Weekly Trends

PRIVATE CLIENT SOLUTIONS

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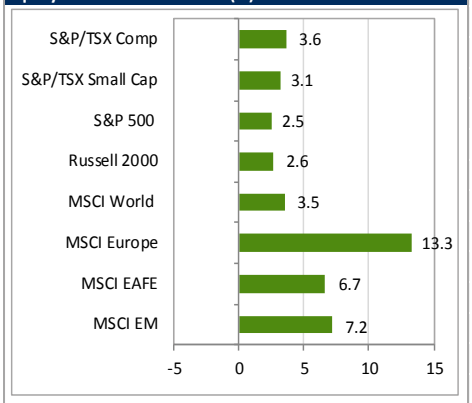
Canada Or US?

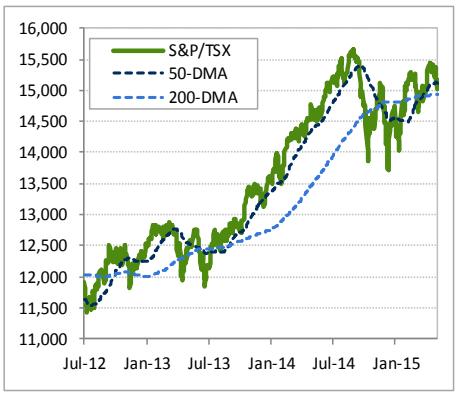
- The first estimate of Q1/15 US GDP was released last week and it showed that the US economy stalled in the quarter, posting a disappointing 0.2% annualized growth rate and coming in below expectations of 1%.
- The weak GDP report sum ups the weak economic momentum seen over much of the quarter for the US economy. This weakness has significant implications for US Federal Reserve (Fed) monetary policy, which has led to dramatic moves across the bond, currency and commodity markets in recent weeks.
- We believe US economic growth will trough soon and begin to improve. If correct in our reacceleration call, this should push the Fed to hike rates in the H2/15, which should drive further US dollar strength. However, if growth continues to slow, then the Fed is likely to delay their tightening. In this scenario, the US dollar would likely drop having significant ramifications for Canadian investors. In particular, it would impact Canadian returns on US-dollar held investments. We've favoured the US stock market for some time, in part driven by our call for a continued appreciating US currency. Therefore, is it time to revisit our CAD/US call?
- From our perspective the fundamentals are stronger for US equities, supporting our call to overweight the region. The better fundamentals for US stocks include: 1) stronger corporate earnings; 2) more attractive valuations; 3) a weak outlook for commodities; and 4) positive fund flows into US stocks. Additionally, from a technical perspective the S&P 500 remains in a long-term relative uptrend versus the S&P/TSX (see Chart of the Week). Therefore, until we see these stated trends reverse, we will continue to favour US to Canadian equities.

Equity Market YTD Returns (%)



Canadian Sector	TSX Weight	Recommendation
Consumer Discretionary	6.4	Overweight
Consumer Staples	3.6	Market weight
Energy	20.9	Market weight
Financials	34.8	Market weight
Health Care	5.4	Underweight
Industrials	8.1	Overweight
Information Technology	2.4	Overweight
Materials	11.1	Underweight
Telecom	4.7	Market weight
Utilities	2.1	Underweight

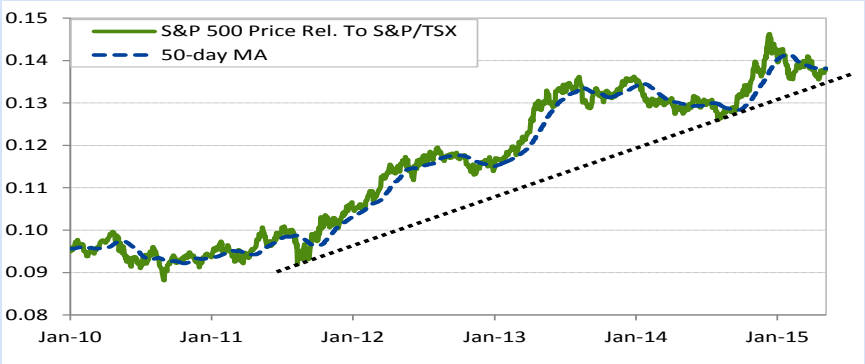
Technical Considerations	Level	Reading
S&P/TSX Composite	15,161.3	
50-DMA	15,120.6	Uptrend
200-DMA	14,931.3	Uptrend
RSI (14-day)	42.8	Neutral



Source: Bloomberg, Raymond James Ltd.

Chart of the Week

The S&P 500 Remains In A Long-term Relative Uptrend Versus The S&P/TSX



Source: Bloomberg, Raymond James Ltd.

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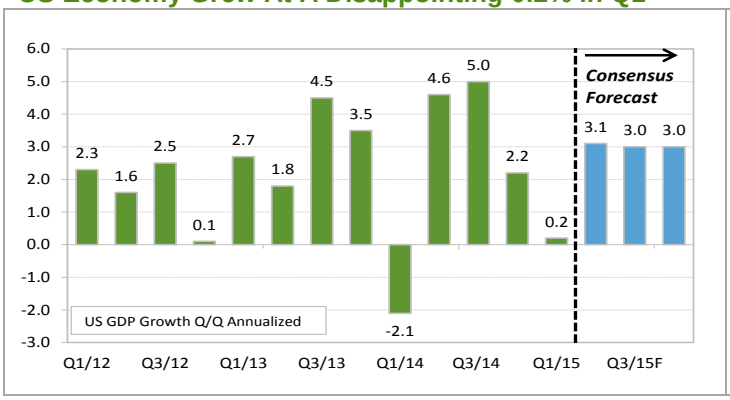
Q1/15 US GDP Update

The first estimate of Q1/15 US GDP was released last week and it showed that the US economy stalled in the quarter, posting a disappointing 0.2% annualized growth rate and coming in below expectations of 1%. Positive contributions to growth came from personal consumption expenditures and inventories which rose 1.9% and 0.7%, respectively. Detractors from growth were business fixed investment (oil & gas drilling activity was a major drag on investment), government spending and net exports which declined 3.4%, 0.6% and 1.2%, respectively. This is the first estimate for Q1, with the next reading on May 29. We expect the second estimate to be revised lower; possibly registering a negative print for the quarter, following the poor March trade deficit numbers released this week. The US trade deficit widened in March to -$51.4 bln as imports rose at a higher rate than exports. In Economics 101 we learned that GDP = consumption + investment + government spending + net exports. As imports outstrip exports this results in a drag on economic growth, and as such, we see the potential for negative revisions to Q1/15 GDP.

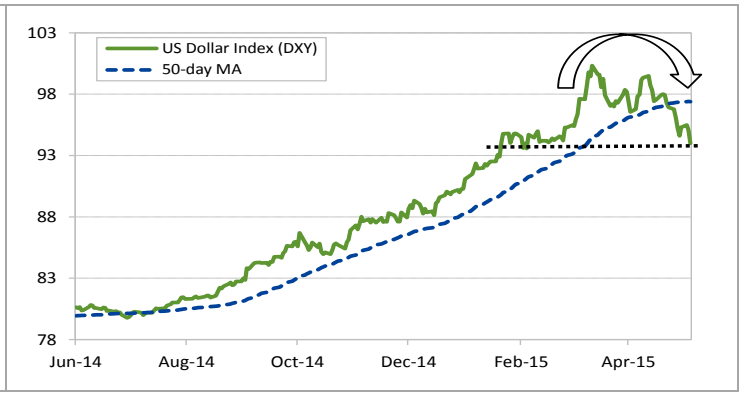
The weak GDP report sums up the weak economic momentum seen over much of the quarter for the US economy. This weakness has significant implications for US Federal Reserve (Fed) monetary policy, which has led to dramatic moves across the bond, currency and commodity markets in recent weeks. For example, the US Dollar Index has declined 6% since April while the WTI oil price was up over 20% over this period.

We believe US economic growth will trough soon and begin to improve through the summer. As we've discussed in recent publications, this trend of a weak Q1 followed by strength through the summer has been prominent in recent years. Additionally, we believe the cold winter and the US west coast port shutdown likely weighed on economic activity over the quarter. If correct in our reacceleration call, this should push the Fed to hike rates in H2/15, which should drive further US dollar strength. However, if growth continues to slow, then the Fed is likely to delay their tightening. In this scenario, the US dollar would likely drop having significant ramifications for the Canadian markets. First, a decline in the US dollar could provide a boost to commodity prices, helping parts of our economy and in turn, our heavy resource-based stock market. Second, it would impact Canadian returns on US-dollar held investments such as stocks and bonds. We've favoured the US stock market for some time, in part driven by our call for a continued appreciating US currency. Therefore, is it time to revisit our CAD/US call?

US Economy Grew At A Disappointing 0.2% in Q1



US Dollar Rolls Over On Weaker US Growth



Source: Bloomberg, Raymond James Ltd.

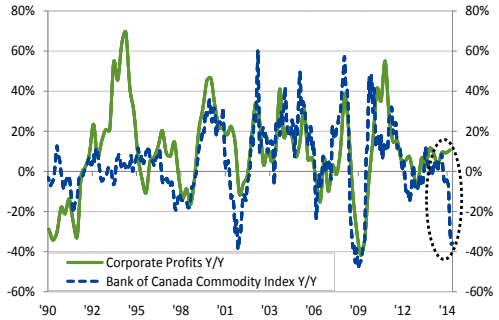
S&P 500 Or S&P/TSX?

The S&P/TSX outperformed the S&P 500 in Q1/15, but we believe this will reverse in the coming quarters, similar to last year. From our perspective the fundamentals are stronger for US equities at present, supporting our call to overweight the region. Our continued preference for US stocks is predicated on the following:

- The outlook for S&P 500 corporate earnings is much stronger than for the S&P/TSX. As illustrated in the accompanying chart (sidebar), Canadian corporate profits are signficantly impacted by commmodity prices. With commodities continuing to trend lower (CRB index is down 12% since December) this has weighed on S&P/TSX earnings expectations. While S&P 500 forward earnings estimates have declined 4% year-to-date (YTD), S&P/TSX earnings estimates have declined a sizable 12%. Below we show that S&P 500 earnings continue to trend higher relative to S&P/TSX earnings, which we believe should support continued outperformance.
- US valuations are more attractive with the S&P 500 trading at 17.7x forward earnings versus 18.8x for the S&P/TSX. This equates to a 6% premium which we believe is unwarranted given the S&P/TSX's weaker fundamentals.
- The emerging markets (EM) continue to slow, driven in large part by China's deceleration. Until we see stronger EM growth we believe commodity prices, particularly industrial metals, will remain under pressure. As such, we see this providing a significant headwind to the Canadian economy, and S&P/TSX performance.
- From a funds flow perspective, we see the US equity markets continuing to benefit from positive international fund flows. For example, in Canada $1.5 bln has flowed into US ETFs YTD – the largest of any asset category – while $1.2 bln has flowed out of Canadian-centric ETFs. We see this trend continuing among Canadian and international investors.
- Finally, from a technical perspective the S&P 500 remains in a long-term relative uptrend versus the S&P/TSX.

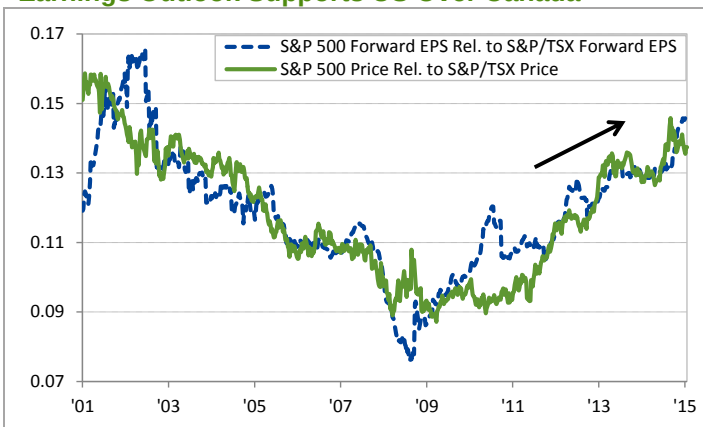
Until we see these stated trends reverse, we will continue to favour US to Canadian equities.

Canadian Corporate Profits Are Largely Driven By Commodity Prices

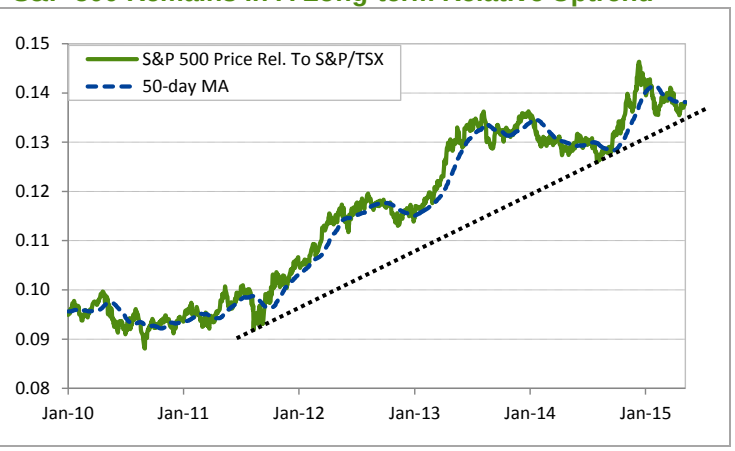


Source: Bloomberg, Raymond James Ltd.

Earnings Outlook Supports US Over Canada



S&P 500 Remains In A Long-term Relative Uptrend



Source: Bloomberg, Raymond James Ltd.

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