Weekly Trends

PRIVATE CLIENT SOLUTIONS

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What Are Your Expectations?

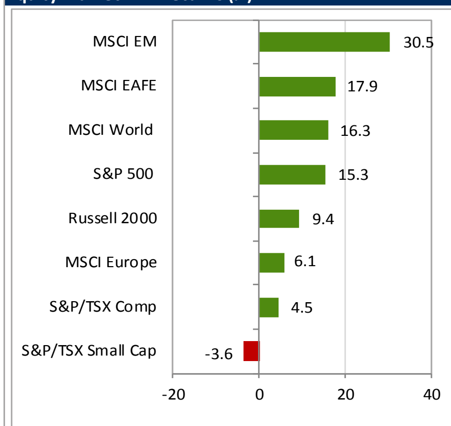
Broadly speaking, equities have enjoyed an almost uninterrupted run over the past few weeks, so it is not too surprising to see a pause in the market. From a technical perspective, the S&P/TSX remained in overbought territory for much of October, but subsequently worked off the condition in November. The index slipped below the February high of 15,943; however, it regained the level this morning.

Underlying the recent weakness has been a pullback in the energy and materials sectors. Benchmark WTI crude briefly slipped below US$55/bbl following industry data that showed US stockpiles unexpectedly rose last week and Russia displaying less support for an extension of the production output cuts.

We view the US$54-55/bbl level as an important support level for crude, as it had acted as a key resistance level over the last ~12 months. With overbought conditions now worked off in the commodity and WTI testing and holding the key support level, we believe oil is setting up to take a run at US$62/bbl. The S&P/TSX energy sector has also worked off overbought conditions and remains in a healthy technical uptrend, presenting buying opportunities for those looking for energy exposure.

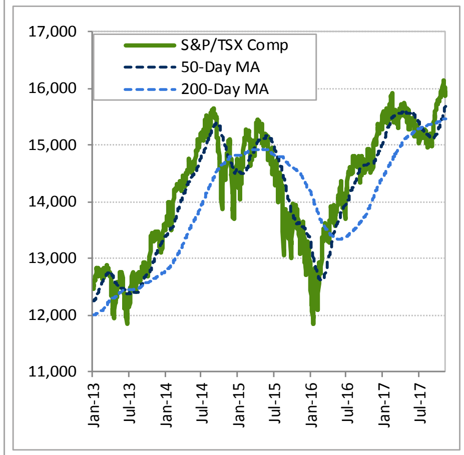
NAFTA negotiations resumed this week. The fifth round of talks kicked off in Mexico City on Wednesday and will continue through November 21st. We are often asked about the potential impact NAFTA may have on Canadian equities to which we believe there are too many moving parts to make an educated guess. When making market forecasts we take inputs from the economy, corporate earnings and fiscal and monetary policy to arrive at some expected value. Attempting to predict the outcome and impact of a negotiation when we have no measurable inputs would simply be a guess, not an educated one. As Sir Winston Churchill once said, "I always avoid prophesying beforehand because it is much better to prophesy after the event has already taken place." In the case of NAFTA, we will take our lead from Churchill

Equity Market YTD Returns (%)



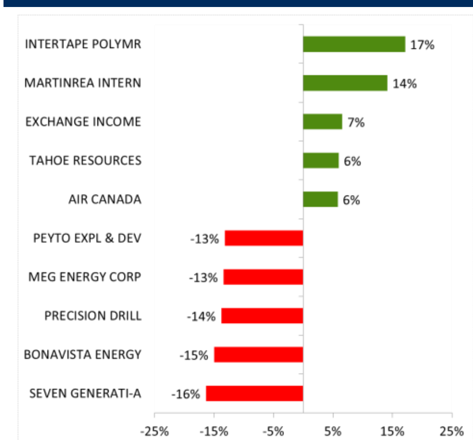
Canadian Sectors	Weight	Recommendation
Consumer Discretionary	5.4	Market weight
Consumer Staples	3.7	Market weight
Energy	19.5	Overweight
Financials	35.0	Overweight
Health Care	0.7	Underweight
Industrials	9.5	Overweight
Technology	3.3	Market weight
Materials	11.3	Market weight
Communications	5.0	Underweight
Utilities	3.8	Market weight
Real Estate	2.9	Market weight

Technical Considerations	Level	Target
S&P/TSX Composite	15,969	16,500



Source: Bloomberg, Raymond James Ltd.
Sectors are based on Bloomberg classifications

S&P/TSX Top 5 Gainers/Laggards*



S&P/TSX Market Internals

Weekly Advance	120	48%
Weekly Decline	127	51%
Advance-Decline	-7	
New 52 wk high	10	4%
New 52 wk low	8	3%
No. Stocks Above 50-d	151	60%
No. Stocks Above 200-d	141	56%
Arms Weekly Index	0.64	Neutral
RSI (14-day)	53.2	Neutral
50-DMA	15,699	Uptrend
200-DMA	15,472	Uptrend

Source: Bloomberg, Raymond James Ltd; * 5-day price return

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and figure out winners and losers when we have all the facts. However, one often overlooked reset mechanism is currency. If the US decided to walk away from NAFTA, we would anticipate a sudden and sharp negative currency reaction. Under this scenario, a devalued loonie would make Canadian goods and services more attractive to foreign companies potentially offsetting the negative impact of a collapsed trade deal.

On the economic front this week we received two readings on US inflation – the producer price index (PPI) and consumer price index (CPI). Headline PPI rose 0.4% m/m in October, ahead of consensus expectations for a 0.1% gain. This pushed the y/y rate to 2.8%, the highest since February 2012. Core PPI also increased 0.4% m/m, ahead of consensus expectations for a 0.2% gain, with the y/y inflation rate increasing to 2.4%. The CPI print was highly anticipated by the market, as it was the last reading before the December FOMC meeting. CPI gave the Fed a green light to hike in December with headline CPI increasing in line with expectations, while core CPI came in 0.1% below expectations at 1.7%. A miss, but not enough to change the Fed's interest rate path.

The focus on inflation extended past economic data. Bloomberg reported Fed officials are pushing to revamp the central bank's view on inflation. In 2012, the Fed officially settled on a 2% inflation target, but today officials are discussing a change to the target level, perhaps to 3%. In addition, there are discussions about changing from a target rate to price-level targeting, which would allow prices to overshoot for the same amount of time they undershot.

While We're On The Subject Of Inflation

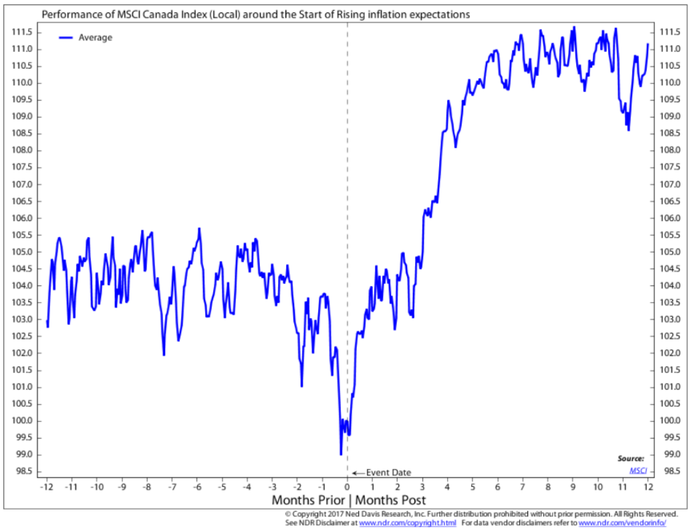
During our National Business Conference we had the pleasure of attending a presentation by Picton Mahoney. The asset manager believes one of the risks the market is not well prepared for is an inflation scare. We would tend to agree with this given that inflation has persistently run below central bank's targets, so there has been little need to protect against a jump in consumer prices.

US bond markets are not signaling any concern about inflation as the yield curve has continued to flatten. In fact, the spread between US 5-year and 30-year yields slipped to 76 bps marking the narrowest spread since November 2007.

While there are secular headwinds that will contain inflation over the long run, such as demographics, increased financial leverage on a global scale and technology, there have been, and will be, periods where inflation and inflation expectations are on the rise. Today, there is some evidence that US inflation pressures are building, such as modest wage gains, low unemployment, rebound in commodity prices (particularly crude oil), and the general global economic expansion.

Since 2008 there has been five periods where US inflation expectations were on the rise for an extended period. The latest period began in June of this year, which happened to coincide with a bottoming out in the S&P/TSX. We found this curious, if not coincidental, so we went out to see if any relationship exists between US inflation expectations and Canadian stock market returns. We isolated those periods and looked at the performance of the Canadian market. On average, the Canadian market performed poorly ahead of a trough in US inflation expectations, but once US inflation expectations began to rise the S&P/TSX performed remarkably well. On average, the S&P/TSX gained over 10% and on a sector level, industrials, energy and financials experienced the strongest returns (note we exclude health care due to the limited number of members in the sector).

Canada Market & Rising US Inflation Expectations



Source: Ned Davis Research, Raymond James Ltd.

US Inflation Expectations – Bottomed in June

Source: Federal Reserve Bank of St. Louis

If we're at the beginning of a period of rising prices, we screen for S&P/TSX members within the sectors that performed the best during periods of rising inflation expectations and identify the top 10 equities in each sector.

S&P/TSX Sector Returns

	Period of Rising Inflation Expectations					
Sector	1	2	3	4	5	Average
Health Care	72.1	33.7	15.8	46.2	(24.4)	28.7
Industrials	15.4	19.8	19.6	21.9	19.3	19.2
Financials	17.9	12.0	13.1	18.6	22.0	16.7
Energy	24.0	13.8	11.1	12.9	12.1	14.8
Cons. D	6.7	11.8	11.2	21.5	12.0	12.7
Materials	14.5	(4.6)	18.7	16.3	3.8	9.7
Cons. S	11.0	7.7	13.3	9.9	5.0	9.4
Telecom	7.8	8.3	12.9	16.1	1.4	9.3
IT	18.0	(12.8)	16.7	8.3	13.0	8.7
Real Estate	12.6	11.3	5.8	4.9	(2.0)	6.5
Utilities	9.8	3.5	5.3	4.9	2.7	5.2
S&P/TSX	*17.7*	*8.5*	*13.8*	*17.2*	*13.3*	*14.1*

Source: Bloomberg, Raymond James Ltd.

Top Performing Sectors & Top 10 Equities During Periods of Rising Inflation Expectations

Company Name	Ticker	Average Return (%)	Company Name	Ticker	Average Return (%)	Company Name	Ticker	Average Return (%)
Energy			**Financials**			**Industrials**		
CES Energy Solutions	CEU	55.8	Manulife Financial	MFC	32.7	Air Canada	AC	89.5
Secure Energy Services	SES	38.3	Home Capital	HCG	26.8	Badger Daylighting	BAD	49.2
Precision Drilling	PD	34.5	Industrial Alliance Ins.	IAG	25.5	Boyd Group	BYD-U	39.9
Paramount Resources	POU	34.1	Canadian Western Bank	CWB	25.1	TFI International	TFII	38.5
Trican Well Service	TCW	32.6	Royal Bank of Canada	RY	21.3	Stantec	STN	31.7
Parkland Fuel	PKI	32.3	National Bank of Canada	NA	20.9	Canadian Pacific Railway	CP	30.4
Ensign Energy Services	ESI	29.7	Sun Life Financial	SLF	20.0	Finning International	FTT	30.2
Vermilion Energy	VET	28.6	Genworth MI Canada	MIC	18.6	Russel Metals	RUS	28.2
Mullen Group	MTL	28.2	Toronto-Dominion Bank	TD	16.6	Exchange Income	EIF	25.9
Suncor Energy	SU	24.7	CIBC	CM	16.3	Westshore Terminals	WTE	25.8

Source: Bloomberg, Raymond James Ltd.

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