A strong dollar always leads to a crisis, with emerging markets being hit first as the usual candidate. However, this time a persistently strong dollar is likely to lead to a weaker than expected growth in the American economy; a condition Canadian businesses have suffered from as a result of our high flying Loonie. If the affinity for the American dollar gets too strong, I believe the Federal Reserve will step in and introduce measures to curb currency appreciation, possibly even a QE4! Japan has successfully applied reforms to come out of a very long period of an over valued Yen which lasted more than a decade.

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Negative real rates of return on trillions of dollars of European and Japanese bonds is distorting capital flows. The EU and Japan's QE programs will push investors to see the American dollar as more attractive not less.

The other economic theme we have been watching closely is capital being allocated to infrastructure programs around the world. China is in the process of forming an infrastructure development bank with approximately 8 trillion dollars set aside for infrastructure development throughout Asia. We will see the unfolding of some of the largest infrastructure programs the globe has ever witnessed. Both commerce and population growth will push the world to expand roadways, railways, utilities, and ports to keep up with demand. Even Egypt, as troubled as it is politically, has undertaken plans to expand and widen the Suez Canal to accommodate demand for oil tankers and shipping containers.

Here at home, the deeper effects of the drop in oil will become much more evident. Oil rigs that are operating continue to decline, and with it so do jobs. We are seeing early signs of people leaving western Canada and looking for work in Ontario. Capital flows have shifted from out west to South-Western Ontario. The real estate market has seen a significant push forward as prices continue to climb and it is very common to see multiple offers on property listings. Corporate Canada is slowly making a comeback in Ontario, with it bringing more jobs, higher pays; consequently, the demand for real estate will only expand. Lastly, a major event such as the Pan Am games, brings with it a jump in capital investing and economic growth which typically follows suit 6-8 months after the games; lasting for up to two years. Western Canada saw a boom in investment capital after our winter Olympic games, which opened the world's eyes to how wonderful Canada is to live and invest in. The city of Toronto is about to see a big boost in the arm.