Weekly Trends

PRIVATE CLIENT SOLUTIONS

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September 13, 2019

Back to School

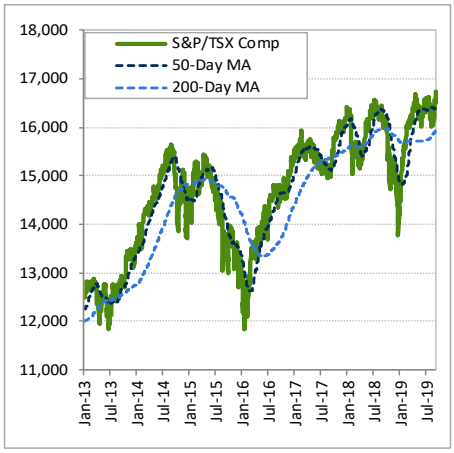
Yet another school year is upon us and for parents of young children it is back to the regular routine of shuttling the kids to and from their activities. As we get back into the swing of things it is worthwhile to review some of the more significant events that occurred over the past few weeks.

- The monetary policy pivot that began earlier this year was cemented this summer with the Fed cutting the fed funds rate by 25 bps and the central bank is on track to cut rates another 50 bps by the end of the year.
- On both sides of the border, employment and wage gains have been resilient.
- Thanks in part to the employment picture, the consumer economy is performing well.
- Last week the S&P 500 resolved its month-long period of indecision, breaking out to the upside with market breadth confirming the move.
- Much of the US and Canadian yield curves have inverted this year and one of the more closely watched spreads (US 2-10) inverted briefly in August, the first time since 2007. We discussed this at length in our Monthly *Insights & Strategies: Inversion Diversions.*
- Globally, we are seeing a pronounced slowdown in manufacturing activity and most recently US ISM manufacturing slipped below 50 for the first time since January 2016.
- Apart from global trade pressures, Brexit and tensions in the Gulf remain at the forefront of geopolitical risks.

Equity Market YTD Returns (%)

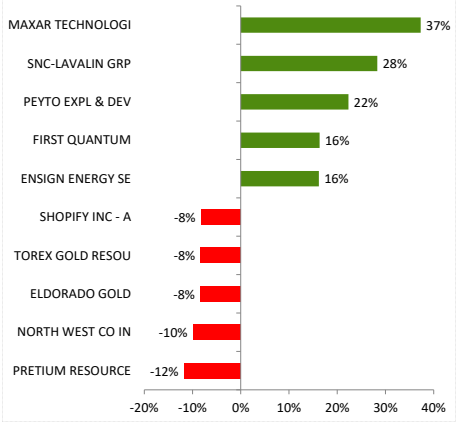
Canadian Sectors	Weight	Recommendation
Consumer Discretionary	4.3	Underweight
Consumer Staples	4.1	Overweight
Energy	16.5	Underweight
Financials	32.3	Overweight
Health Care	1.6	Underweight
Industrials	11.1	Market weight
Technology	5.4	Market weight
Materials	11.1	Market weight
Communications	5.6	Market weight
Utilities	4.5	Market weight
Real Estate	3.5	Market weight

Technical Considerations	Level	YE Target
S&P/TSX Composite	16,745	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	150	60%
Weekly Decline	85	34%
Advance-Decline	65	
New 52 wk high	7	3%
New 52 wk low	1	0%
No. Stocks Above 50-d	145	58%
No. Stocks Above 200-d	156	62%
Arms Weekly Index	0.87	Neutral
RSI (14-day)	62.1	Neutral
50-DMA	16,404	Uptrend
200-DMA	15,948	Uptrend

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

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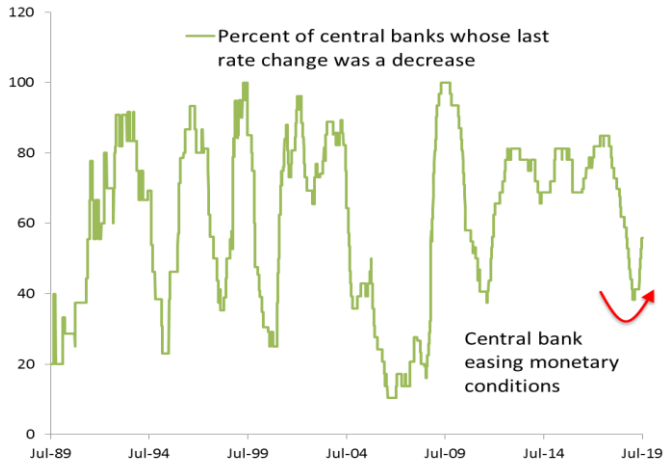
Back to School

Yet another school year is upon us and for parents of young children it is back to the regular routine of shuttling the kids to and from their activities. As we get back into the swing of things it is worthwhile to review some of the more significant events that occurred over the past few weeks. Not surprisingly, a lot has happened over the past month, but at the same time nothing has changed. If you walked out of the office at the beginning of August, the S&P/TSX Composite Index (S&P/TSX) was trading at 16,377; today the Canadian market is little changed hovering a couple hundred points higher. We suppose the same thing could be said over one full year as the S&P/TSX has gained just 3.5%, which could be hard to imagine considering the numerous headlines weighing on sentiment. We think this is an important point worth emphasising: headlines often create noise and sometimes cause us to act counter to our long-term goals. Nonetheless, the past few weeks have given us a few more data points to think about within the context of our broader outlook for the markets.

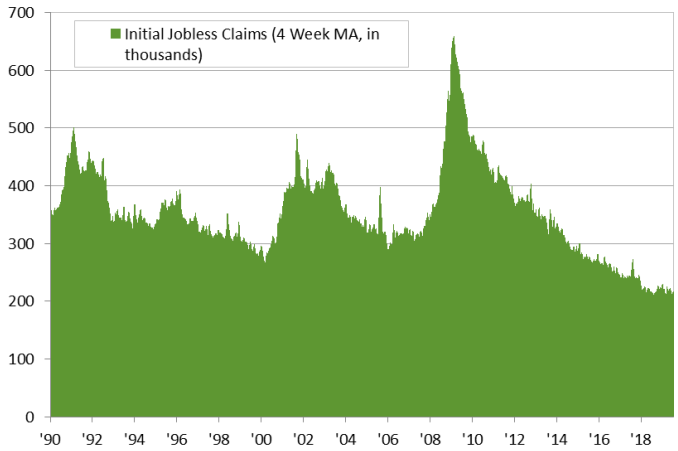
Good News

- **Central banks to the rescue.** The monetary policy pivot that began earlier this year was cemented this summer with the Fed cutting the fed funds rate by 25 bps and the central bank is on track to cut rates another 50 bps by the end of the year. Just this week, the ECB cut its deposit rate and restarted its asset purchase program. China added additional stimulus this month by injecting $126 bln. As for the Bank of Canada (BoC), our central bank has managed to remain on the sidelines for the time being given a rebound in housing, stronger commodity prices and modest employment gains. Nonetheless, the BoC is anticipated to follow the easing trend within the next 6 to 12 months. The probability of a rate cut within the next 6 months stands at 48%.
- **Employment gains.** On both sides of the border, employment and wage gains have been resilient. While most employment data is backwards looking, the forward looking indicators such as jobless claims remain low.

Central Bank Easing



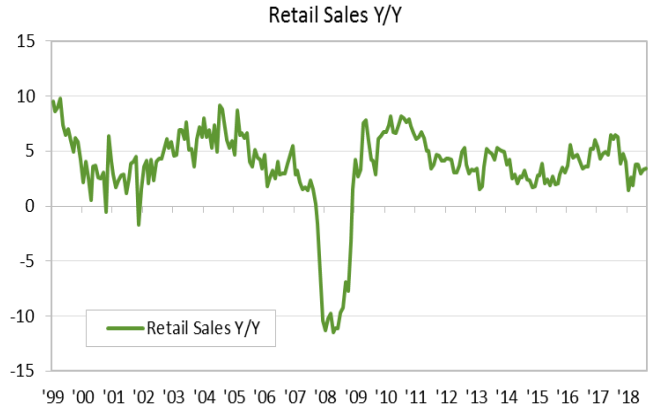
US Weekly Jobless Claims



Source: Bloomberg, Raymond James Ltd.

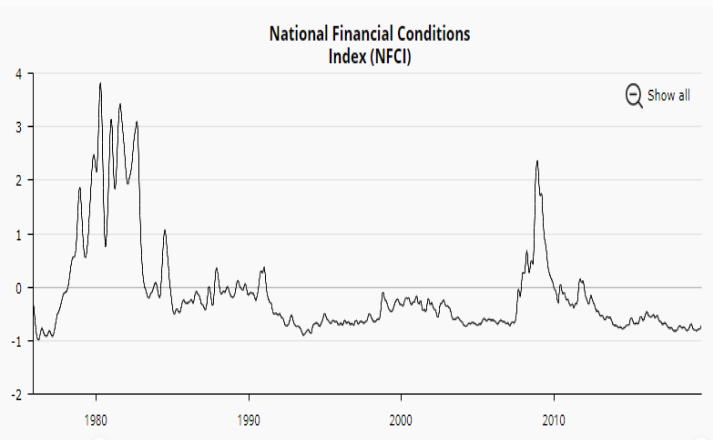
- **Consumer remains healthy.** Thanks in part to the employment picture, the consumer economy is performing well. This is particularly important given the consumer represents ~70% of GDP in both Canada and the US. Retail sales have recovered from their December lows and grew by 3.4% yoy in July. US ISM non-manufacturing remains in healthy expansion territory, expanding to 56.4 in August, rebounding from a three-month low of 53.7 in the previous month. New orders and business activity both saw notable pickups, which bodes well for future activity.
- **Financial conditions remain loose.** Credit is the engine that drives the modern economy. Typically, one of the precursors of a recession is a tightening in credit conditions, which is not the case today. According to the Federal Reserve Bank of Chicago, the national financial conditions index remains well below levels associated with recessionary periods. As credit remains readily available, consumers and corporations can continue to borrow and consume. Another measure of the availability of credit is high yield debt relative to investment grade. While the measure has widened recently, mostly due to weakness in the energy space, spreads have not reached worrying levels nor have spreads widened much for non-energy related industries.

US Retail Sales Bounce of December Low



Source: Bloomberg, Raymond James Ltd.

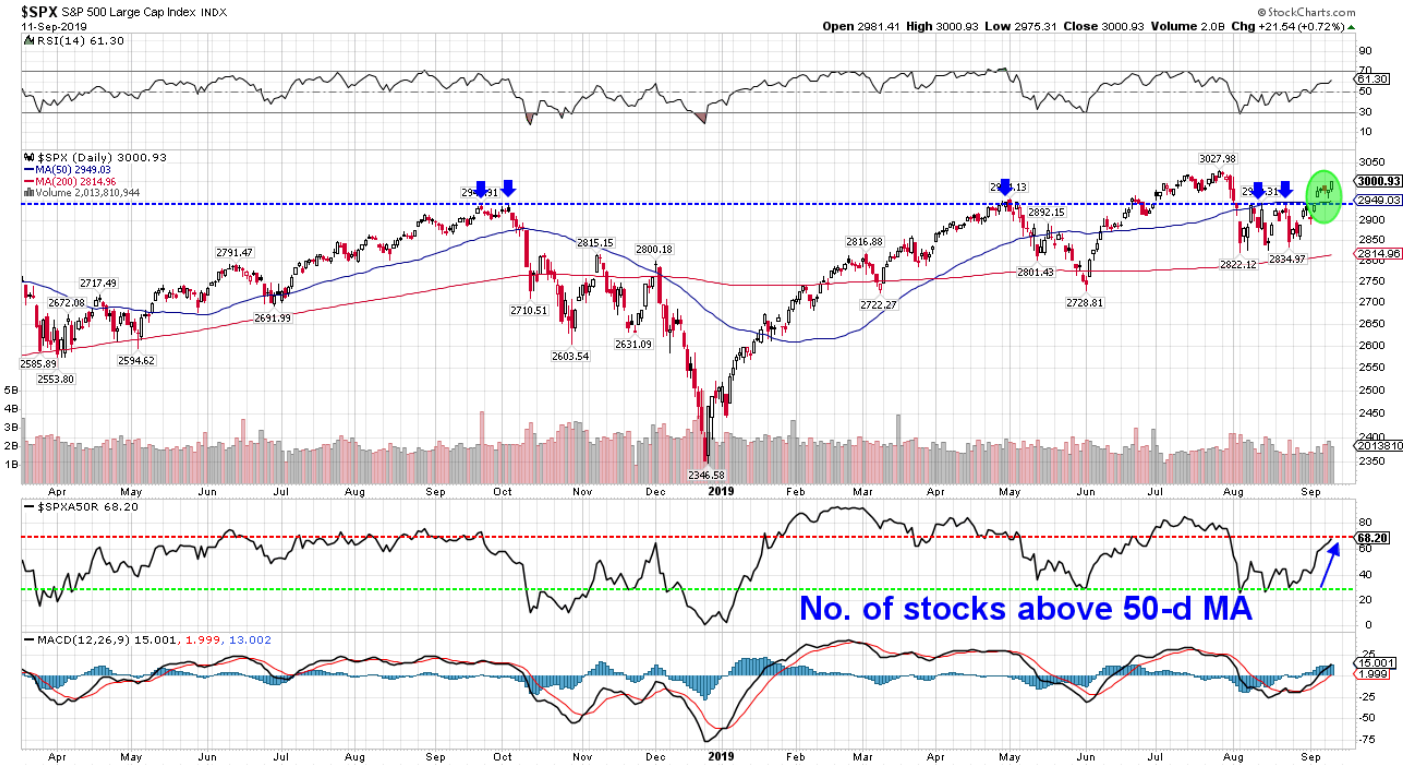
US Financial Conditions Remain Accommodative



Source: Federal Reserve Bank of Chicago

- **US technical picture remains supportive.** Last week the S&P 500 resolved its month-long period of indecision, breaking out to the upside with market breadth confirming the move. The number of stocks above the 50-day moving average jumped and the cumulative advance-decline has trended higher with the market move. This week we witnessed a notable factor rotation into value stocks (particularly energy and financials) and, while a few days do not make a trend, the shift in style is something to monitor and a potential harbinger of better things to come. The supportive technical picture is pointing to the S&P 500 attempting to overtake its all-time high of 3,027, assuming no hasty trade-related headlines derail the markets.

S&P 500 Breaks Higher on Good Breadth

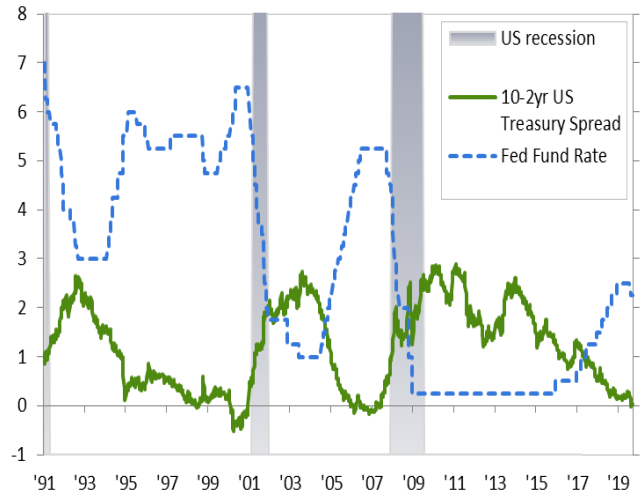


Source: stockcharts.com, Raymond James Ltd.

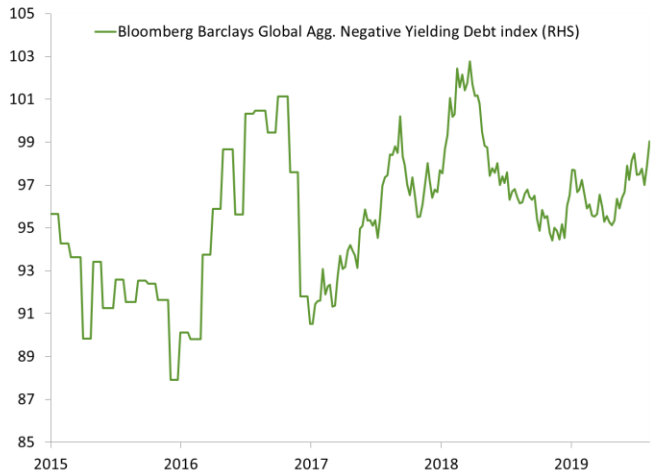
Bad News

- **Yield curve inversion.** Much of the US and Canadian yield curves have inverted this year and one of the more closely watched spreads (US 2-10) inverted briefly in August, the first time since 2007. We discussed this at length in our Monthly *Insights & Strategies: Inversion Diversions.*
- **Going more negative.** The value of bonds trading with negative yields touched some $16 trillion, or ~27% of the market. There are only five developed markets where bond yields have not slipped into negative territory – the US, Canada, UK, Australia and New Zealand. The global push lower has dragged down yields in Canada and the US to the point that in both countries 10-year government bonds are near historic lows.

Yield Curve - US 2yr10yr Briefly Invert



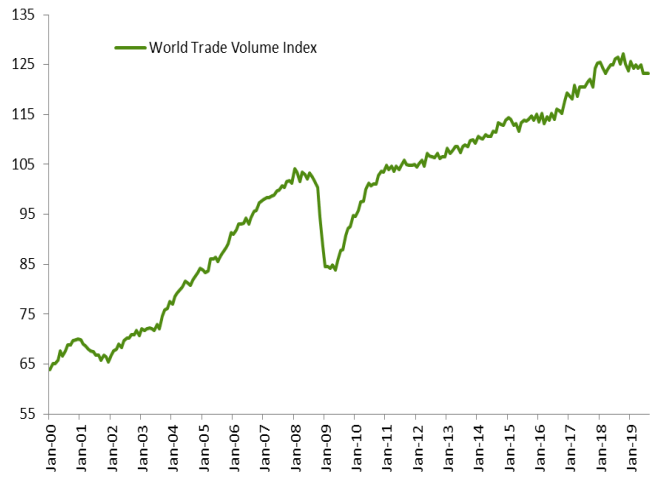
Negative Yielding Bonds on the Rise



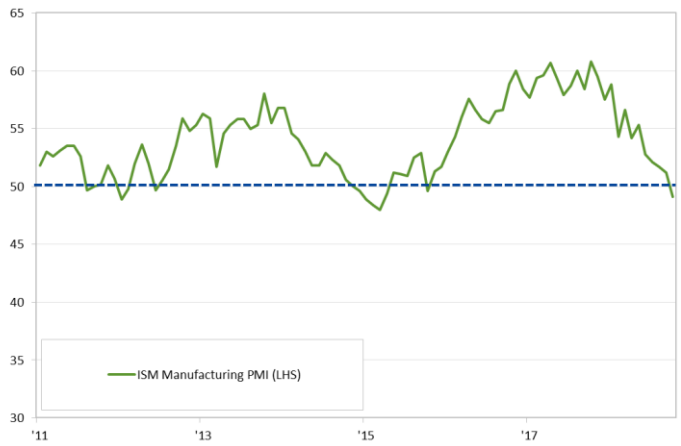
Source: Bloomberg, Raymond James Ltd.

- **Trade war and currency war.** A surprise tariff announcement by Trump in August set off a wave of market volatility deepened by the decision of the Chinese authorities to depreciate the Chinese yuan to decade-plus lows, encouraging investors to seek out alternatives in both the fixed income and precious metals markets. There have been a couple of gestures of good faith: the US delayed implementing more punitive tariffs to later this year and the Chinese have published a list of products that will be exempt from its retaliatory tariffs. The two sides have agreed to meet in Washington for a face-to-face meeting scheduled for early October.
- **Global trade volumes.** The US-China trade war appears to be weighing on more regions outside of the countries, particularly Germany, the engine of the Eurozone. German factory orders declined, business confidence hit a seven year low and GDP growth contracted in Q2/19 with the country's central bank warning of a possible recession.
- **Manufacturing data.** Globally, we are seeing a pronounced slowdown in manufacturing activity and most recently US ISM manufacturing slipped below 50 for the first time since January 2016. It remains to be seen if the weakness experienced with the manufacturing sector will spill over to the broader economy, but given manufacturing represents ~11% of GDP the contagion effect should be contained.

Global Trade Volume Stalling



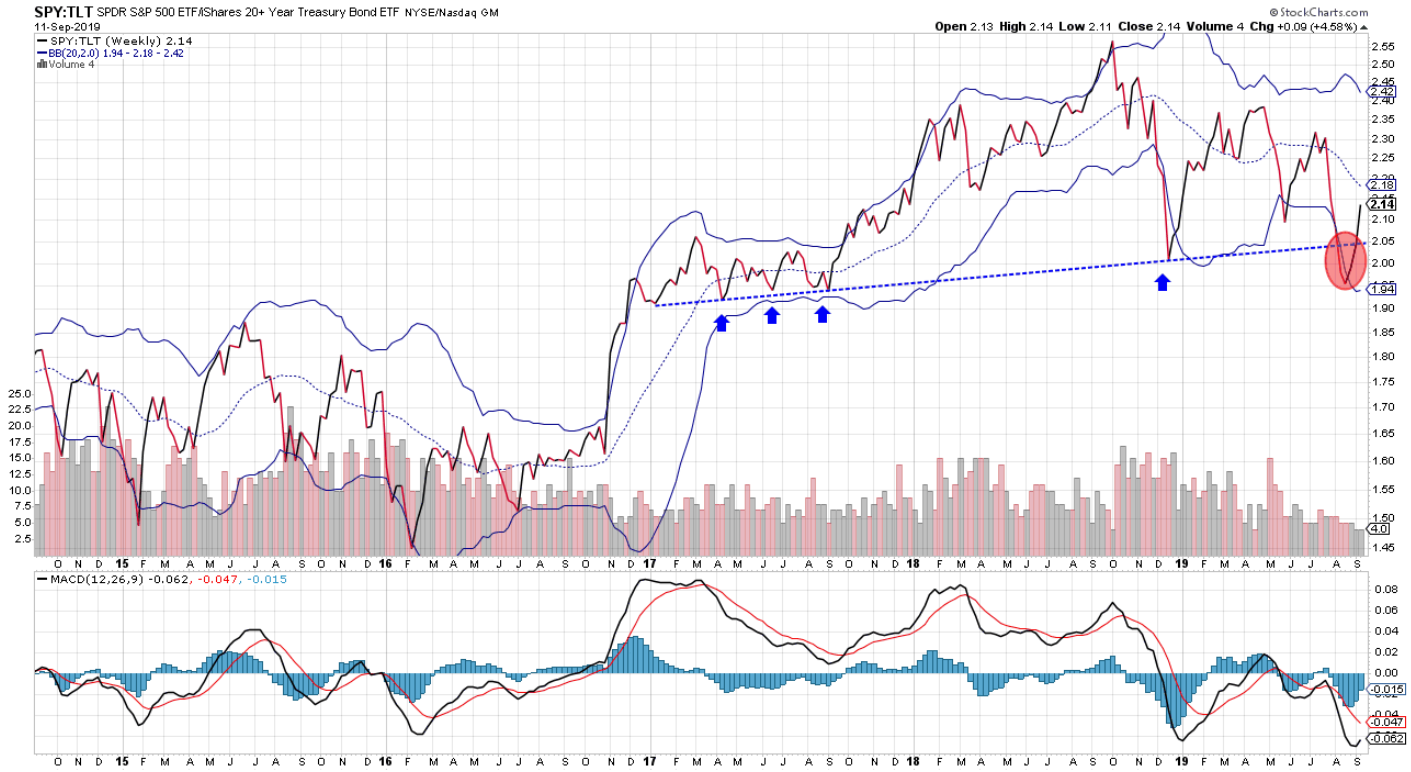
US ISM Manufacturing Slips Below 50



Source: Bloomberg, Raymond James Ltd.

- **Corporate earnings.** If markets are truly driven by earnings, this may help to explain the lack of gains we've seen over the past 12 months. Most leading economic indicators are pointing to another round of negative EPS revisions over the coming quarters.
- **Geopolitical risks.** Apart from global trade pressures, Brexit and tensions in the Gulf remain at the forefront of geopolitical risks. The UK is tumbling towards the October 31 Brexit deadline with great uncertainty. In short order, Boris Johnson managed to split his own party and lose his fragile parliamentary majority as he tries to force through a no-deal Brexit. Tensions in the Gulf, particularly between the US and Iran, have also risen in recent months.
- **Non-US Technicals.** Outside of the US, equity markets are struggling to achieve new highs. Looking at intermarket behavior, there are some key levels we must monitor. Stocks have been underperforming bonds since late last year and we saw a break below a key level at the end of August. This trend reversed in September, but we will need to pay close attention to this dynamic. The defensive rotations within equities is another area to focus on. Bond proxy sectors have outperformed cyclicals for a good portion of 2019 though September has seen a temporary reversal of the trend. We will need more evidence to confirm we have entered a new trend where cyclicals outperform defensives.

Stocks Underperforming Bonds



Source: stockcharts.com, Raymond James Ltd.

As we head into the final quarter of the year, we remain comfortable with our current recommendations to remain neutral-weighted towards equities. We can very easily view the market from the glass half-full or half-empty point of view considering the compelling evidence from both camps. For us to become more constructive, we would wish to see a continuation in the market action we've experienced in September.

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