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“By The Way”

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Good news! The embarrassment that passes for a U.S. Presidential campaign will soon be over. The polls show Clinton with a healthy lead, but I have a concern (perhaps an out of consensus one) that there are a lot of closet Trump supporters who are afraid to publicly admit it. Undecideds, independents, and people just sick of Washington and all politicians (which Hillary represents) might just hold their nose and vote for Trump once in the privacy of the voting booth. The more mainstream concern on Wall Street is that given Trump’s tendency to go off the rails, there is a risk the Democrats could sweep the Presidency and both Houses of Congress, which would allow Clinton to push through much of her agenda. The Republicans will surely lose seats, but I don’t believe enough to lose the majority position in the House of Representatives. It is however a risk and if it should occur it will be negative for stocks, particularly those of certain energy and drug companies. As an aside, there is a chance that if they do lose around 20 seats, Republican Paul Ryan may have a difficult time keeping his position as Speaker of the House, which will cause more uncertainty. Nevertheless it remains our base case that the stalemate between the two parties will continue, and that there will be no major impact on financial markets.

We track Global Purchasing Manager’s indices as a useful leading indicator of economic growth. As we noted last month these reports had been lethargic, and we were hoping to see a rebound. Such is now the case; the Markit U.S. Composite PMI came in at 54.8% - up from September’s 52.3%. The Eurozone, despite Brexit fears, also improved to 53.7%, with Germany leading the way at 55.1%. And finally, even Japan reported 51.7%, where anything above 50% indicates expansion. Let us hope this is the start of a stronger trend. Corporate earnings reports are also providing support for equity markets, as around two thirds of S&P 500 companies that have reported so far this quarter have beaten consensus estimates.

The world’s second largest economy, China, continues its efforts to transition to a more consumer based economy, without causing a recession in the process. So far, so good, albeit with large amounts of Government stimulus. Unlocking some of China’s high rate of “household savings” would provide considerable impetus to economic growth both in China and globally. While the savings rate in Canada is 3.8%, and in the U.S. 5%, China comes in at in at an incredible 38.5%. It won’t change overnight, but it is a reserve that could be tapped into at some point. A strong Chinese economy is traditionally good for commodity prices, which would be good for Canada.

It has become pretty much a given that the Fed will raise rates at the December meeting. Fixed income markets are indicating a 75% chance of such a move. Unlike last winter when the specter of higher rates sent markets tumbling, it would appear the market has already priced in such an eventuality, (or at least we are counting on it). I have long espoused the belief that central bank policies, and the attendant stimulus coming from those policies, provided a floor for markets and encouraged risk taking which moved markets higher. I am becoming less confident in that view. While I don't doubt global central banks would jump back in if financial markets were to take a steep fall, the aggressive addition of liquidity that found its way into financial assets may be a thing of the past. In such an environment, the risk to asset values in the bond market would be particularly bearish. As examples, the Fed will likely raise rates, and the European Central Bank is widely thought to be preparing to "taper" its quantitative easing. Along with a better economic outlook this change in attitude may well be coming from a change in how the Fed and ECB view future inflation. Deflation has been the main concern for central bankers over the last 5 or more years. We are now seeing something of a turn higher in price indices and inflation expectations, which would allow, or perhaps, demand, taking the foot off the accelerator. Given we are seeing high valuations in many areas of the market, it is important that we have good fundamental growth in the economy and corporate earnings, to compensate for the slowdown in monetary stimulus. As stock markets approach the ninth year of the bull market, it is becoming more and more important to be apprehensive and on the alert. But for now, we remain positive, and await a breakout to new highs to confirm that view.

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