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BNN BLOOMBERG MARKET CALL

***e*Research Corporation** is pleased to provide two excerpts from Wednesday's BNN Bloomberg Market Call Newsletter.

Set out below are the respective Market Outlook commentaries from two leading investment analysts, plus Links to their respective 45-minute video interviews.

MARKET OUTLOOK

Daniel Straus, head of ETF research and strategy at National Bank Financial
Focus: ETFs

2018 has been an eventful year so far, with long-anticipated equity market turbulence finally starting to stir, but the ETF industry keeps growing at a fast pace.

There is a record number of ETFs. The number of regular class ETFs in Canada passed the 700-count milestone. As of May 15, there were 703 ETFs in Canada.

The number of ETF providers in Canada has grown to 28. Brompton Group and Bristol Gate are the latest to join the fray but, in recent months, we have started to see small signs of consolidation. Evolve acquired Sphere and the Redwood brand of ETFs consolidated under parent company Purpose.

There is thematic ETF innovation. The Canadian ETF market is a bubbling cauldron of innovation, with new product categories and investment ideas emerging on a regular basis. In 2018, we saw the first blockchain technology ETF debut from Harvest (HBLK.TO), and now there are three on the market with more on the way. With the popularity of Horizons' Marijuana Life Sciences Index ETF (HMMJ.TO), there are now three other "strains" of product on the market: one for Junior Growers (HMJR), and two active funds, one from Purpose (MJJ), and another from Evolve (SEED.TO).

Inflow to Canadian ETFs is strong year-to-date with $8.4 billion created so far. In the USA, the pace of asset-gathering has slowed moderately due to increased volatility in the market since February but, at $94.1 billion in flows year-to-date, the numbers are still impressive. ETF assets stand at $153 billion in Canada and US$3,488 billion in the USA as of April 30.

It may be a late-cycle push, but the global economy is continuing to expand, despite some cooling in the euro area. National Bank's tactical asset allocations strategists are drawn to emerging market equities, which have had a choppy year so far despite a booming calendar 2017. The recent fortunes of emerging markets have been affected by weakness in some tech heavyweights, trade tensions, and U.S. dollar strength, but this short period of under-performance does not buck expectations. Our strategists continue to believe that emerging markets will end the year as leaders, and Canadian investors should take pause to consider them for several reasons:

- Emerging markets have grown from less than 1 per cent of world equities to 12 per cent, four times larger than the Canadian stock market.
- The emerging markets have matured from export-focused manufacturing towards local consumption and an expanding tech sector.

Emerging market indexes and the S&P/TSX composite have shown similar volatility in the past few years, and the emerging market/Canadian dollar currency pair is relatively less risky than emerging market/U.S. dollar, given that a global investor "flight to safety" would affect the Canadian dollar too.

VIDEO: Daniel Straus 45-Minute Video Interview <CTRL-CLICK> HERE

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MARKET OUTLOOK

Brian Madden, Senior Vice-President and Portfolio Manager at Goodreid Investment Counsel
Focus: Canadian Equities

Canadian stocks are recovering nicely from their earlier weakness, with the S&P/TSX Composite index up nearly 9 per cent off of its February 9 lows and now back to within 2 per cent of its all-time high.

A number of factors are involved in this resurgence, but the most impactful surely has to be the rapid growth in Canadian corporate profits. Earnings are up 23 per cent above their levels a year ago for the constituents of the S&P/TSX Composite index. The index itself is up just 3.5 per cent since that time (although it has paid a further 2.9 per cent in dividends) such that the net effect has been to compress the price-to-earnings ratio for Canadian stocks down to 17.9 times actual reported earnings from 21.3 times a year ago. With earnings forecast to grow a further 18 per cent over the coming twelve months, Canadian stocks, as represented by the S&P/TSX Composite, trade at a fairly modest 15.1 times forecast earnings.

First-quarter financial reporting shows that roughly half of Canadian companies have been exceeding consensus earnings forecasts and half have been falling short of estimates, but the aggregate earnings surprises have been about 2.3 per cent for S&P/TSX Composite members as bigger companies have been more apt to have large upside to analysts' expectations. The 2.3 per cent aggregate earnings surprise is somewhat below the recent average of 4 per cent earnings surprises, although the heavyweight banking complex will be front and centre with their earnings parade next week and the following week, and their results could add some further thrust to these figures, since the banks are well positioned to benefit from rising interest rates, a topic we recently addressed in a piece on our website.

A close second to rapid growth in corporate earnings in terms of factors explaining the renewed strength in Canadian stocks is the price of oil. Not only are the prices of major international oil blends like Brent light sweet crude and West Texas Intermediate crude up sharply year-to-date (up 17 per cent and 18 per cent, respectively), with Venezuelan oil production falling into the abyss and with Iranian sanctions imminent, but the steep discounts Canadian producers had been receiving for their production have narrowed considerably with the return to full service on TransCanada's Keystone pipeline, which had been under volume constraints for several months following a spill last fall.

The discount for Western Canadian Select crude has narrowed to around $15 per barrel from as much as $28 earlier this year. The impact of this, coupled with higher benchmark Brent and WTI

prices is difficult to overstate. For instance, Scotia Economics in mid-February estimated that the then-prevailing WCS-WTI discount was costing the Canadian energy sector $15.6 billion annually in revenue. Since the lows in the stock market (which coincided almost perfectly, within a single day, with the deepest WCS-WTI discounts), the energy sector has shone brightly after being all but left for dead since 2014. Energy stocks have risen 14.3 per cent since the market lows of February 9. This is exactly neck-and-neck with the other leader of the pack, the technology sector. Apart from the return to full service on the Keystone pipeline, a few other glimmers of hope are emerging in regards to some of the government and regulation-inflicted problems this sector has been plagued with.

First, Canada's finance minister this morning reaffirmed the federal government's commitment to advancing the Trans Mountain Express pipeline expansion project that would move crude from Alberta to tidewater in British Columbia, and ultimately onto global markets.

Secondly, Enbridge advanced a step closer towards approval of its massive $8-billion Line 3 replacement that would double oil export capacity on that line into markets in the U.S. Midwest. Finally, the global energy giants backing the $40-billion LNG Canada project on the British Columbian coast are sounding increasingly confident they will sanction a go-ahead decision and begin construction on this crucial project by the end of this year.

A third consideration in the rebound in Canadian stocks has been the more conciliatory tone that negotiators at the NAFTA table have been taking in recent months. U.S. legislative deadlines and procedures and the imperative of getting ahead of the mid-term elections in November seem to have eroded the brash and bullying leverage the Trump negotiators initially brought to bear on this file, and it is entirely possible we may see an agreement on this crucial trade policy within a matter of weeks.

As a partial offset to these three very important supports for higher stock prices, Canada is experiencing a weakening in both its housing markets and its labour markets.

In housing, resale activity, resale prices and new construction activity are all down, with weakness especially concentrated in certain cities. In some measure, the housing weakness is a function of government policies undertaken by the federal, provincial, municipal and regulatory bodies to cool down an overheated and overvalued market in several cities. These measures are now being compounded by rising interest rates, which further erodes housing affordability. Housing has a high "multiplier effect" on economic activity overall, so the slowdown in housing and the generally high levels of consumer debt may now be spilling over into other areas of consumer spending and negatively impacting employment growth. This will certainly bear watching in the coming quarters.

In jobs activity, after a torrid pace of job creation last year, Canada has suffered net job losses in two of the last four months, and net job losses year-to-date overall after the dreadful January jobs

report saw 88,000 jobs disappear - a drop that the last three months have thus far been unable to recover.

For our part, we continue to see a market of stocks, rather than a stock market. In this environment, active management is rewarded and we have added some exposure to both defensive sectors like grocery, property and casualty insurance, and gold royalties in recent months, as well as exposure to more pro-cyclical sectors, like oil, for instance. We remain mindful of the late stage of the economic cycle that we are in, but we are also unconvinced that the economy is at imminent risk of tipping into recession, given the massive U.S. fiscal stimulus boosting growth in that country, strong corporate profit growth domestically, improving terms of trade with key commodity prices back on the upswing and, at long last, signs of the political and regulatory clouds parting over the critical energy infrastructure sector, potentially opening a floodgate of new capital spending.

As such, we see good prospects for Canadian stocks to surge to fresh highs this year, and are investing accordingly.

VIDEO: Brian Madden 45-Minute Video Interview <CTRL-CLICK> HERE

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