Weekly Trends

PRIVATE CLIENT SOLUTIONS

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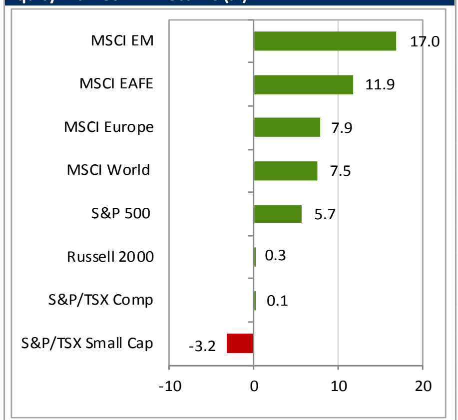
Buy The Earnings Dip?

Wow, a 1%+ sell off in one day; haven't seen one of those in a while! The S&P 500 traded to a record 2,405 on Tuesday, but subsequently gave back almost a month's gains on Wednesday. North American markets were spooked by the drama surrounding Trump's alleged ask of then-FBI Director Comey to stop investigating Michael Flynn and the preceding fallout. As the drama unfolded, the markets paused to assess the impact and the potential for Trump's pro-growth agenda to stall. The S&P/TSX slipped 269 points to 15,273, the lowest level in nearly one month. Despite this, we did receive some positive news on the oil front. OPEC had its Mario Draghi moment. Saudi Arabia's oil minister Khalid al-Falih said on Monday that OPEC would "do whatever it takes" to rebalance the global oil market. Saudi Arabia and Russia both backed extending production cuts until March 2018. This is longer than the six-month extension that had been widely expected. OPEC and non-OPEC producers meet on May 25 to decide on policy. US inventory data was also supportive, as crude inventories saw their sixth straight crude draw, although the decline was less than expected. As discussed last week, credit conditions in China have been tightening amid a regulatory crackdown on the shadow banking system, which has put downward pressure on commodity prices. This week Chinese officials took action to ease credit conditions with PBOC adding liquidity to the system, injecting 140 billion yuan (~US$20.3 bln) of reverse repos. The action helped to ease interbank lending rates.

On the economic front, the Canadian calendar saw little in the way of market moving events, but this morning's CPI and retail sales release will be in focus. In the US, industrial production advanced 1.0% in April, the third consecutive monthly increase and the largest gain since February 2014.

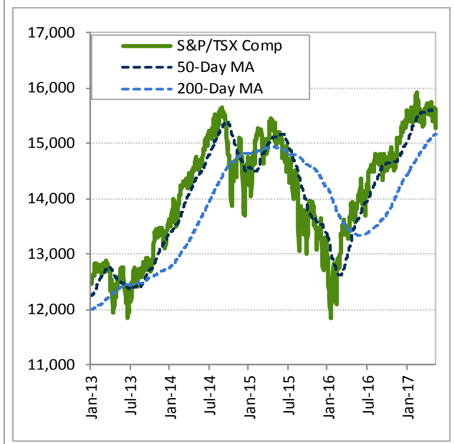
Looking to next week's events, it's a shortened week in Canada due to the observation of Victoria Day. Wednesday's Bank of Canada (BoC) rate decision will be closely watched. We expect no change to the overnight rate despite increased calls

Equity Market YTD Returns (%)



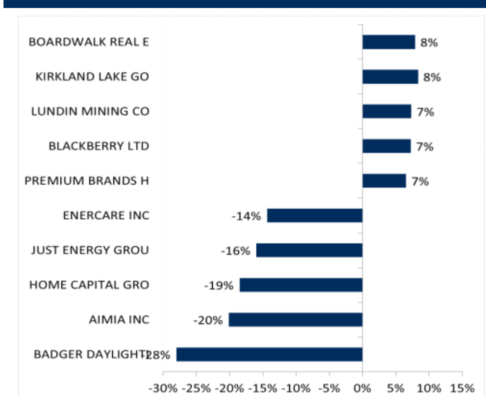
Canadian Sectors	Weight	Recommendation
Consumer Discretionary	5.4	Market weight
Consumer Staples	3.9	Market weight
Energy	21.3	Overweight
Financials	33.4	Overweight
Health Care	0.6	Underweight
Industrials	9.3	Overweight
Technology	3.0	Market weight
Materials	12.0	Market weight
Communications	5.0	Underweight
Utilities	3.1	Market weight
Real Estate	3.0	Market weight

Technical Considerations	Level	Target
S&P/TSX Composite	15,296	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	125	50%
Weekly Decline	123	49%
Advance-Decline	2	
New 52 wk high	3	1%
New 52 wk low	5	2%
No. Stocks Above 50-d	109	43%
No. Stocks Above 200-d	132	53%
Arms Weekly Index	0.77	Neutral
RSI (14-day)	37.6	Neutral
50-DMA	15,564	Downtrend
200-DMA	15,172	Uptrend

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

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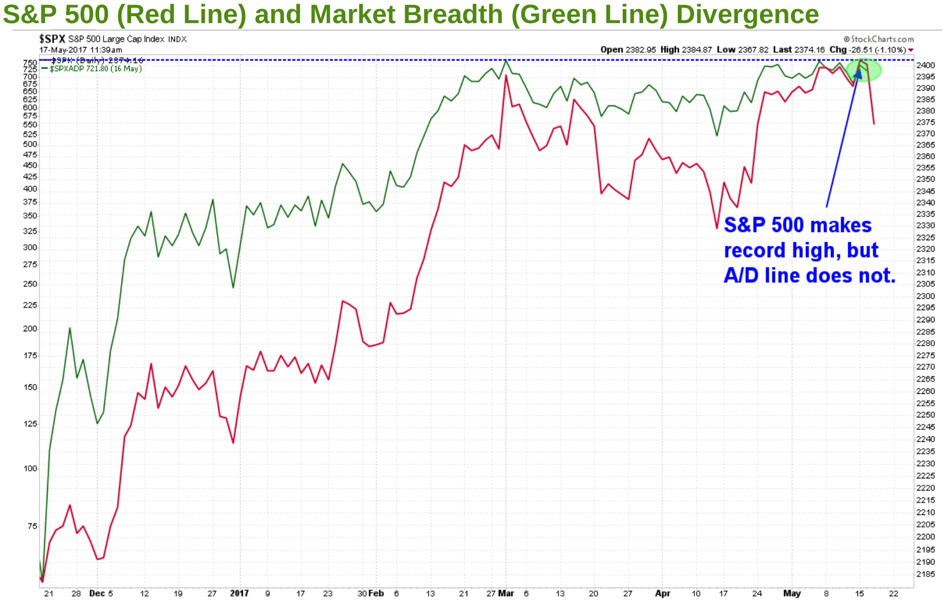
for the BoC to raise rates to cool the housing market. There are pockets of the Canadian housing market that are clearly in bubble territory, but using the blunt instrument of raising interest rates is not the preferred option of the BoC. In the US, we will see the release of many regional manufacturing indices (Chicago, Richmond and Kansas), Markit PMI manufacturing and services, new and existing home sales, FOMC minutes, durable goods, Q2 GDP (second preliminary) and consumer sentiment.

On the Canadian earnings front, the Canadian banks wrap up Q1 reporting season with BMO, CM, RY and TD reporting quarterly results. We anticipate the banks to post another strong quarter with the consensus EPS growth rate estimated to be 11%. Valuation levels for the Canadian banks have become more attractive in recent weeks, as the group now trades at 11.6x forward earnings, in-line with the 5-year average of 11.5x. For the banks to re-rate higher we'll be looking for positive EPS revisions and an improved outlook on the Canadian housing market.

Market Breadth

We have noticed a small divergence in the S&P 500 and market breadth, which we believe could make the market vulnerable over the next few weeks. The S&P 500 achieved a record high, however, the cumulative advance/decline line failed to make a new high as well. At this time, the minor market divergence is not a major concern, but we are entering a period where there are very few near-term catalysts on the horizon given: US earnings season is complete (it was a great quarter as a reminder), the next major economic print, the US employment report, is 16 days away and the US Federal Reserve does not meet for another month. As the political drama continues to play out in the US and/or if economic data surprises to the downside over the next week, this could result in increased volatility. Looking at support levels on the S&P 500, the next level of support is 2,320 (2% from current levels), followed by 2,255 (4.7%).

S&P 500 (Red Line) and Market Breadth (Green Line) Divergence



Source: Bloomberg, Raymond James Ltd.

Buying the Dip

Everyone one loves a good bargain, particularly when your favourite stock goes on sale. We spent this week looking through S&P/TSX earnings releases over the past few years, looking for negative reactions to an earnings report, searching for excessively large corrections which we define as a 10%+ sell off. We observed 46 instances taking a representative sample across various sectors to determine: a) should you “buy the earnings release dip” and b) how long does it take for the stock to recover. Generally, the answer we found is no and a relatively long time. On average, stocks that fell more than 10% in one day following an earnings release took 30.8 trading days to bottom out (the median was 23 trading days). The time to recovery, or the time that it took for the price to trade higher than the price prior to the earnings release was 82.8 trading days (median was 66 trading days), meaning it took about 4 months for the stock to retrace its losses. There are always exceptions to the rule and averages can be deceiving, but as a rule of thumb based on these observations you don’t need to rush in to buy the earnings dip. However, during this exercise we did observe two distinct patterns. If the stock was positively trending (you can gauge this by looking at the slope of the 200-day moving average) and sells off on an earnings release, the bottoming out and recovery process times were shorter and the stock generally resumed its prior trend. If the stock was negatively trending, the bottoming process took longer and in some cases the recovery never happened. This underlines one of the important guideline we follow: buy stocks that exhibit strength and that are positively trending and sell (or avoid) those that are not.

Observations By Sector					Earnings Correction Stats		
Sector	Count	Sector	Count			Bottom	Recovery
Con. Disc.	6	Industrials	7		Average	30.8	82.8
Con. Staple	3	Materials	11		Median	23	66
Energy	6	Real Est.	4		Min.	2	11
Financials	2	IT	3		Max.	100	322
Health Care	2	**Total**	**46**		St. Deviation	25.5	64.4

Source: Factset, Raymond James Ltd.

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