



April 17, 2017

## World: Risk off for now

Global equities posted their first back-to-back weekly decline since the U.S. election last week. The MSCI AC is still up 4% for the year but with four declines in six weeks the benchmark is back to February levels (chart). Geopolitical concern such as Korea, Syria, Turkey, Afghanistan, European elections and U.S. trade policy are weighing down on investor sentiment.

### World: Global equities back to February levels

MSCI AC (weekly data)



Reflecting some of these concerns, yields on 10-year Treasuries have been declining in all of the main economies since mid-March. In the U.S., yields are getting dangerously close to 2.2% - an important support level (chart).

### U.S.: Treasury yields continue to decline

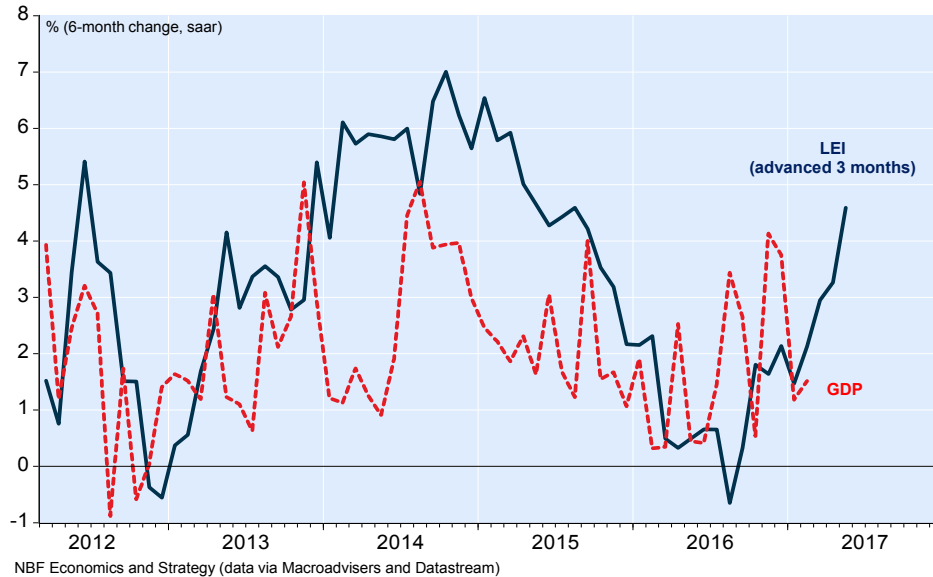
Yield on U.S. 10-year note (daily data)



Lower Treasury yields, however, can also be attributed to lower-than-expected U.S. inflation and lacklustre retail sales (down for two months in a row through March). Yes GDP is likely to be weak in Q1 (perhaps 1% or lower) but do not expect this situation to endure. As the chart below shows, the leading economic indicator computed by the Conference Board is pointing to a tangible rebound in Q2.

## U.S.: Set to rebound after a weak Q1

Monthly real GDP vs. leading economic indicator (LEI)



China also remains supportive of global growth. Its GDP data showed an increase of 6.9% in Q1 while the trade report showed a substantial rebound in volume imports in March with big rebounds for copper, petroleum and iron ore (the latter two rising to new record highs). So do not expect a collapse in commodity prices (chart).

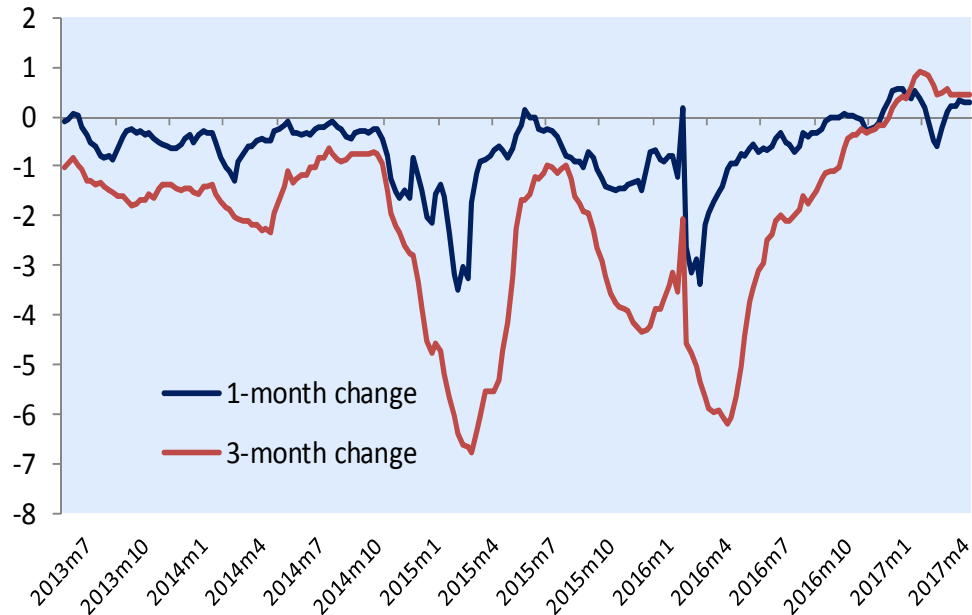
## World: No collapse for base metals

CRB metals



Interestingly, despite the risk-off sentiment, earnings are currently being revised up globally (chart). This means that the current market pullback is restoring valuation even faster. As shown, the MSCI AC is now back to trading at less than 16x forward earnings.

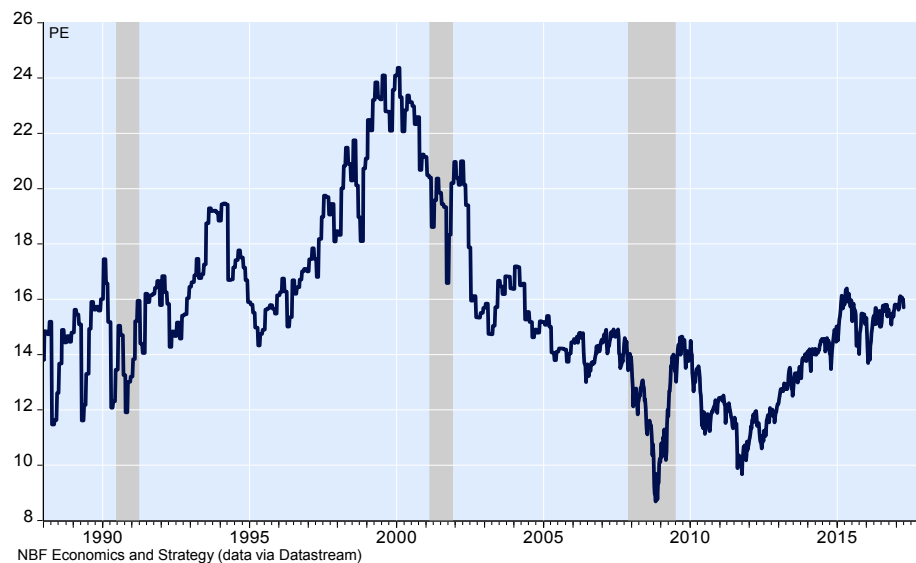
## MSCI World AC: change in 12-month forward earnings



NBF Economics and Strategy (data via Datastream)

## World: PE back below 16

12-month forward PEs

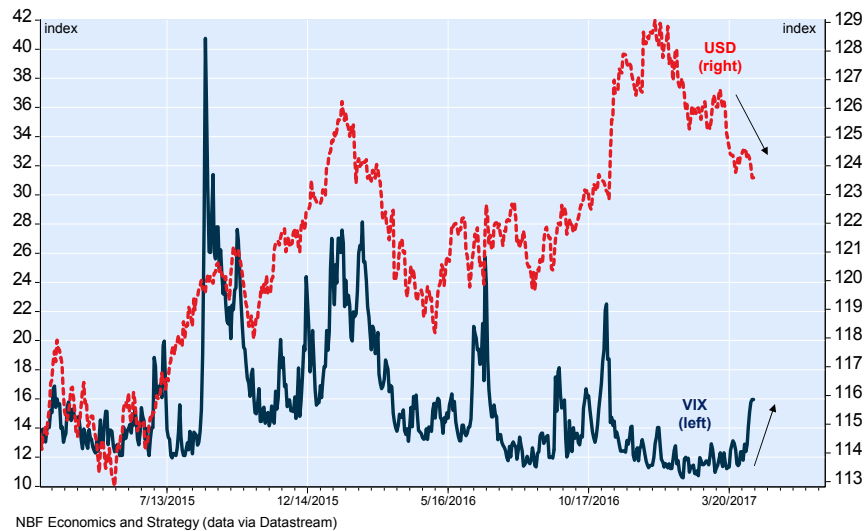


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Against this backdrop of improving earnings and prospects of faster economic growth, we do not expect a big market correction for equities unless the geopolitical situation goes haywire. Interestingly, the currency market is not behaving the way one would expect if fear was rampant. As the chart below shows, despite the recent increase in stock market volatility, the USD has actually weakened.

## World: USD not behaving like it's really risk off

U.S. broad dollar index (26 currencies) and equity volatility (CBOE VIX)



## U.S.: Q1 2017 earnings season starts well

Although we are still early in the Q1 2017 earnings season, the start has been a good one. Of the 28 companies that have published their numbers so far, 25 (or 89%) have reported earnings above analyst expectations. We thus remain on track to beat the 10% growth in EPS expected by the consensus. On the revenue side, however, things are a little soft right now: though 19 (or 67%) of companies beating expectations, the beat has been minimal (0.54%, see table). We have said many times since the start of the year that sales will be the focus of attention for investors in 2017. We are at the point in the economic cycle where sales instead of profit margins offer the key support to overall profitability. This week, 68 companies are expected to report their results.

### U.S.: Q1 2017 earnings season off to a good start

Update on S&P 500 reporting season (as of April 13, 2017)

Industry (ICB)	Reported	Sales Surprise				Earnings Surprise				
		Positive	Inline	Negative	%	Positive	Inline	Negative	%	
All Securities	28 / 498	19	0	9	0.54%	25	0	3	6.35%	
> Oil & Gas	0 / 32	0	0	0		0	0	0		
> Basic Materials	0 / 19	0	0	0		0	0	0		
> Industrials	6 / 80	3	0	3	-0.12%	4	0	2	-3.02%	
> Consumer Goods	7 / 61	3	0	4	1.85%	7	0	0	15.04%	
> Health Care	0 / 51	0	0	0		0	0	0		
> Consumer Services	7 / 72	6	0	1	-1.03%	6	0	1	1.32%	
> Telecommunications	0 / 4	0	0	0		0	0	0		
> Utilities	0 / 29	0	0	0		0	0	0		
> Financials	4 / 99	4	0	0	1.63%	4	0	0	6.00%	
> Technology	4 / 51	3	0	1	0.35%	4	0	0	9.14%	

NBF Economics and Strategy (data via Bloomberg)

## Ontario: Province vows to cool housing market

Ontario Finance Minister Charles Sousa promised to target “property scalpers” as he prepares for his April 27 Budget. The Minister is set to meet with his Federal counterpart Bill Morneau and Toronto mayor John Tory on Tuesday to discuss the state of the housing sector in the Greater Toronto Area (GTA). With affordability at a multi-year low, a number of measures have been discussed by Ontario’s politicians: taxing foreign buyers, rent control, a levy on vacant homes, increasing the inclusion rate for capital gains on real estate. **In our opinion, these policies are unlikely to have lasting impact on affordability unless the supply side of the equation is addressed.** As the table below shows, Canada’s immigration policy is a potent elixir to counteract the impact of an aging population but with more than half of the newcomers settling in Montreal, Toronto and Vancouver, housing supply is set to remain a major constraint for the foreseeable future. Unless Ottawa opts to revise down the quota for international immigrants, we need policies that will help foster a greater densification of Canada’s largest urban areas.

### Canada: Immigration remains key source of demand for housing

Growth in international immigration and impact on cities

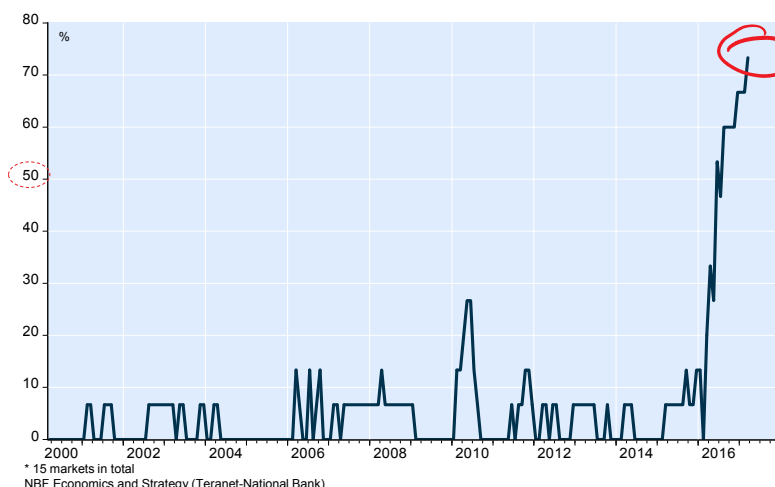
Annual growth in immigrant population (3-year average)					
Ontario	102,000				
Quebec	47,000				
Alberta	35,000				
BC	27,000				
Other provinces	39,000				
<b>Total Canada</b>	<b>250,000</b>				
QC annual population growth (3-yr avg)		ON annual population growth (3-year avg)		BC annual population growth (3-yr avg)	
Total QC	50,000	Total ON	150,000	Total BC	60,000
Greater Montreal	37,000	Greater Toronto	92,000	Greater Vancouver	34,000
of which: immigrants	<b>39,000</b> ←	of which: immigrants	<b>82,000</b> ←	of which: immigrants	<b>23,000</b> ←

- International immigration accounts for 70% of total population growth in Canada
- More than half of international immigrants settle in Toronto, Montreal and Vancouver
- Immigration accounts for virtually all of total population growth in those cities (for Montreal it exceeds 100%: 39K vs. 37K – see arrow above)

Having said this, we do not deny that demand for housing is now running ahead of fundamentals. This is particularly true for Ontario where 11 of the 15 major markets that we follow show double-digit home price inflation (chart).

### Canada: Ontario home price inflation not confined to the GTA

Share of regional markets\* in Ontario where price inflation is 10% or more year over year



Despite the appearance of speculative activity, Bank of Canada governor Stephen Poloz defended his policy of keeping the overnight rate at a multi-year low last week, arguing that “when you are looking at making an investment you think will make you 20% or more over the next 12 months, and you have to borrow the money to make that investment, is a quarter point or a half a point going to make a difference to that decision? I don’t think even a five percentage point difference would take you away from that”. WOW! Despite above-potential growth and tight labour markets, our central bank is washing its hands when it comes to using interest rates to slow housing speculation. We think this is a mistake. In our opinion, even a small increase in interest rates could help cool expectations of ever-rising home prices.

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# Morning Comment

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