TD Wealth

Weekly Market Update

December 14, 2015 **A Comprehensive Perspective on Markets around the World**

In This Newsletter:

- **The S&P/TSX Composite was down -4.26% last week; -12.60% YTD**
- **The S&P 500 was down -3.79% last week; -2.26% YTD**
- **Santa Clause Rally Stalls -** Last week, stocks had their worst showing since August, as new lows in oil and rising credit concerns weighted heavily on stocks. It has been a while since I have written about oil & gas as we have been mostly absent in the commodity stocks in our portfolios for the last 18 months.

Commodities started last week with renewed weakness as crude oil prices tumbled to new multi-year lows following the bearish OPEC decision, while a stronger dollar weighed on the metals. Crude oil, currently at $36.38, continued to break down, falling to near-seven-year lows as traders digested the implications of OPEC's decision to not mention a target output level following their last meeting. The fundamentals are clearly bearish right now as inventories sit at near record high and global production is still decidedly higher than corresponding global demand.

Looking ahead, the path of least resistance will remain lower until we see the fundamentals shift back in favor of the bulls, or at least get *less bearish* than things are right now. With OPEC continuing to focus on defending market share rather than supporting prices, focus will be on the new class of "swing producers." The primary one being the United States, as the forces of economics will eventually begin to correct the supply and demand imbalance through low prices running the high-cost producers out of business. Until production begins to trend lower in the US as well as other major, non-OPEC oil-producing countries like Russia and Mexico, it will be hard for the bulls to make a case. The longer oil and gas prices stay lower, the more the industry will shake out and only the fittest will survive.

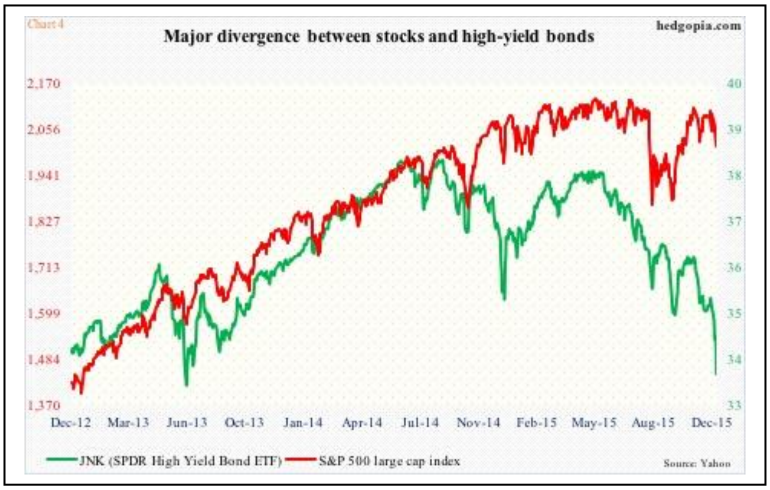
Commodity Stocks Could Be a Potential Macro Risk

Last Tuesday, Anglo American, which is the fifth largest metals miner in the world, announced they are reducing their number of employees from 150,000 down to 65,000, an 85,000 person job cut while also eliminating its dividend. Then, after the close, Kinder Morgan, a U.S. pipeline company, confirmed fears that it would cut its dividend. These cuts are confirmations of the difficulty in the industry and indicate that it is not a short term problem. With commodities plunging, it's important to understand that there are a growing number of analysts that think the commodity/natural resource industry may represent the next big macro risk to the market. It was the suspension of the Anglo American dividend that was the reason for the drop in the mining and related stocks, as a dividend cut was expected, not a total suspension.

The logical question one may be asking is, "Why are these miners a potential macro risk?"

The answer is, as usual, leverage. Commodity producers are by nature massively leveraged enterprises, as it's the leverage that gives them their returns. And, in a post financial crisis world, no one knows just how deep this leverage runs. Like the housing crisis, the concern is that these commodity producers begin to default, and then banks are left with assets that are significantly underwater (think of '07 or '08, and replace homes with metals stockpiles or unprofitable mines). This risk first materialized with Glencore back in August (that contributed to the August collapse) and again popped up with Anglo American yesterday.

In the post financial crisis world, a lot of risks get aggrandized, but there are legitimate signs that credit quality in the commodity space is a problem—the question is how big? According to the Shared National Credits Report in the U.S., bad loans are rising and we see that in the declines in the junk bonds and high yield bond markets. The index of CCC-rated bonds saw yields rise above the 2011 highs to levels last seen in July 2009. So, there is legitimate stress there. Now, the bulls will say the stress in these junky loans are contained while the bears will say that's what people said about subprime. Yet, the fact that massive global commodity companies like Glencore, Anglo American, Kinder Morgan and Rio Tinto are suffering and under stress begs the question just how rough is it for all the smaller players that do not have access to debt and equity capital?



Adding to the concerns about credit, Third Avenue Focused Credit Fund, an $800 Million High-Yield Mutual Fund, halted redemptions last week. What makes this especially interesting is that this is not a small fund. It currently has $788 million Assets-Under-Management, and in July 2014 was a $3.5 billion fund. This year, it's faced over a billion dollars in redemptions, and for good reason: It's down 27% year to date, and 13% this month. The halting of redemptions was to avoid selling bonds at "fire sale" prices according the company. While so far this is just an isolated event, the evidence is mounting that there is growing stress in the credit markets. This is something that should not be ignored.

More often than not, credit knows better and it pays to listen. Once again, credit (green line) is leading to the downside.

From a market standpoint, we have seen precipitous oil price declines weigh heavily on markets multiple times in the last 18 months and expect that to continue. The energy sector will continue to get pummeled while airlines and other transports are likely to benefit from the lower costs. Speaking of costs, as prices at the pump continue to fall the consumer should remain healthy into 2016 as discretionary income will rise with the falling cost of refined products, which will support consumer discretionary stocks.

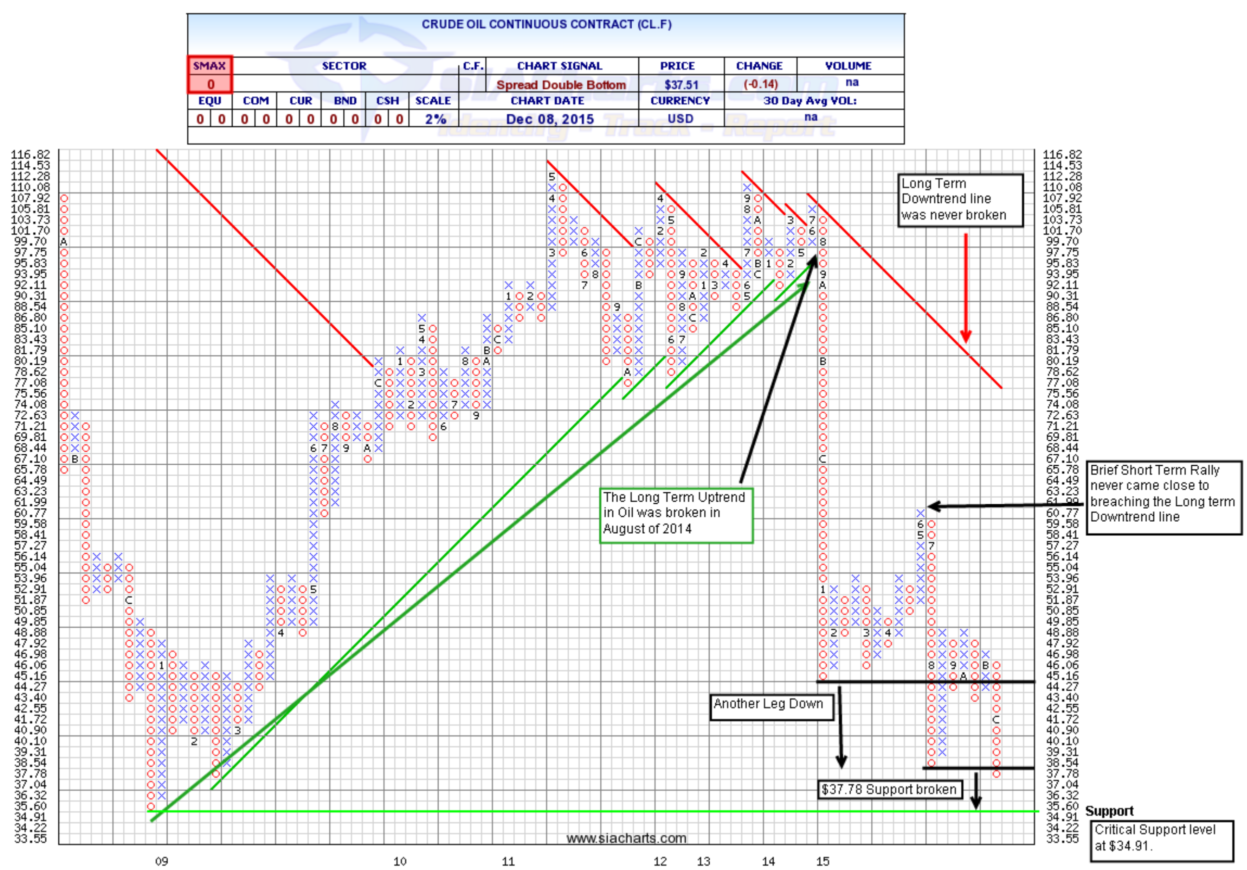
Lastly, after much anticipation and at least one false alarm, the time has finally arrived. This week the Federal Reserve is set to announce the first increase in its policy rate in over nine years. The rate increase comes amidst of a pickup in financial market volatility as concerns about global growth are set against news that supply in the oil market continues to build and OPEC is unlikely to do anything to slow it down. Concerns about global growth are nothing new and have been a mainstay of the American economic outlook for the past year. The recent bout of financial volatility is mild compared to the last round in August that caused the Fed to delay rate liftoff back in September. It also appears more concentrated in the commodity sector. As such, the Fed is more than likely to see through it. Nonetheless, the broader question about whether the decline in commodity prices is a net negative or net positive for the global economy has persisted. Even in United States, there is lingering doubt about where the gains to consumer purchasing power have gone.

CRUDE OIL (CL.F) – TECHNICAL UPDATE

The price of oil has fallen quite drastically in the past week as OPEC has decided against a cut in crude production in order to maintain market share. The latest numbers illustrate actual production was higher than the OPEC target of 30 million barrels per day production level. This coupled with non-OPEC nations such as Russia continuing to pump out record supply of crude oil continues to contribute to the worldwide supply glut of oil.

In examining the chart of Oil (CL.F), we see Oil broke its longer term uptrend line at $95.83 back in August of 2014 and continued on its precipitous decline until February of 2015. After a brief rally heading into the early summer months, we can also see the longer term downtrend line was never broken. We have continued on to lower lows in August at the $37.78 level. With the most recent weakness in the price of oil, we have now broken the August support level of $37.78; the next level of support is at the critical $34.91 level not seen since the stock market meltdown in 2008-2009. Upside resistance is now found at the $45 level.

In hindsight, what we must all consider is the longer term supply/demand relationship as dictated by our relative strength analysis. Crude Oil is still down more than 60% over the past year. The long term downtrend line was never broken during the brief rally that occurred earlier this summer. It is always important to remember there will always be the possibility of short term trading rallies in any asset class or stock such as the case with the past recent trading action of oil. Also keep in mind throughout this time period the commodity asset class had remained at the bottom of our asset class ranking list. This is a primary indicator of relative strength on an asset class level and indicates to you that money is flowing out of that asset class. It is critical to align yourselves with these changing money flows. Paying attention to the longer term trend lines and our "macro" indicator, the asset class ranking list, will help you avoid getting caught in short term trading rallies.



Source: SIA Chart

S&P/TSX COMPOSITE – TECHNICAL UPDATE

Source: SIA Charts

- **The S&P/TSX Composite was down -4.26% last week; -12.60% YTD**
- The S&P/TSX Composite is now down **-17.68%** from its high reached on September 2014, almost in bear market territory.
- Since last August, the S&P/TSX Composite was range bound between 13,000 and 14,000. Last week, we broke the range to the downside and are currently at the next support of 12,859. Continued weakness in the commodities could pressure the market down to 11,875.
- Only four sectors have shown positive returns in 2015. These include Health Care, Telecommunication, Consumer Goods and Technology.

Sorted By: Yr-To-Date (Descending) **Dec, 14 2015**

RELATIVE STRENGTH							
RANK	SECTOR/BENCHMARK	5-DAY	30-DAY	60-DAY	QTR-TO-DATE	YR-TO-DATE ↓	12-MONTH
1	Health Care	-1.15 %	-2.70 %	-12.55 %	-2.94 %	41.43 %	40.72 %
2	Telecommunicati	-3.04 %	-4.76 %	0.41 %	2.01 %	7.40 %	9.61 %
3	Consumer Goods	-1.26 %	0.45 %	-0.13 %	5.44 %	4.16 %	8.35 %
4	Technology	-1.25 %	-3.08 %	1.60 %	3.67 %	1.67 %	7.88 %
5	Industrials	-1.52 %	-3.85 %	-3.14 %	-0.81 %	-2.67 %	1.98 %
6	Financials	-2.23 %	-4.73 %	-3.42 %	-1.66 %	-5.22 %	-1.23 %
7	Utilities	-1.21 %	-5.99 %	-5.29 %	-2.55 %	-7.24 %	-3.07 %
8	Consumer Servic	-2.53 %	-5.38 %	-5.60 %	-3.76 %	-9.03 %	-4.87 %
9	Basic Materials	0.27 %	-6.06 %	-3.87 %	3.63 %	-9.85 %	-6.93 %
10	Oil & Gas	-1.06 %	-16.37 %	-16.55 %	-9.46 %	-37.05 %	-28.62 %

Source: SIA Charts

S&P 500 – TECHNICAL UPDATE:

Source: SIA Charts

- **The S&P 500 was down -3.79% last week; -2.26% YTD**
- The S&P 500 has not been able to break its previous high of 2,130 reach on May 21, 2015.
- Up until December 1st, the S&P 500 large cap index was a mere 1.5 percent off the all-time high reached in May this year. That said, the index has been going sideways since February. Merely marking time. Throughout this period, equity inflows have been lacking in strength. $37 billion moved into money-market funds in the past three weeks.
- Fewer and fewer stocks have been pushing the market higher including Apple, Microsoft, Alphabet, Amazon and Facebook. These companies are being watched closely especially as they gave back ground last week.
- Nowhere is this investor apathy more evident than in small-caps. By nature, the Russell 2000 small cap index tends to be more popular when investors are in a risk-on mode. The small cap index peaked last March and 57.8% of small cap stocks are down 20% or more.
- Only three sectors hold positive returns for the year including Technology, Health Care and Consumer.

Sorted By: Yr-To-Date (Descending) Dec, 11 2015

PERFORMANCE TABLE

RANK	SECTOR/BENCHMARK	5-DAY	30-DAY	60-DAY	QTR-TO-DATE	YR-TO-DATE ↓	12-MONTH
1	Information Technology Sector	-3.55 %	-0.29 %	3.85 %	8.06 %	6.77 %	9.48 %
2	Health Care Sector	-2.04 %	-0.12 %	-5.77 %	3.10 %	4.80 %	6.25 %
3	Consumer - Noncyclical Sector	-1.15 %	-0.80 %	1.40 %	3.71 %	3.22 %	5.09 %
4	Financial Sector	-3.22 %	-2.84 %	0.23 %	1.15 %	-0.72 %	1.13 %
5	Industrial Sector	-3.33 %	-2.59 %	-2.12 %	1.98 %	-4.20 %	-1.08 %
6	Consumer - Cyclical Sector	-2.16 %	-4.05 %	-5.99 %	-2.64 %	-4.63 %	-2.47 %
7	Telecom Sector	-4.33 %	-6.03 %	-2.79 %	1.49 %	-6.12 %	-3.00 %
8	Basic Materials Sector	-3.19 %	-3.12 %	-1.54 %	2.70 %	-8.04 %	-5.39 %
9	Utilities Sector	-1.78 %	-5.05 %	-3.24 %	-2.74 %	-10.08 %	-7.35 %
10	Energy Sector	-3.94 %	-7.00 %	-6.51 %	-1.86 %	-16.16 %	-12.55 %

Source: SIA Charts

GLOBAL NEWS – Around the World at a Glance

CANADA:

- The Bank of Canada is applying lessons from the global financial crisis as it updates its framework for the use of unconventional monetary policy measures, Governor Stephen Poloz said Tuesday in a speech to the Empire Club of Canada. In the unlikely event that the economy was hit with another major negative shock, the Bank could implement unconventional monetary policy measures. These include forward guidance on the future path of its policy rate, stimulating the economy through large-scale asset purchases (commonly referred to as quantitative easing), funding to ensure that credit is available to key economic sectors, and moving its policy rate below zero to encourage spending. **The Bank now estimates that the effective lower bound for its policy interest rate is around negative 0.5%, a change from its 2009 assessment of +0.25%.** Furthermore, the Bank no longer considers that these measures would be used in a predetermined sequence, the Governor said. Rather, it would use whatever combination of policies it judged appropriate under the circumstances. However, Poloz clearly noted that the BoC does not see an immediate need for such action and re-affirmed the bank's latest growth forecast, which sees steady growth at or above 2.0% over 2016 and 2017; obviating the need for further monetary easing.
- The Bank of Canada opined that Canada's *"economy continues to undergo a complex and lengthy adjustment to the decline in Canada's terms of trade. This adjustment is being aided by the ongoing US recovery, a lower Canadian dollar and the Bank's monetary policy easing this year. The resource sector is still contending with lower prices for commodities. In non-resource sectors, exports are picking up, particularly in exchange rate-sensitive categories. However, business investment continues to be weighed down by cuts in resource-sector spending. The labour market has been resilient at the national level, although with significant job losses in resource-producing regions. The Bank expects GDP growth to moderate in the fourth quarter of 2015 before moving to a rate above potential in 2016. While bond yields are slightly higher, financial conditions remain accommodative in Canada."*
- Canada's trade deficit widened to C$2.8 bln in October, from a revised C$2.3 bln in September (previously reported as C$1.7 bln). Exports fell by 1.8% m/m, while imports were down by a more modest 0.8%. In real terms, the declines were slightly smaller, with export volumes slipping 1.5%, and import volumes falling 0.2%.

UNITED STATES:

- The U.S. economy added 211,000 jobs in November, ahead of market expectations for a slightly more modest 200,000 gain. While this pace of job growth reflects a slight down-drift from the brisk 298,000 pace the month before (revised higher from +271,000), the addition of 35,000 net revisions to previous estimates suggests that the labour market is in far better shape than previously thought. The unemployment rate remained unchanged at 5.0% .

EUROPEAN:

- **Germany's** industrial production rose 0.2% m/m in October after two months of decline, but was short against market expectations of +0.7% as energy output fell 5.9%. The Economy Ministry said that the recent high level of energy output could not be maintained as the gains were backed by a surge in renewable energy that was led by wind and the sunny summer. Excluding energy and construction, industrial production grew 0.7%.
- **Germany's** exports fell by a more-than-expected 1.2% m/m in October, compared to market expectations of a more modest 0.6% decline. Imports dropped 3.4% m/m, representing the biggest fall since April 2012, and was also worse than the consensus forecast for a 1.0% decline. As imports dropped more than exports, the trade surplus rose to a seasonally adjusted €20.8 bln in October from about €19.2 bln a month earlier. The data reflect a weak start to Q4/15 economic growth.
- The British Chambers of Commerce lowered its gross domestic product forecast for the **U.K.** this year to 2.4% from 2.6% on the back of weaker-than-expected trade figures and a worse than predicted manufacturing performance. The GDP growth for 2016 was lowered to 2.5% from 2.7%. For 2017, growth is projected to be 2.5% compared to previous forecast of 2.7%. The BCC now expects the Bank of England to begin raising interest rate policy in Q3/16, a quarter further out than its previous forecast.

- The **Bank of England** maintained its key interest rate a record low of 0.5% and its quantitative easing target at £375 bln, as widely expected. The vote was 8-1, in line with the trend since August when a voter first called for a rate hike to make sure tightening remains gradual. The outlook was broadly consistent with that in the November Inflation Report, and did not push back on the market's dovish shift in recent weeks.
- The **Swiss National Bank** left its key policy rate on sight deposits unchanged at a record low of negative 0.75% and maintained its pledge to intervene, if needed, to push back against pressure on the "significantly overvalued" franc. Since dropping its 1.20-per euro cap in January, the SNB has relied on a twin strategy of negative rates and interventions to keep the franc in check. The currency is still up about 10% this year.

ASIA & OTHER – Divergent growth from different countries

- The value of **China's** foreign exchange reserves stood at $3.438 trillion at the end of November (the Bloomberg median was $3.493 trillion), a decrease of $87 bln from a month earlier. The data suggest continued capital outflows, predominately driven by increased expectations for renminbi depreciation, despite the currency's recent inclusion into the International Monetary Fund's Special Drawing Rights (SDR) basket. The People's Bank of China on Sunday lowered the currency's reference rate, which limits the onshore yuan's moves to 2% on either side, by 0.21% to 6.3985 a dollar.
- **China Nov exports weaker than expected but import decline eases** China's trade performance remained weak in November, casting doubt on hopes that the world's second-largest economy would level off in the fourth quarter and spelling more pain for its major trading partners. **China's** exports fell 6.8% y/y in November (worse than market expectations of a 5.0% decline, with October at -6.9%), its fifth straight month of declines on weak global demand. Imports fell for the 13th consecutive month, sliding 8.7% y/y, but were better than an expected decline of 11.6% and an 18.8% fall seen in October. As a result, the trade surplus fell unexpectedly to $54.1 bln from $61.6 bln in October, compared to consensus of a rise to $63.5 bln in November.
- The **People's Bank of China** on Wednesday cut the country's currency's reference rate to 6.4140 per dollar, its weakest level since 2011.
- **Japan's** Q3/15 gross domestic product was revised up to 1.0% y/y from a preliminary reading that suggested a contraction of 0.8%. The revision means that Japan escaped a technical recession, since the final Q2/15 figure was a contraction of 0.7%.
- The **Reserve Bank of New Zealand** cut interest rates for the fourth time this year, lowering the official cash rate by 25 bps to 2.50%. Anemic inflation, soft commodity prices and a stronger-than-expected New Zealand dollar were among the factors that had put pressure on the bank to move. Inflation is sitting at 0.4%, well below the central bank's target range of 1% to 3%, with Governor Graeme Wheeler saying the bank will reduce rates if circumstances warrant.
- Moody's placed **Brazil's** Baa3 debt rating on review for a downgrade that would put it into junk territory, citing the country's rapidly worsening economic and political situation (the initiation of impeachment proceedings against the president in early December). The budget deficit is approaching 10% of GDP, and gross debt is on its way to hitting 70% of economic output. Standard & Poor's had already cut its rating on Brazil to junk in September. Moody's also downgraded the debt of state-controlled oil company **Petróleo Brasileiro SA** (Petrobras) to Ba3 from Ba2, moving it deeper into junk territory, and placed the company on review for a further downgrade. Moody's stated that its rating actions reflect Petrobras' elevated refinancing risks in the face of deteriorating industry conditions that make it more difficult to raise cash through asset sales.
- The **Bank of Korea** kept its main interest rate steady at 1.5%, in line with analyst expectations. Rates have been at this record low for half a year.

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