WEEKLY MARKET OUTLOOK

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WEEKLY MARKET OUTLOOK - An Overview

Economics

US Stock Outperformance

The out-performance of American equities is more than just the result of Trump's tax cut, fiscal stimulus and investment spending pulled in before potential tariffs hit. There is a dynamism not seen in European companies. US companies have shrugged off risk and focused on the opportunities (solid domestic and global demand). Threat of a trade war has not slowed investment or strategic initiatives. US companies also enjoy a white-hot economy (GDP printing at 4.2% against 4.1% expectations) led by consumer optimism (highest since 2000) and business confidence that is materializing into solid earnings (75% of S&P 500 beat Q2 estimates). Data shows the confidence of the current rally as consumption spending rose 3.8% while business investment increased 8.5%. With Trump, dominating the narrative over tariff there is a feeling that American companies are protected. Unlike, European companies which are under the whim of the next tweeter rant. Last week, Trump stated that the EUs proposal to eliminate auto tariffs was "not good enough". True or not, just bad news for European stocks.

In Europe, risks such as Italy's budget, Brexit, bad weather, Turkey crisis, Germany's October elections and EU political fragmentation are paralyzing. EU stocks have a higher correlation to EM risk. 10-year yields spread between Italy and Spain have blown out indicated the concern over Italy's new governments. However, the risk of an "ITexit" is low, as Fitch Rating states "highly unlikely". Yet EU companies' profit growth around 6% is not terrible. Investment remains heavy in defensive while selling cyclical stocks. Meanwhile, EU economic backdrop remains positive despite marginal cool down. Consumer lending and consumption is positive making the inflation outlook the bright. Euro-area inflation in August provided policy makers at the ECB with additional evidence that the economy is performing well.

While Germany, the soft spot in the industrial sector, perhaps the European Central Bank is overly dovish. However, with constricted valuations comes opportunities. As the European Central Bank begins to lift rates, financial stocks will go higher, leading to a broader rally in European shares.

Economics

The Tone Is Changing For The Loonie

Although Canadian economy is proving resilient with strong growth numbers for Q2, NAFTA trade negotiations with the US take center stage among investors. Additionally, Trump recent statement related to rejection of EU zero tariff proposal as well as his intent to impose extra $ 200 billion tariffs in Chinese imports by next week favors a global risk-off sentiment.

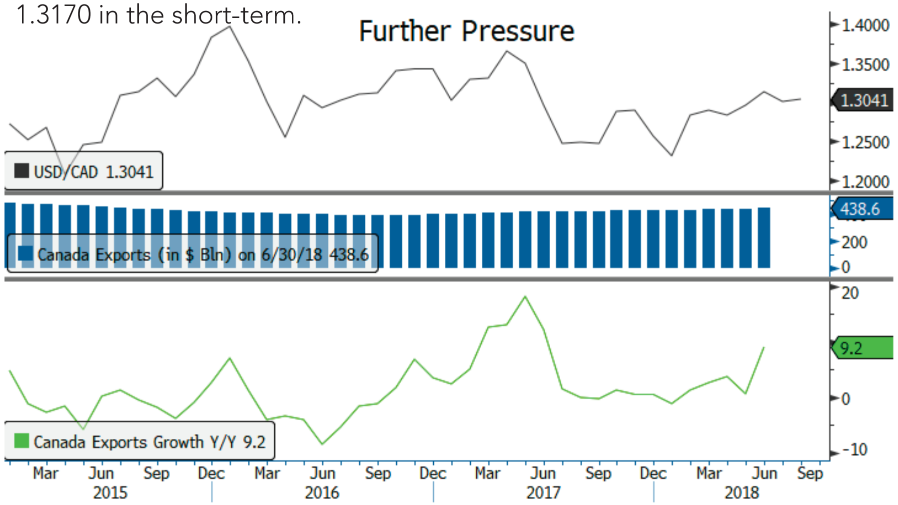
Indeed, EU – Canada talks resumed last Tuesday after Mexican Economy Minister Ildefonso Guajardo finally found an agreement with US trade representative Robert Lighthizer with regard to the rules of origin and specifically related to the North American automotive manufacturing content that should be included in cars, a topic for which Canadian authorities are globally accepting the adjustments. This actually stipulates that 75% (under NAFTA terms: 62.50%) of auto content has to be built on the territory where it is supposed to be sold in order to benefit from the zero-tariff treatment. Furthermore, between 40% - 45% of the workforce deployed for the production of the car must be paid a minimum of $16/hour, rendering Mexican production plants much less attractive than before while enforcing tougher protectionist initiatives.

For now, Canada and the US have turned to the second phase of NAFTA discussions, specifically looking at agricultural products and derived products such as dairy, poultry, eggs and wine as well as US tariffs on aluminum and steel and the broadening of dispute settlement mechanisms (initially limited to regulated industries such as energy, IT and Telco).

But as last Friday deadline was too short, further discussions would be expected in the coming weeks, while recent statement confirms that Canada made no concession in agriculture, pushing the no-deal scenario upfront and where the Congress would not agree to extend the negotiation period by 90 days and thus ratifying auto tariffs of 25% on Canadian car imports.

Accordingly, further pressure is expected on the loonie while Canadian exports, which are highest since July 2015, are expected to lower strongly. Also, weaker Q3 GDP growth figures are therefore forecasted. Important outflow from foreign investment could also occur. In this context, the Bank of Canada is expected to maintain its policy rate unchanged at 1.50% during next week MPC (05. September 2018), as uncertainties dominate the marketplace.

Subsequently, USD/CAD is expected to bounce higher, heading along 1.3170 in the short-term.



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