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Weekly Market Recap for October 23, 2015

It's been a busy week for the central banks around the world: The Bank of Canada held tight, the European Central Bank hinted at further easing, the Fed kept tightening on the table and most importantly China surprisingly cut interest rates this morning. These policy moves show the growing divergence among the central banks and corner the Fed.

On Thursday European Central Bank President Mario Draghi hinted further monetary stimulus measures could be brought out in December to prop up the European economy. At the conference the ECB also removed its self-imposed deposit rate floor of -0.20% suggesting they could lower the rate even further at the next meeting; this sent German 2 year yields to record lows of -0.32%.

The ECB cut was followed up this morning by China which surprised everybody by cutting interest rates for the sixth time in a year and reducing reserve requirements by 0.50%. The news was welcomed by global investors who had fled markets earlier this year over concerns about China's slowing growth. It also indicates China's desperation to bring momentum back to their economy.

These back to back easing moves from the ECB and China are in direct contrast to the Fed's intention to raise rates. The US dollar jumped on the news of both cuts and it will go even higher if the Fed follows through on a hike. Traders aren't convinced about Fed follow through though with the latest odds of a hike at 36% (that is roughly what the probability was before the September 17th meeting where the Fed delayed hiking). We will get a better idea of the Fed's position at next week's meeting.

As I have been stressing (see my blog post here) the key factor to consider in the macro landscape is how the US dollar is performing. One event which could offset a strong US dollar and further help commodities and Emerging Markets in the short term would be the inclusion of the Chinese Yuan in the IMF's SDR basket (see here). This is almost a certainty as China just got the nod from IMF officials.

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In Canada, Monday's election resulted in an unexpected Liberal majority government. Canadians opted for higher government spending over balanced budgets however stocks jumped on the results. As a note, historically Canadian equities have performed better under a Liberal majority than a Conservative majority.

Entire Mandate: Compounded Annualized Return			
Government	**Type**	**Election Date**	**TSX**
Liberal	Minority	1972-10-30	-7.5%
Liberal	Majority	1974-07-08	7.8%
Conservative	Minority	1979-05-22	58.3%
Liberal	Majority	1980-02-18	3.2%
Conservative	Majority	1984-09-04	7.7%
Conservative	Majority	1988-11-21	5.0%
Liberal	Majority	1993-10-25	12.8%
Liberal	Majority	1997-06-02	10.7%
Liberal	Majority	2000-11-27	-2.1%
Liberal	Minority	2004-06-28	23.1%
Conservative	Minority	2006-01-23	-5.9%
Conservative	Minority	2008-10-14	14.1%
Conservative	Majority	2011-05-02	-0.2%
Average			
All	Elections		9.8%
All	Majority		5.6%
All	Minority		16.4%
Liberal	Majority		6.5%
Conservative	Majority		4.2%

Source: Canaccord Genuity

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Weekly Market RunDown

Stocks	Price (today's close)	Weekly % chg	YTD %chg
S&P/TSX	13953.66	0.84%	-4.64%
S&P500	2075.16	2.07%	0.79%
Nikkei	18825.30	2.92%	7.88%
FTSE100	6444.08	1.04%	-1.86%
Euro Stoxx50	3425.81	4.93%	8.88%
Shanghai Composite Index	3412.43	0.62%	5.50%
Emerging markets ETF	36.29	0.11%	-7.64%
Nasdaq	5031.86	2.97%	6.25%

Bonds	Yield	Weekly Net chg	YTD Net chg
Canada 10 year bond	1.51%	0.04%	-0.28%
US 10 year bond	2.08%	0.05%	-0.09%
Avg. cdn 5 yr mortgage rate	4.64%		-0.15%
US 30 year mortgage rate	3.78%	-0.02%	-0.21%

Commodities & FX	Price (today's close)	Weekly % chg	YTD %chg
Gold	1164.300	-1.59%	-1.92%
Silver	15.845	-1.67%	0.71%
Oil	44.630	-6.48%	-24.93%
USD/CAD	1.318	2.05%	13.41%
EUR/CAD	1.451	-0.96%	3.23%
USD/YEN	121.400	1.64%	1.35%
EUR/USD	1.101	-2.95%	-8.97%

Gas	Price	Yest. Avg	Year ago avg.
US gas price at pump	2.22	2.22	3.08
Canada gas price at pump	1.06		1.30

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Reads of the Week

The great ball of china money rolls into bonds

Alternative finance boom adds to case for interest rate rise

Amazon is hiring 100,000 staff for the holidays

This Week's Macro Thoughts

Massive QE efforts haven't stimulated inflation

Since the financial crisis, central banks around the world have engaged in massive quantitative easing programs intended to spur economic activity and inflation. To get an idea of the record amounts printed check out the table below, it summarizes the dates of the QE programs, the amounts printed in US dollars and the size of the programs relative to the starting central bank balance sheets.

Central Bank	Start	End	Beginning Assets	Total QE ($, Billions)	% Change
Federal Reserve	11/25/2008	10/31/2014	$2,189.1	$2,297.6	105%
Bank of Japan	10/5/2010	--	$1,450.4	$1,618.0	112%
Bank of England	1/19/2009	11/8/2012	$375.7	$286.6	76%
European Central Bank	7/2/2009	--	$2,814.4	$181.1	6%
			Total	**$4,383.4**	

Source: Strategas Research Partners

Clearly the US and Japan led the QE charge, more than doubling their balance sheets, but did these extraordinary measures achieve what they were supposed

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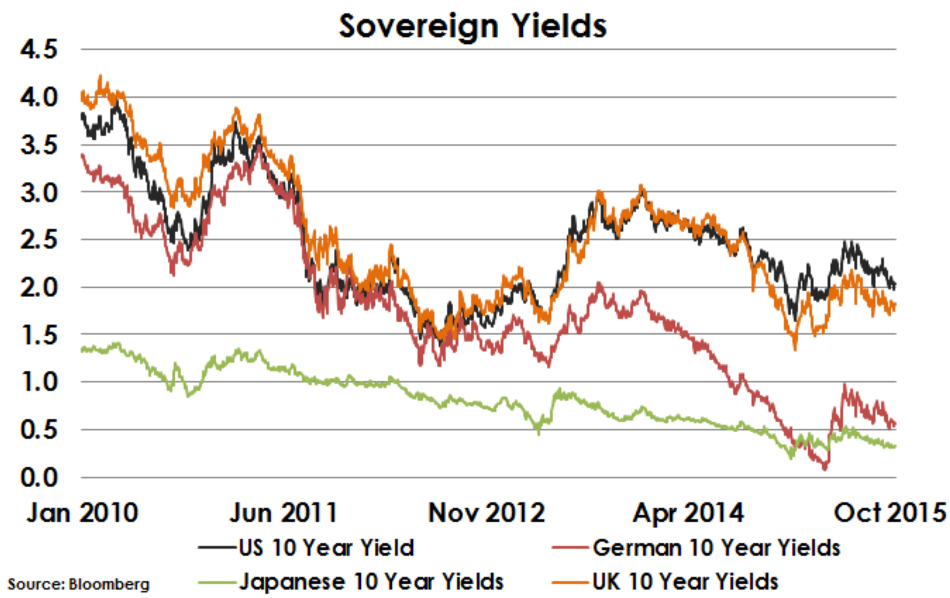
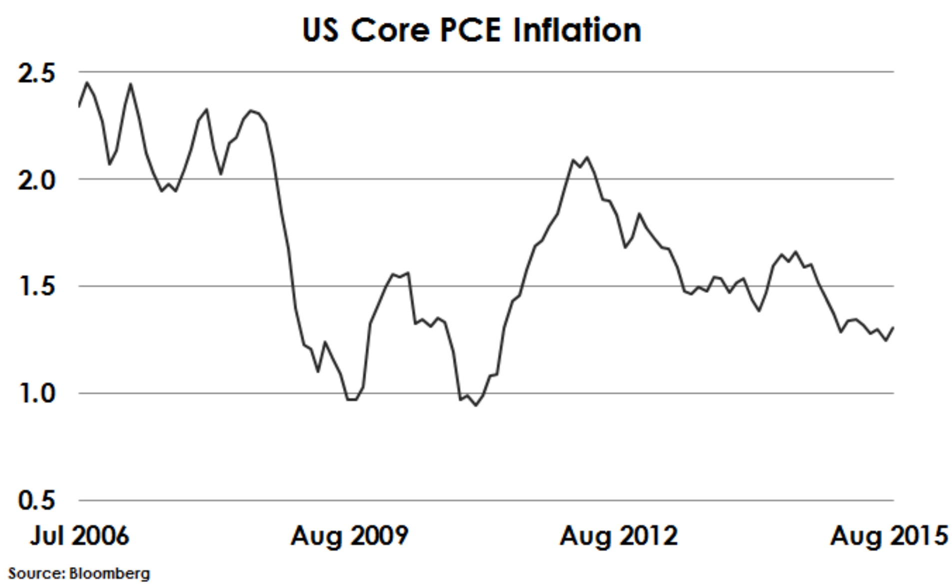
to? The goal of these QE programs was to increase economic activity and inflation (more business activity should have increased inflation). However when you look at sovereign yields, they are down, not up since all the printing began. One must ask: Where is all the inflation?



Below shows the Fed's preferred method of tracking inflation, Core PCE indicator. Since 2012 QE has had the opposite effect on desired inflation!



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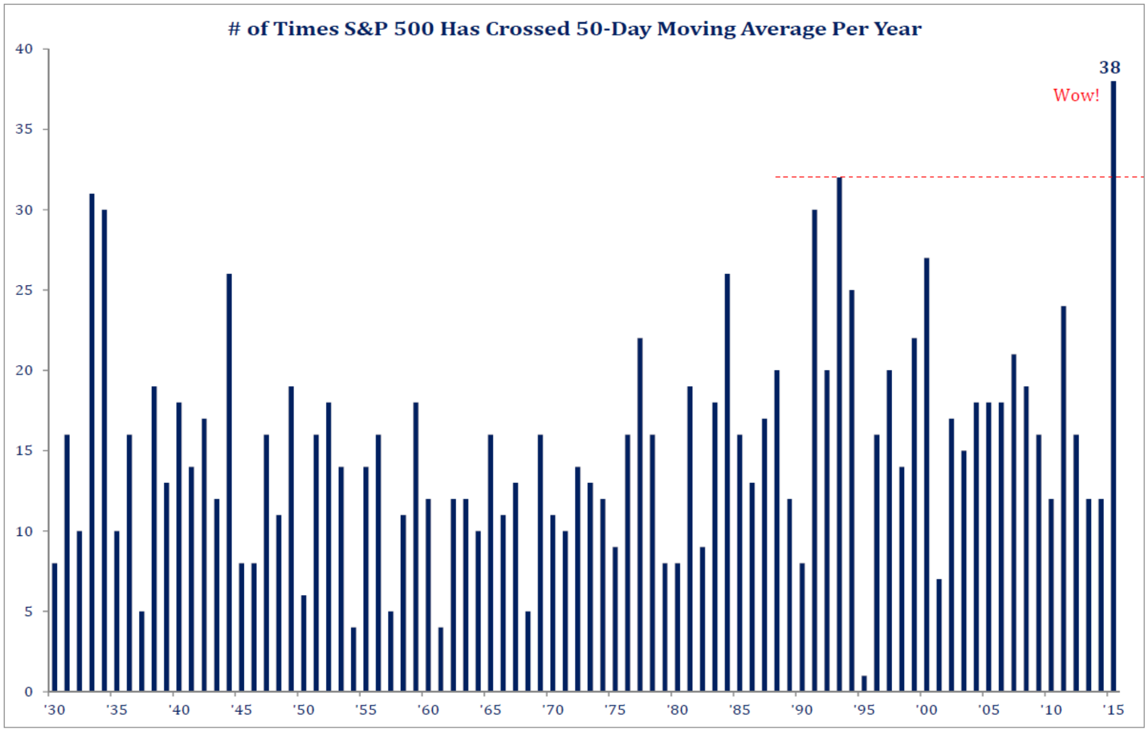
Indecision….

Never before has the S&P 500 been so undecided, just this year it has crossed the 50 day moving average 38 times and we're still counting.



Source: Strategas Research Partners

Glencore could be the canary in the coalmine

We have recently experienced some relief in commodities and emerging markets due to the fall in the USD (see my post here) but a canary in the coalmine for the markets could be the commodity giant Glencore. The chart below shows how Glencore's stock and the credit default swaps spreads (inverted) have both rolled over again recently (credit default swaps are contracts which are essentially insurance policies against borrowers going bust).

Right now Glencore is trying to be big and leveraged and as Roger Lowenstein said in his book *When Genius Failed* you can be large or you can be leveraged but you can't be both. Glencore is one of the world's largest commodity traders

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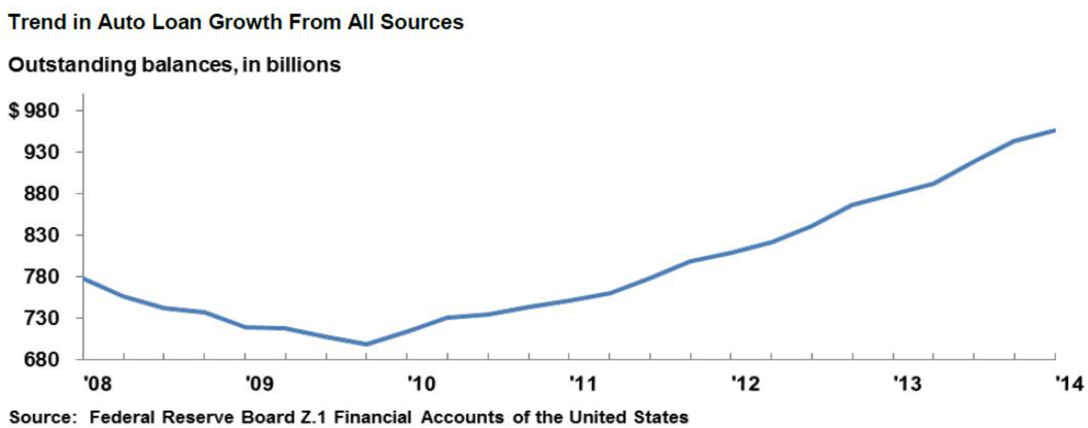
and it provides a pulse for what is going on at the top of the market. If these guys were to go bust it would set off a huge chain of events that would be very negative for markets.

Subprime auto lending

Auto sales have done considerably well since the financial crash thanks to record low interest rates, cheap gas and strong consumer demand. During the years after the crisis auto loans performed relatively well because cash-strapped households still had to pay for transportation and it's easy (for banks as a safety net) to repossess a car on a delinquent auto loan (as oppose to foreclosing on a house on a bad mortgage). These factors have caused banks to pile into the auto lending market; check out how outstanding auto loans have grown since 2009 in the chart below:



Recently banks have begun relaxing lending standards to increase the amount of auto loans they can make. More borrowers are getting longer repayment periods and the loan-to-value ratios (LTV) have increased from the year before, see the chart below. Higher LTV ratios means the loans are riskier since the borrower owes more on the car than it is worth.

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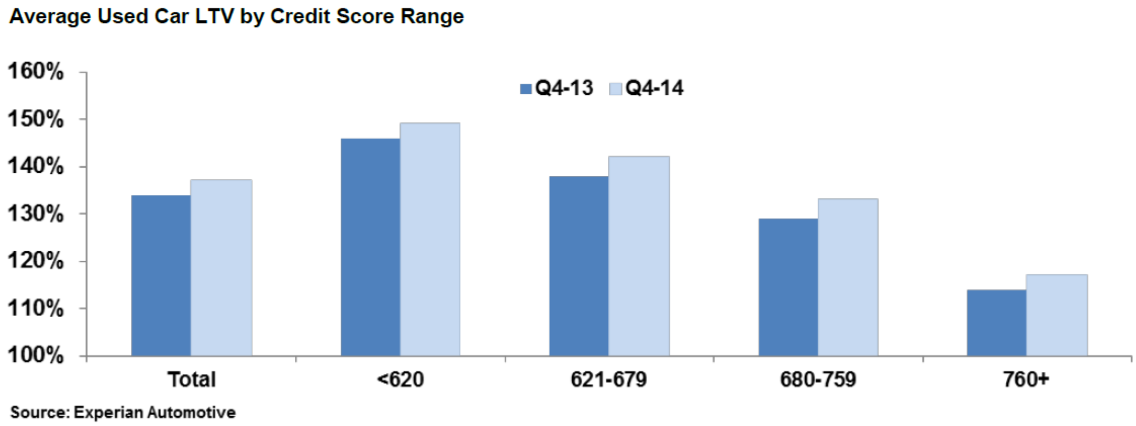

This development has the Comptroller of the Currency Thomas Curry very concerned and he suggested there should be more regulation in the sector. In a speech yesterday he said the auto loan market "reminds me of what happened in mortgage-backed securities in the run-up to the crisis." This is something I will be watching.