Weekly Trends

PRIVATE CLIENT SOLUTIONS

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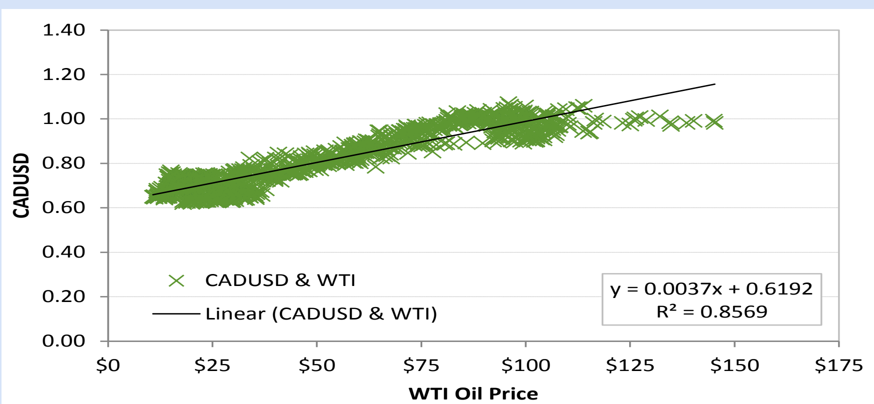
CAD Outlook

- CAD has rallied an impressive 17% since its low of 0.6859/USD on January 19. While we stated in our Q1/16 Asset Allocation report dated January 22 that, “with CAD trading near our long-term target in the low $0.70s, we believe selling some US equities and converting back to Canadian dollars makes sense here,” we did not envision it rallying 17% in just a few months. Where do we go from here?
- From a longer term perspective we are bullish on CAD, and see it higher 12 to 18 months out. This view is predicated on the following: 1) we see higher oil prices; 2) we expect the Bank of Canada (BoC) to more closely track Fed rate hikes next year which should support CAD; and 3) the technical profile of CAD has improved which augurs for further upside.
- While we are bullish on CAD from a longer term perspective, we do see the potential for some short-term weakness given: 1) CAD is technically overbought; and 2) we see the potential for US dollar strength, which could pressure oil and result in a pullback in CAD.
- We would view weakness in CAD favourably and would look to sell USD into strength, as we see CAD higher on a longer term basis. We would not be surprised to see CAD at 0.82 to 0.84 (or 1.2195 to 1.19/CAD using normal convention), 12 to 18 months out, on a higher oil price (see Chart of the Week).

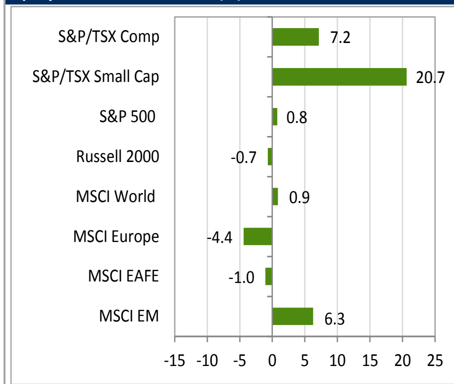
Chart of the Week

Expect CAD To Trade 0.82 To 0.84 On WTI Price Of US$55 To US$60/bbl. Next Year



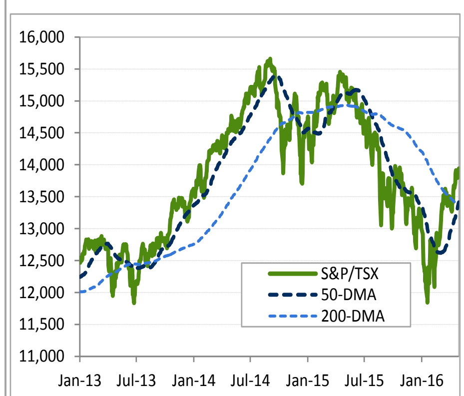
Source: Bloomberg, Raymond James Ltd.

Equity Market YTD Returns (%)



Canadian Sectors	Weight	Recommendation
Consumer Discretionary	6.7	Underweight
Consumer Staples	4.7	Market weight
Energy	18.3	Market weight
Financials	38.1	Market weight
Health Care	3.0	Underweight
Industrials	8.0	Overweight
Technology	3.2	Overweight
Materials	9.5	Market weight
Communications	5.9	Overweight
Utilities	2.5	Underweight

Technical Considerations	Level	Reading
S&P/TSX Composite	13,940.9	
50-DMA	13,392.4	Uptrend
200-DMA	13,388.8	Uptrend
RSI (14-day)	67.0	Neutral



Source: Bloomberg, Raymond James Ltd.
Sectors are based on Bloomberg classifications

CAD Outlook

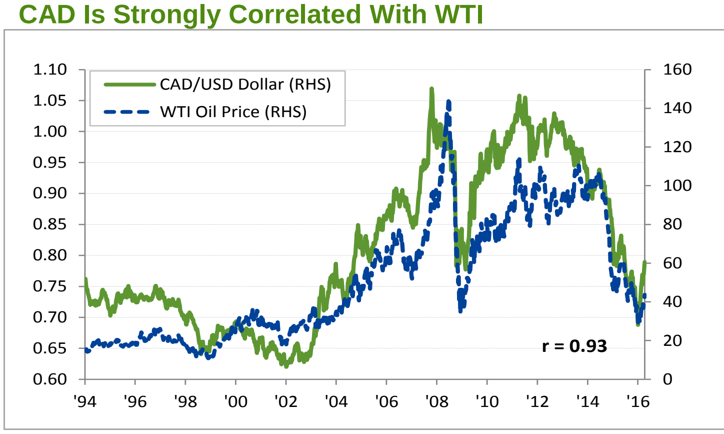
CAD has rallied an impressive 17% since its low of 0.6859/USD on January 19. While we stated in our Q1/16 Asset Allocation report dated January 22 that, "with CAD trading near our long-term target in the low $0.70s, we believe selling some US equities and converting back to Canadian dollars makes sense here," we did not envision it rallying 17% in just a few months. Where do we go from here?

From a longer term perspective we are bullish on CAD, and see it higher 12 to 18 months out. This view is predicated on the following:

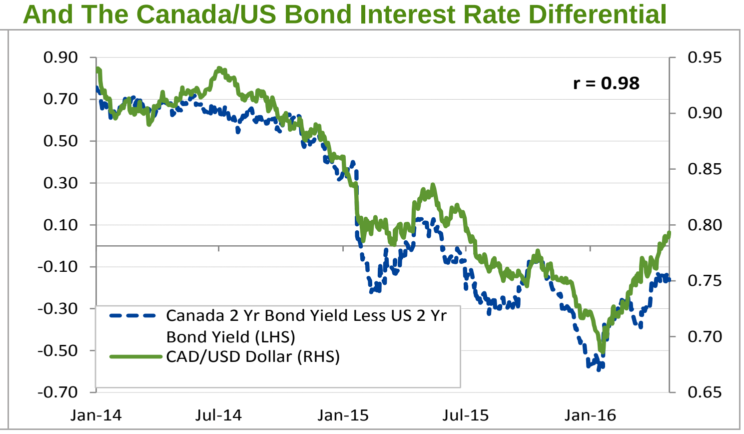
- **Higher oil prices:** We have been increasingly getting more bullish on oil prices in recent months. For example, in our Weekly Trends report dated February 19 we stated, "we believe the oil markets are in the process of addressing the oversupply, which should result in a bottom sometime this year". In the near term, which we address on the following page, we believe oil could pull back, but we continue to call for higher prices, and see WTI in the US$50/bbl to US$60/bbl range over the next 12 months. As illustrated below, with the CAD having a 0.93 correlation with WTI over the long-run, this should support higher levels in the CAD. Based on our CAD/WTI regression model, and our expectation for the WTI oil price, we believe CAD could rally up to 0.84 cents in 2017 (see Chart of the Week on page 1).
- **Interest rate differentials:** Another important driver of CAD is the interest rate differential between Canadian and US government bond yields. Since 2014, the interest differential between Canada and US 2-year bond yields has had a 0.98 correlation with CADUSD. In layman's terms, as the Fed tightened monetary policy and the BoC lowered rates in 2015, this led to CAD weakness. For 2016, we expect additional Fed rate hikes while the BoC should stand pat. Next year however, we expect the BoC to more closely track Fed rate hikes, which should provide another support for CAD.
- **Technicals:** Finally, from a technical perspective, CAD has broken an important downtrend since mid-2014, and is trading above its 50- and 200-day moving averages (MA). We believe this material improvement in the technical profile of CAD augurs for further upside over the 12 to 18 months.

Combining our bullish view of WTI oil prices, the historical relationship between CAD and WTI, and the improving technicals for CAD, we believe the CAD will trend higher over the next 12 to 18 months, possibly up to 0.84 cents.

CAD Is Strongly Correlated With WTI



And The Canada/US Bond Interest Rate Differential



Source: Bloomberg, Raymond James Ltd.

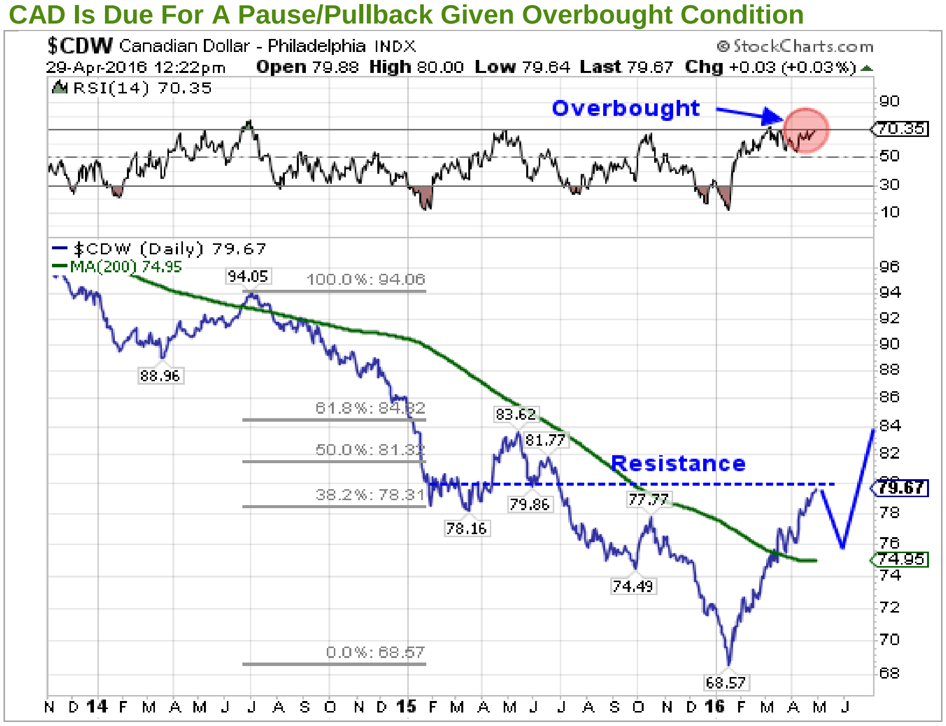
Short-term Outlook

While we are bullish on CAD from a longer term perspective, we do see the potential for some short-term weakness given the following factors:

- As a result of the impressive 17% gain since the January lows, CAD is now technically overbought on a number of technical readings. Currently, CAD has an RSI reading of 70.35 (above 70 indicates overbought) and its MACD indicator appears elevated. Given these overbought readings, we believe CAD is due for a breather, and could pullback in the short term.
- Possibly triggering a short-term pullback is strength in the US Dollar Index, and a contemporaneous pullback in oil prices. As illustrated in the sidebar, WTI prices have a strong negative correlation with the US Dollar Index. As the US Dollar Index has rallied over the last few years, this has helped drive oil prices lower. More recently, the US Dollar Index has weakened, which has in part led to the rally in WTI oil prices. However, we now see the potential for short-term strength in the US Dollar Index, which could pressure WTI in the short term. If this unfolds, this could put downward pressure on CAD in the short term as well.

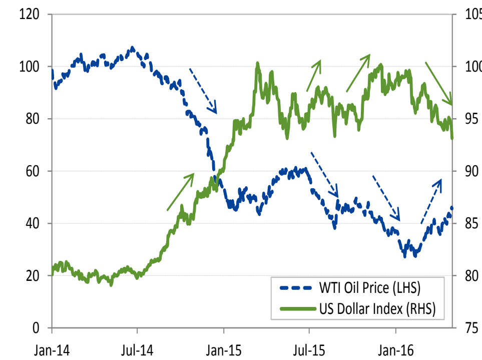
So there you have it. We see the potential for some short-term weakness in CAD given its overbought condition and potential for oil weakness. However, we would view weakness in CAD favourably and would look to sell USD into strength, as we see CAD higher on a longer term basis. We would not be surprised to see CAD at 0.84, 12 to 18 months out.

CAD Is Due For A Pause/Pullback Given Overbought Condition



Source: Bloomberg, Stockcharts.com, Raymond James Ltd.

WTI Is Negatively Correlated With The US Dollar Index



Source: Bloomberg, Raymond James Ltd.

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