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## Market Update

02 June 2017

Markets seemed to shrug off the newest radical move by President Trump to exit from the Paris climate change accord. President Trump made the official statement that America wants to back out of the accord. What is worrisome is that all the big oil companies back the Paris climate accord and not Trump. Next Thursday will be a big day as former FBI head Comey is to testify June 8th before the senate panel. Comey has made it clear in his written comments that Jared Kushner is a key figure in the Russian scandal plaguing Trump's administration.

The activity of American factories picked up in May after slowing for two straight months and private employers stepped up hiring, suggesting the economy is regaining speed after struggling at the start of the year. The signs of renewed energy in the economy and labor market tightness could encourage the Federal Reserve to raise interest rates later this month. The Institute for Supply Management (ISM) said its index of national factory activity ticked up to a reading of 54.9 last month from 54.8 in April. The index hit a 2 and 1/2-year high of 57.7 in February amid optimism over President Donald Trump's pro-business policy proposals.

It had declined for two consecutive months as concerns mounted in the business community that political scandals could derail the Trump administration's economic agenda, including its push to cut corporate and individual taxes.



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A reading above 50 in the ISM index indicates an expansion in manufacturing, which accounts for about 12% of the U.S. economy. The manufacturing recovery remains underpinned by the energy sector as steady increases in crude oil prices boost drilling activity, growing demand for machinery.

Manufacturers continued to steadily increase inventories and still viewed their customers' stocks as too low, according to the survey. While raw materials prices rose for a 15th straight month, the pace of increase slowed sharply in May. American equities were trading higher on Thursday, while American Treasury debt prices fell. The greenback dollar rose against a basket of currencies. The ADP National Employment Report showed private payrolls increased by 253,000 jobs last month, beating economists' expectations for a gain of 185,000 jobs. Private payrolls rose by 174,000 jobs in April. The economy grew at a 1.2 percent annualized rate in the first quarter. The Atlanta Fed is forecasting gross domestic product increasing at a 3.8 percent pace in the second quarter.

Minutes of the Fed's May 2nd and 3rd policy meeting, which were published last week, showed that while policymakers agreed they should hold off hiking rates until there was evidence the growth slowdown was transitory. However, the Fed has been focused on keeping inflation at 2% a year. However it appears that as stated by chair Janet Yellen allowing to go above the 2% line in the sand. Moving to a flexible price levelling targeting by the Fed as opposed to drawing lines in the sand would be like a car speeding up and slowing down on route. The American Fed has been looking for ways since the great recession to avoid past cycles of rapid economic expansion and destructive economic recession or even collapse. Price levelling targeting is a monetary policy goal of keeping overall price levels stable, or meeting predetermined price level targets. Consumer price index (CPI) is used as a measure of rising cost where by raising and lowering interest rates to keep price levels in line. It may be the goal of the Federal Reserve to raise interest rates higher in anticipation of a necessary interest rate drop if the American economy weakens in the next 2 years.

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The Fed is essentially creating a hedge policy with a predictable outcome if the American economy contracts faster than anticipated in the near future. At the same time the Fed wants to have the economy on a steady path, as opposed to a feast or famine of past economic cycles. This new application of price levelling is diametrically opposed to Trump's desire to have America go through explosive growth which was reflected in his budget comments of American growing by 30% in a decade.

Britain may be entering its darkest economic days as it heads towards national elections. Without a clear path on Brexit the Labour party is grabbing an additional two seats in Wales which is a very tight election. If Labour wins could Brexit be reversed? The British Pound has bounced from its lowest of \$1.2829 against the dollar. German unemployment fell to a new record low as Europe's largest economy continued to power ahead. The jobless rate dropped to 5.7 % in May from 5.8 %, data from the Federal Labor Agency in Nuremberg showed on Wednesday. The number of people out of work slid by a seasonally adjusted 9,000 in May to 2.54 million. The uber economy expanded by 0.6% in the first quarter on the back of strong domestic and global demand. The Bundesbank expects the upswing to continue in the coming months, blistering employment and private lending. The ECB is betting the trend continues with Germany, which would start to see meaningful wage inflation. Managing deflation since 2009 has been a must in restoring inflation in the Euro area. If the upbeat sentiment continues to wash over Germany, Chancellor Angela Merkel and her party look to retain power for another term. A strong mandate from the German people will allow the Chancellor to bring France's new leader Macron closer to the EU agenda. It has been unfortunate that President Trump has been speaking out against German trade. This is not even remotely correct as German firms employ more people and produce record levels of goods in North America. German firms are a major contributor to employment. Talk about fake news.

Oil prices eked out gains after a larger than expected draw in

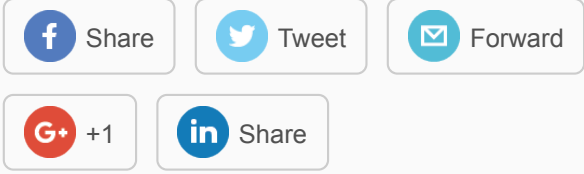
American inventories, providing some relief amid investor skepticism that OPEC led cuts will be enough to rebalance an oversupplied market. American crude stocks fell sharply last week, driven by a surge in refining and exports to record highs, while gasoline inventories also dropped sharply ahead of the start of the summer driving season, the Energy Information Administration (EIA) reported. Oil futures initially extended gains after the data, but the rally eventually lost steam.

The EIA data showed that crude inventories dropped 6.4 million barrels, more than the forecasted 4.4 million barrel drop. Which was a smaller drawdown than the industry group the American Petroleum Institute's (API) report stated, of a fall of 8.7 million barrels. On Wednesday, a Reuters survey found output from the Organization of the Petroleum Exporting Countries (OPEC) rose in May, the first monthly increase this year, as higher supply from two states exempt from a production cutting deal, Nigeria and Libya, offset improved compliance with the accord by others. OPEC and other producers, including Russia, have agreed to restrict output by 1.8 million bpd to drain stockpiles that are close to record highs in many parts of the world. The group, however, last week discussed cutting output by a further 1.5 %. There are signs that the 1.8 million barrel cut is not really what the market is feeling because of rising production in the America, Libya, Nigeria and the North Sea. Russia, which has cut production by 300,000 bpd under the deal, could increase production next year to as much as 11.07 million bpd as the country's deputy energy minister stated. So, the underlying question is how long can OPEC and friends keep true to their pact. It has always failed in past attempts.

Where is the world's second largest economy headed? Challenges abound as China looks to liberalize its financial markets, rein in its mountainous debt and reform bloated state owned enterprises. If President Xi pulls off a clean sweep at the 19th congress and uses his enhanced stature to end policy paralysis by actually embarking on major reforms to improve economic efficiency. China must learn to be less dependant on easy credit and forced growth. Such a

transition if successful would see a rapid devaluation of the Yuan and see losses less than \$1 trillion which would see GDP drop below the sacred 6.5% target GDP falling to below 5.5%. China would then be entering a long term recession.

Canada's economy expanded at an annual pace of nearly 4% in the first quarter, more than three times the growth seen in America during the same period. According to Statistics Canada, the total value of all goods and services sold in Canada grew in absolute terms by 0.9% from the level seen at the end of 2016, an annualized pace of 3.7%. The showing, while strong, was less than the 3.9% annual pace of growth that economists had been expecting. Domestic demand led the way in terms of growth, while exports were lower. After falling in four of the previous five quarters, investment in machinery and equipment advanced 5.8%. Household final consumption increased 1.1%, led by vehicle purchases, Stats Canada reported. Speaking to reporters in Ottawa on Wednesday, the International Monetary Fund's mission chief for Canada, Cheng Hoon Lim, called the quarterly growth figure "very robust" and "an impressive achievement" given the current pace of growth in other developed economies. The Canadian economy continues to out perform. Canadian housing has been allowed to over heat and it must find a way to taper rocketing housing prices. However, most home owners feel wealthier based on lofty price appreciation. Current trends point to Canadians borrowing heavily against their properties to continue spending. If the province and federal government don't find a way to further curb home prices, a collapse due to the inability to keep up with debt payments will be underway as we are in an inclining interest rate cycle. Power of sale will be the trend in real estate. I think we all remember the head lines in the 1990's into 2000. We have already seen real estate listings climb as home owners attempt to cash in on a hot market. The reality is that listings are lasting longer with a transition from a sellers market to a buyers market. Additionally we are seeing home buyers walk away from their deposits and backing out of purchase agreements prior to close.



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