Weekly Trends

PRIVATE CLIENT SOLUTIONS

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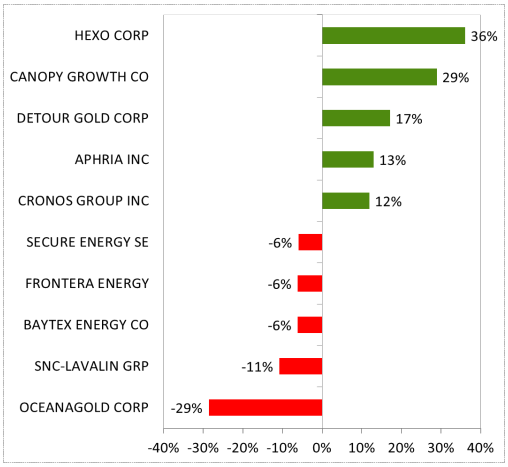
The Consumer Report

The consumer is perhaps the most important component in supporting economic growth. Both the Canadian and US economy rely heavily on consumer spending, representing ~70% of GDP. While it is clear the global economy, and to a lesser extent the US economy, has been slowing for the past 12 months and measures of manufacturing activity are in outright contraction, the consumer economy has held up remarkably well. However, we must be on the lookout for risks the slowdown is spreading to the consumer as this would be an important indication economic growth could slump further, so when we see headlines like "Rising insolvency reading in Canada raise red flags" we naturally need to do some more digging.

- According to the Office of the Superintendent of Bankruptcy, insolvencies and proposals edge up 19% yoy in September with 11,935 consumers filings. The trend has been steadily climbing after a period of relative stability. So far in 2019, there have been 102,023 consumer insolvencies, the second-most for the first nine months of a year in records dating back to 1987.
- Considering these stats and headlines one would believe Canadian consumer stocks would be struggling, so we set out this week to see if corporate Canada was indeed seeing the same type of deterioration.
- It is perplexing we're seeing some broad measures showing stress in the consumer economy given the strength in the labour market and the lack of evidence in corporate financial results. We suspect that there is a segment of society that has simply overextended themselves, which may account for the rise in bankruptcies and of course there is the regional factor at play as Alberta has experienced the largest yoy jump followed by Newfoundland and Labrador.

S&P/TSX Top 5 Gainers/Laggards*

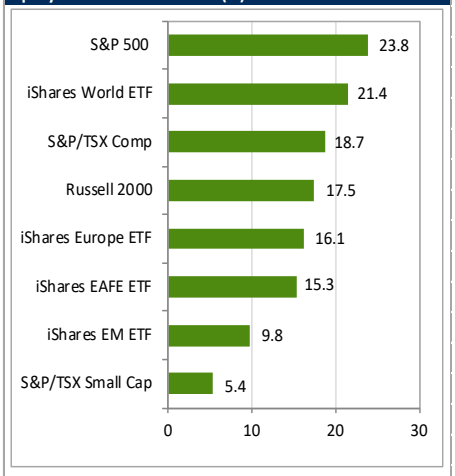


S&P/TSX Market Internals

Weekly Advance	155	62%
Weekly Decline	75	30%
Advance-Decline	80	
New 52 wk high	16	7%
New 52 wk low	3	1%
No. Stocks Above 50-d	150	60%
No. Stocks Above 200-d	154	61%
Arms Weekly Index	1.85	Neutral
RSI (14-day)	74.7	Overbought
50-DMA	16,642	Uptrend
200-DMA	16,378	Uptrend

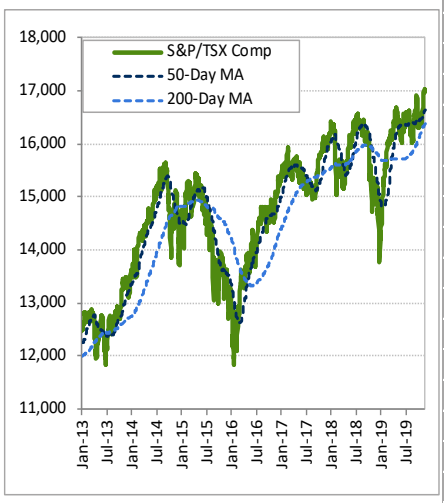
*Source: Bloomberg, Raymond James Ltd; * 5-day price return*

Equity Market YTD Returns (%)



Canadian Sectors	Weight	Recommendation
Consumer Discretionary	4.2	Underweight
Consumer Staples	3.9	Overweight
Energy	16.4	Underweight
Financials	33.1	Overweight
Health Care	1.3	Underweight
Industrials	11.2	Underweight
Technology	5.2	Market weight
Materials	10.9	Market weight
Communications	5.5	Market weight
Utilities	4.7	Market weight
Real Estate	3.5	Overweight

Technical Considerations	Level	YE Target
S&P/TSX Composite	16,999	15,600



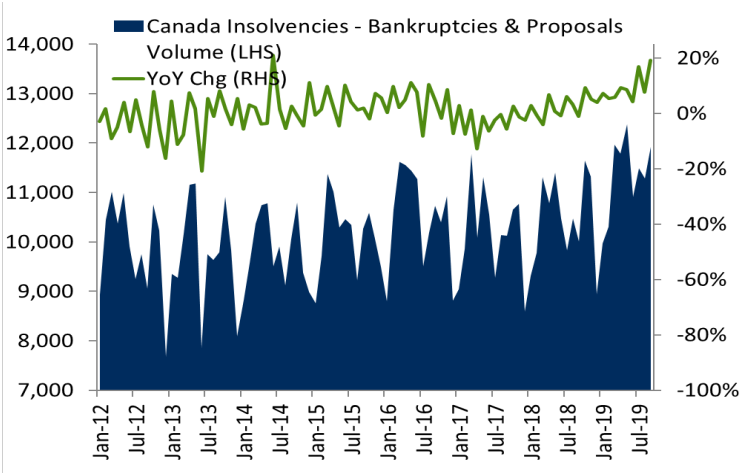
Source: Bloomberg, Raymond James Ltd.

Sectors are based on Bloomberg classifications

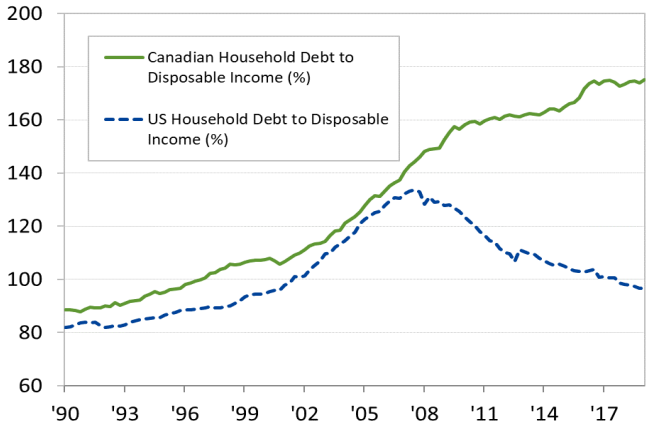
The consumer is perhaps the most important component in supporting economic growth. Both the Canadian and US economy rely heavily on consumer spending, representing ~70% of GDP. While it is clear the global economy, and to a lesser extent the US economy, has been slowing for the past 12 months and measures of manufacturing activity are in outright contraction, the consumer economy has held up remarkably well. However, we must be on the lookout for risks the slowdown is spreading to the consumer as this would be an important indication economic growth could slump further, so when we see headlines like "Rising insolvency reading in Canada raise red flags" we naturally need to do some more digging.

Over the past few months there has been no shortage of dire headlines pointing to a stressed out Canadian consumer. Most recently, consumer insolvencies have risen, which is counter to the strong employment and wage data we've seen over the past few months. According to the Office of the Superintendent of Bankruptcy, insolvencies and proposals edge up 19% yoy in September with 11,935 consumers filings. The trend has been steadily climbing after a period of relative stability. So far in 2019, there have been 102,023 consumer insolvencies, the second-most for the first nine months of a year in records dating back to 1987. Every quarter we are reminded that household debt to income levels remain elevated, currently at 175% (Q2/19), but recently the household debt service ratio (measures total obligated payments of principal and interest of household disposable income) edged 0.1% higher from a quarter earlier to a record 14.9% in Q2.

Insolvencies on the Rise…



…Debt to Disposable Income Elevated



Source: Bloomberg

Considering these stats and headlines one would believe Canadian consumer stocks would be struggling, so we set out this week to see if corporate Canada was indeed seeing the same type of deterioration. In doing so we scoured through quarterly transcripts for evidence the economic malaise occurring within the manufacturing sector was spreading to the all-important consumer economy. We focused primarily on companies that have direct interaction with the Canadian consumer, as well as companies responsible for transporting consumer goods. Based on our review, the broad takeaways are as follows:

- The Canadian consumer is holding up and not showing signs of stress.
- There was evidence that the slowdown in the housing market was weighing on consumer items associated with housing.

- Business confidence is low which has restrained capital investment.
- Inventory levels are elevated due to managers getting ahead of the impact of tariffs.
- Economic conditions outside of Canada and the US are weak and negatively impacting export volumes.

In the table below we provide some of the more interesting excerpts that we found while reviewing the company transcripts. We bold and underline the most pertinent information

Company, Speaker & Business Overview	Comments
MTY Food Group (MTY-T) Eric Lefebvre, CEO & Director *Quick-service and causal dining restaurants*	"It was a pretty steady quarter in Q3. Sometimes we have one or two good months and one or two bad months in a quarter and we aggregate the results. In this case, it was pretty steady. The three months were very similar. **So, we didn't see any major shifts in how the consumers are behaving.**" "… I don't know what October and November are going to have in store for us, but it seems pretty steady at the moment. I'm not seeing any major shifts in how the consumers are behaving one way or another."
Sleep Country (ZZZ-T) David Friesema, CEO *Retail of mattress and accessories*	"So as I said on the last question it was – of the quarter we had July and September were stronger where August wasn't. And interestingly enough what we've been talking about for quite a while has been the correlation between our business and consumer confidence. And if you'll notice that tracked quite nicely with the way consumer confidence is unfolding. **We also do see anomalies region over region and there is nothing new there**."
Richelieu Hardware (RCH-T) Ricard Lord, President, CEO & Director *Wholesale specialty hardware*	The **softness in the third quarter was felt pretty much all across Canada**. But, like we said, it's very – more importantly in the Atlantic provinces and also in Alberta.
Aritzia (ATZ-T) Brian Hill, CEO *Apparel and accessories*	"**We're not seeing any price resistance at all and shopping resistance at all.** We're just seeing the sort of continued shift from retail and bricks and mortar to eCommerce."
Canadian Tire (CTC.A-T) Stephen Wetmore, CEO Dean McCann, CFO *General merchandise retailer*	"Continued great performance from Financial Services in both GAAR growth at 7% and in earnings growth, both of which are on track for the year **with no signs from our data on a weakening economy or credit card portfolio.**" "Our **credit risk and aging metrics remained healthy** and stable with PD2+ flat versus last year and better than planned. The 6% write-off rate is right on plan and as expected given the strong growth in active accounts we experienced in 2018."
Empire Co. (EMP.A-T) Michael Medline, President, CEO & Director *Food retailing*	"But **we're not seeing anything as of this point out in the market that would indicate consumer malaise or over worry.** Like everyone out there, we're concerned about some of the things we're seeing on the horizon and we certainly hope that there won't be a recession, because that could cost people jobs."
Cargojet (CJT-T) Jamie Porteous, EVP & CCO *Air cargo transportation services*	"… if you looked at the e-Commerce segment of our business it's growing at a significant double-digit growth rates year-over-year, which we're really excited about. …If I looked at it or asked our **traditional B2B customers on our core overnight network in Canada, I would think that the demand is somewhat soft, a little bit muted, year-over-year particularly going into the summer of 2019.** And then thirdly and most significantly, if I looked at our international cargo business, which includes both some scheduled international flying that we do and business we receive on part of our domestic network from international airlines that we have commercial interline agreements with, that business is down significantly. Particularly, the international cargo side and I think if you look at some recent IATA statistics, you would see that international air cargo demand is down, probably 12% to 15% and we're seeing that and more on some of our international routes."

Air Canada (AC-T) Calin Rovinescu, President & CEO *Airline transportation services*	"However, in our particular case, **we have seen extremely attractive and bullish passenger market other than in the areas that Lucie pointed out, which include pockets of instability like in China and Hong Kong**, and those were, of course, influenced by other factors…So, we have seen this year a disconnect between demand on the cargo side and demand on the passenger side other than in those pockets. So, we're not reading into, if your question is, should we be reading the indicators coming out of the cargo business as being indicators of a coming recession, we're not reading that into our demand curve for 2020."
TFI International (TFII-T) Alan Bedard, Chairman, President & CEO *Freight transportation and logistics services*	"We see not so much pressure on rates, but we see a little bit of pressure on volume for freight the environment. And like I said earlier, **October has not been the normal October that we normally see. But when we read about the general economy in the US or in Canada, we're confident that this situation probably will resolve in 2020.** But like you said, probably first six months is going to be not so good, maybe the back half of 2020 will probably be much better." "I thought that October we would start to see back to normal freight environment, but we're not seeing that yet. So, I mean, maybe November will change the trend or maybe it's going to have to go into 2020. We don't know yet, but what we're seeing is still a soft environment. And if you look at the guys that came out this year, so far, in Q3 with the U.S. TL, I mean, some of the guys are down 8%, 5%, 10% volume-wise I'm talking about. So, us, we're down also, but not so much. So, we'll see, but I'm confident that **when I look at level of inventory coming down big time versus what it was in January of 2019 versus what it is today, consumer confidence is there. The only problem we face both in Canada and US is the corporate world not investing, okay, because of all this unknown about these trade wars and different political situation right now.**"
CN Railway (CNR-T) Janet Drysdale, VP Financial Planning *Rail and related transportation business*	"We're very focused on **realigning our resources to deal with the volume reality that we are facing.** And as quickly as we are acting though, I think it's important to remember that some of these cost takeout efforts do have a little bit of a lag time. So, the volumes always come down a little bit faster than the cost, but we certainly remain focused on making sure that we get our resources lined up to the new volume that we're seeing." I think there has been a lot of time related distortions in intermodal this year that most people are aware of in the context of freight moving forward, trying to beat tariff, tariffs coming on, tariffs coming off. So, we are continuing to see blank sailings. They appear to be having the intended effect and we are slowly seeing some of those ocean freight rates come up, but there is **still a lot of inventory out there to draw down on. And certainly, the volatility with respect to the broader geopolitical trade issues continues. So, it's increasingly a difficult market to call.** But again we have a very strong franchise when it comes to overseas intermodal
CP Railway (CP-T) John Brooks, Chief Marking Officer & EVP *Rail and related transportation business*	"The markets are performing generally well, so **those retail spaces have been – frankly have held in pretty well for us**. I'm not expecting big things in terms of a big or maybe normal peak as we have seen in the past. But certainly, our transload business in the domestic space has picked up over the last few weeks, and I think we're fairly optimistic that that's going to continue in the fall here."

Source: Factset, Company transcripts

It is perplexing we're seeing some broad measures showing stress in the consumer economy given the strength in the labour market and the lack of evidence in corporate financial results. We suspect that there is a segment of society that has simply overextended themselves, which may account for the rise in bankruptcies and of course there is the regional factor at play as Alberta has experienced the largest yoy jump followed by Newfoundland and Labrador. Nonetheless, there is no doubt many Canadians have limited flexibility to deal with adverse financial shocks given the elevated debt levels, but we suspect corporate Canada has not seen the deterioration in demand because credit remains readily available allowing Canadians to maintain spending habits. Access to credit has always been a key pillar for the consumer, even more so today in our overly leveraged consumer society.

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