The LeBlanc Report

LEBLANC GROUP

Week of July 15th, 2019

Market Overview: July 8th – July 12th, 2019

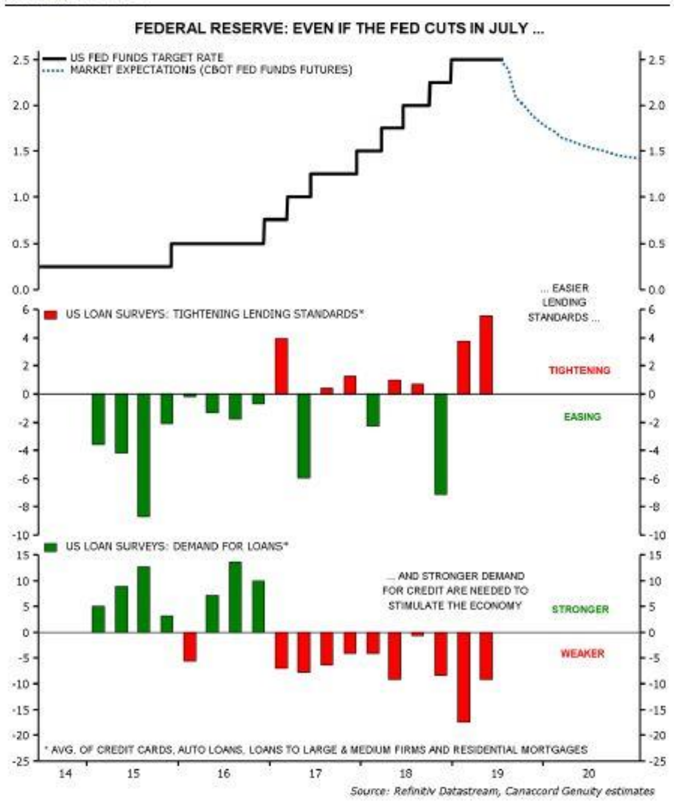
Overall Update

"Don't fight the tape, don't fight the Fed" remains the mantra ruling equity markets these days with both the S&P 500 and Dow Jones Industrials advancing above key milestones. In his testimony on Capitol Hill, Fed Chair Powell delivered the dovish spin that has been ordered by the bond market, and some more (more below). Bonds are decoding this lowering of the guard on inflation and are already up 20bps from their lows last Friday. Commodities (DBC-US) had a strong week, thanks to the strong showing in oil and gasoline prices which have been fueled by significant crude draws (9.5M/bbl) and the upcoming storm in the Gulf of Mexico. Gold is up a tad, resting from the recent surge. If our reading on the Fed is correct, gold should soon break from its long-standing negative correlation with bond yields. Elsewhere, the CDN$ continues to march higher with the Bank of Canada (BoC) boxed-in owing to surprisingly strong inflation data (especially wages). One should ask Governor Poloz if he believes the Phillips curve is dead.

Federal Reserve: Historical Data

Our focus this week is on the historical reset at the Federal Reserve whereby Jay Powell and company have decided to throw the Fed's inflation models out of the window. As such, the upcoming July Fed cut is primarily an insurance cut on inflation rather than on growth. Stating that the relationship between the slack in the economy or unemployment and inflation has gone away, the Fed is essentially willing to let the labour market run hotter and take an inflation risk in order to anchor expectations to 2%. Inflation targeting is not unprecedented at the Federal Reserve. Ben Bernanke was the first Fed Chair to institute the 2% inflation objective in January 2012. Inflation targeting also serves the Fed's growth mandate in the near term. Indeed, taking rates to the zero bound means that the U.S. commercial banks should gradually lose the 2.35% return they currently get on excess reserves parked at the Fed. As such, Jay Powell will be forcing banks to take risks and start lending again. As our *Chart of the Week* shows, U.S. banks have been holding lending standards too tight over the past two years. Now, the next question becomes what if easier lending standards do not fuel borrowing as demand has become saturated owing to the record longevity of this

Chart of the Week



economic expansion? This, however, is a topic for another day.

Economic Data

Regarding economic data, the BoC seems to be in no rush to change its stance. Despite persistent trade tensions, the performance of the Canadian economy does not call for a rate cut, said Governor Poloz. On housing, the MLS Home Price Index declined 0.6% in May from year-ago levels but homes sales advanced 6.7%. Also, housing starts came in strong at 245.7k in June. In short, improved housing affordability seems to be working its magic. In the U.S., headline inflation moderated to 1.6% Year-over-Year (YoY) in June (from 1.8%), held back by gasoline and food prices, but core inflation accelerated to 2.1% (from 2%). The Producer Price Index (PPI) offers similar readings with the headline number declining to 1.7% YoY in June (from 1.8%), with core measures coming in hotter than expected at 2.3%. Otherwise, forward-looking indicators continue to suggest risks remain tilted to the downside for the U.S. economy with the NFIB falling to 103.3 in June (from 105). Elsewhere, in Europe, industrial production declined 0.5% YoY in May (from -0.4%), but that was much ahead of consensus (-1.6%). In China, inflation came in unchanged at 2.7% YoY in June, but PPI inflation flatlined suggesting manufacturers have lost some bargaining chips. Indeed, demand remains soft considering that exports (-1.3% YoY), imports (-7.3%) and vehicle sales (-9.6%) all declined in June. But social financing statistics (+52% YoY) suggest the government remains proactive to protect growth.

Next Week's Forecast

Next week, we await inflation and retail sales statistics in Canada. In the U.S., we will focus on retail sales and industrial production to gauge the strength of the economy in a context of weakening Purchasing Managers' Index (PMIs). Otherwise, we will monitor the housing market with the National Association of Home Builders (NAHB), building permits and housing starts releases. Finally, in China, retail sales, industrial production and Q2 GDP growth are on deck[1].

Please contact LeBlanc Group at leblanc.group@cgf.com or by phone at 604.661.7839 to learn more. You can visit our website by following the link http://www.leblancgroup.ca/.

[1] July 12th, 2019. M. Roberge, Portfolio Strategy Incubator: "Weekly Market Wrap-Up".