Weekly Trends

Private Client Solutions

Jason Castelli, CFA & Larbi Moumni, CFA

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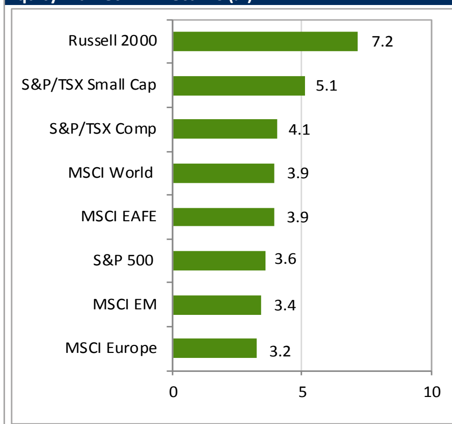
China: Canary in the Coal Mine

A resolution to the trade spat between the US and China is seen by many as the panacea for the current market rut. We're not so sure. A trade deal will certainly improve investment sentiment, but it doesn't solve the fact that growth in the world's second largest economy is decelerating.

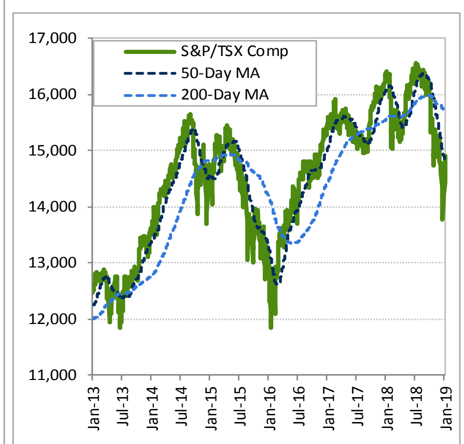
- To support the economy, government officials have taken steps to address the slowdown by lining up additional monetary and fiscal stimulus. While in the last few weeks the government announced plans to boost bond financing for private firms and cut taxes for households, it remains to be seen if the measures can reverse the trend.
- The stellar economic growth that China experienced in the 2000s was a boon to US corporations with exposure to the region. Today, that exposure can act as a headwind. Look no further than Apple's (AAPL-US) recent negative revision to its revenue guidance.
- Over the past decade, companies with exposure to China have produced solid gains relative to the S&P 500; however, we can see there are periods of underperformance (2010, 2015 and current).
- From a market timing perspective, what we find interesting from the chart above is that companies with exposure to China have lead market pullbacks by ~2 months.

Equity Market YTD Returns (%)



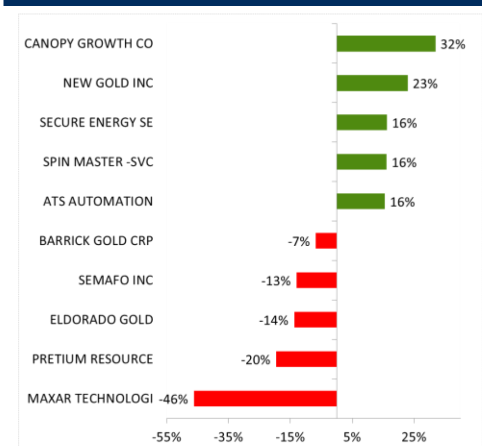
Canadian Sectors	Weight	Recommendation
Consumer Discretionary	4.3	Underweight
Consumer Staples	4.0	Market weight
Energy	18.4	Market weight
Financials	32.6	Market weight
Health Care	1.8	Underweight
Industrials	10.7	Market weight
Technology	4.0	Market weight
Materials	11.2	Market weight
Communications	5.8	Market weight
Utilities	4.0	Market weight
Real Estate	3.2	Overweight

Technical Considerations	Level	Target
S&P/TSX Composite	14,903	15,600



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

S&P/TSX Top 5 Gainers/Laggards*



S&P/TSX Market Internals

Weekly Advance	180	72%
Weekly Decline	56	22%
Advance-Decline	124	
New 52 wk high	2	1%
New 52 wk low	0	0%
No. Stocks Above 50-d	141	56%
No. Stocks Above 200-d	74	29%
Arms Weekly Index	1.09	Neutral
RSI (14-day)	59.5	Neutral
50-DMA	14,826	Uptrend
200-DMA	15,692	Downtrend

*Source: Bloomberg, Raymond James Ltd; * 5-day price return*

Raymond James Ltd. 5300-40 King St W. | Toronto ON Canada M5H 3Y2.
2200-925 West Georgia Street | Vancouver BC Canada V6C 3L2.

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A resolution to the trade spat between the US and China is seen by many as the panacea for the current market rut. We're not so sure. A trade deal will certainly improve investment sentiment, but it doesn't solve the fact that growth in the world's second largest economy is decelerating. The slowdown in China has far more to do with internal factors rather than external pressures, such as trade. Looking at China's export data, we can see that the impact of trade tariffs has had a minimal impact on China's export growth in 2018. China posted a double-digit growth in all but three months of the year. The export resiliency can likely be explained by exports/imports potential front running more punitive tariffs imposed in late September and ahead of the potential jump in the tariff rate on $200 billion of Chinese goods. Such front loading may gradually fade to some extent and the negative impacts may begin to appear in 2019. If so, this could put further downward pressure on the Chinese economy, which continues to show signs that domestic growth is struggling. The deceleration in GDP growth, which began mid-year, has gained further momentum as indicated by recent inflation data that points to deflationary risks, weak retail sales and passenger vehicles sales.

To support the economy, government officials have taken steps to address the slowdown by lining up additional monetary and fiscal stimulus. While in the last few weeks the government announced plans to boost bond financing for private firms and cut taxes for households, it remains to be seen if the measures can reverse the trend.

China Key Economic Data – Moving in the Wrong Direction

Date	China GDP (YoY)	China Industrial Production (YoY)	China Retail Sales (YoY)	China Export Trade (USD YoY)	China PPI (YoY)	China Monthly Money Supply M2 (YoY)
January-17		6.0	10.9	-6.2	5.5	11.3
February-17	6.9	6.0	10.9	7.5	6.9	10.7
March-17		6.0	10.9	-1.7	7.8	10.4
April-17		7.6	10.9	16.4	7.6	10.1
May-17	6.9	6.5	10.7	8.0	6.4	9.8
June-17		6.5	10.7	8.7	5.5	9.1
July-17		7.6	11.0	10.3	5.5	9.1
August-17	6.9	6.4	10.4	6.4	5.5	8.9
September-17		6.0	10.1	4.9	6.3	8.6
October-17		6.6	10.3	7.9	6.9	9.0
November-17	6.8	6.2	10.0	6.3	6.9	8.9
December-17		6.1	10.2	11.5	5.8	9.1
January-18		6.2	9.4	10.9	4.9	8.1
February-18	6.8	6.2	9.4	10.6	4.3	8.6
March-18		6.2	9.7	43.5	3.7	8.8
April-18		6.0	10.1	-3.0	3.1	8.2
May-18	6.7	7.0	9.4	11.9	3.4	8.3
June-18		6.8	8.5	11.9	4.1	8.3
July-18		6.0	9.0	10.7	4.7	8.0
August-18	6.5	6.0	8.8	11.6	4.6	8.5
September-18		6.1	9.0	9.5	4.1	8.2
October-18		5.8	9.2	14.4	3.6	8.3
November-18	6.5	5.9	8.6	15.6	3.3	8.0
December-18		5.4	8.1	5.4	2.7	8.0

Source: Bloomberg, Raymond James Ltd.

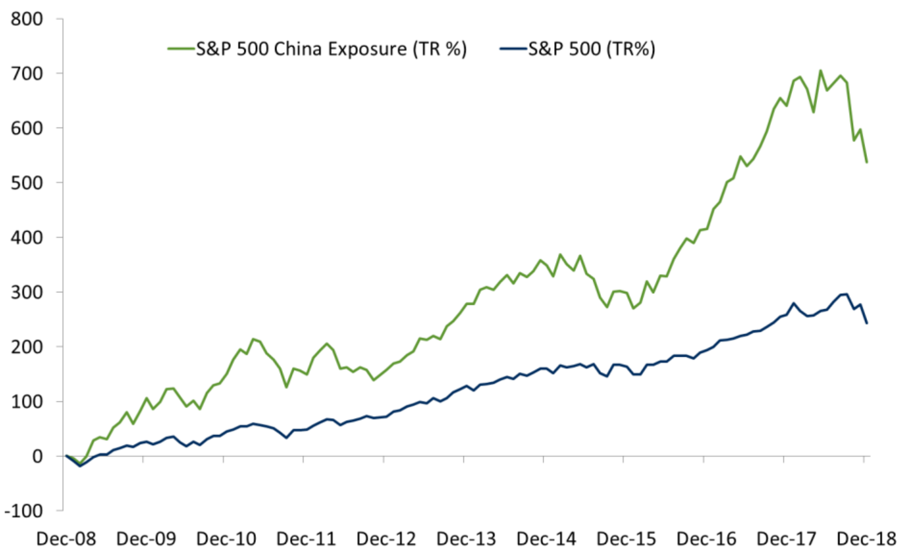
Cuts Both Ways

The stellar economic growth that China experienced in the 2000s was a boon to US corporations with exposure to the region. Today, that exposure can act as a headwind. Look no further than Apple's (AAPL-US) recent negative revision to its revenue guidance. In CEO Tim Cook's letter to shareholders he wrote:

> "*While we anticipated some challenges in key emerging markets, we did not foresee the magnitude of the economic deceleration, particularly in Greater China. In fact, most of our revenue shortfall to our guidance, and over 100% of our year-over-year worldwide revenue decline, occurred in Greater China across iPhone, Mac and iPad.*"

To illustrate how China can help or hinder, we looked at US companies with exposure to the region. Over the past decade, companies with exposure to China have produced solid gains relative to the S&P 500; however, we can see there are periods of underperformance (2010, 2015 and current). Regardless, a buy-and-hold strategy over the past ten years has been a winning trade, as a China-exposure weighted portfolio of the top 20 companies has resulted in a 537% total return compared to the S&P 500 returning 242%.

China Exposure a Winning Strategy Over the Long Haul



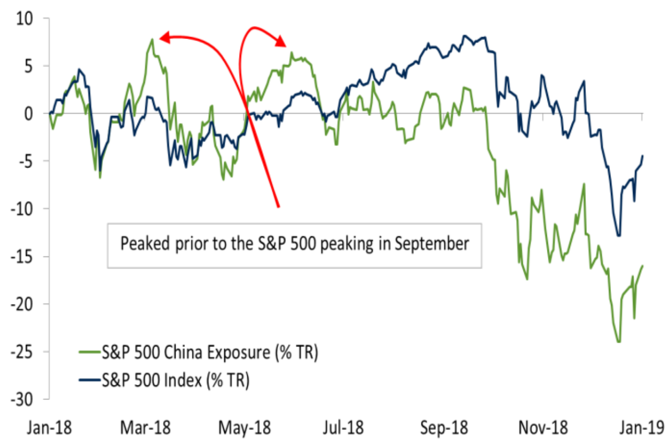
Source: Bloomberg, Raymond James Ltd.

From a market timing perspective, what we find interesting from the chart above is that companies with exposure to China have lead market pullbacks by ~2 months.

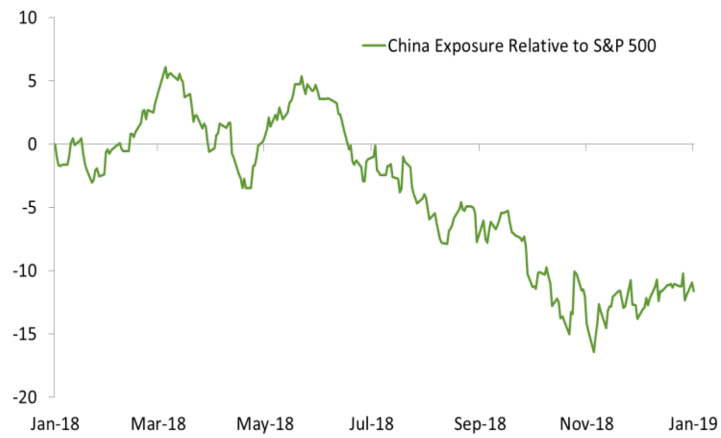
In the charts on the following page, we isolate the most recent performance, which shows companies with China exposure peaked in March, made a lower high in June followed by several weeks of underperformance relative to the S&P 500.

We've incorporated this customized index within our process to help determine inflection points in the market. We'll now be looking for a retest and a higher low, which may suggest the market has found a firmer footing.

China Exposed Co. Lead the Market Downturn…



…China Exposure Co. Relative to S&P 500



Source: Bloomberg, Raymond James Ltd.

Top 20 US Companies with China Exposure

Ticker	Name	Sector	Market Cap (mln)	Last Price	China % of Revenue	Forward P/E (x)	1Y Total Return (%)
QCOM	Qualcomm Inc	Information Technology	$ 70,257	$ 56.80	67	14.3x	-9.5
MU	Micron Technology Inc	Information Technology	$ 40,167	$ 35.91	57	4.6x	-17.1
AVGO	Broadcom Inc	Information Technology	$ 102,542	$249.52	49	11.0x	-2.0
TXN	Texas Instruments Inc	Information Technology	$ 94,133	$ 97.72	44	17.4x	-8.6
IPGP	Ipg Photonics Corp	Information Technology	$ 6,802	$128.52	44	17.2x	-49.5
MXIM	Maxim Integrated Products	Information Technology	$ 14,510	$ 51.72	36	19.2x	-0.6
AOS	Smith (A.O.) Corp	Industrials	$ 7,889	$ 46.55	35	18.1x	-25.6
WYNN	Wynn Resorts Ltd	Consumer Discretionary	$ 12,083	$111.40	34	17.1x	-29.9
AMD	Advanced Micro Devices	Information Technology	$ 19,888	$ 19.74	33	43.4x	65.1
AMAT	Applied Materials Inc	Information Technology	$ 33,197	$ 34.76	30	10.0x	-33.7
APH	Amphenol Corp-Cl A	Information Technology	$ 24,453	$ 81.82	29	22.0x	-7.7
XLNX	Xilinx Inc	Information Technology	$ 22,974	$ 90.37	26	26.0x	24.3
SWKS	Skyworks Solutions Inc	Information Technology	$ 12,413	$ 68.59	25	10.0x	-29.3
INTC	Intel Corp	Information Technology	$ 223,825	$ 48.56	24	10.9x	17.1
GLW	Corning Inc	Information Technology	$ 24,060	$ 30.35	22	16.8x	-6.7
WDC	Western Digital Corp	Information Technology	$ 11,385	$ 39.81	21	5.8x	-49.1
A	Agilent Technologies Inc	Health Care	$ 22,170	$ 69.90	21	22.9x	-0.3
TEL	Te Connectivity Ltd	Information Technology	$ 26,657	$ 78.12	20	13.7x	-19.2
AAPL	Apple Inc	Information Technology	$ 720,065	$153.80	20	12.6x	-10.4
NVDA	Nvidia Corp	Information Technology	$ 88,883	$145.23	20	20.2x	-34.9

Source: Bloomberg, Raymond James Ltd.

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