

# Global Insight

## Weekly

## How Canada's election changes the contours of the economic landscape

Patrick McAllister, CFA – Toronto

Canada's Liberal Party claimed victory in the 2019 election. However, it comes in the form of a chastened minority government that will require cooperation to govern. We look at how this affects the outlook for the Canadian Energy and Telecom industries, as well as the implications for portfolios.

Following a closely contested race, Prime Minister Justin Trudeau's Liberal Party lost support but not its claim to government. Despite losing the popular vote, the Liberals hold enough seats that it would require all three major opposition parties to unite to defeat them in Parliament. Cooperation will still be required to pass legislation, with the New Democratic Party (NDP) looking the most ideologically aligned candidate.

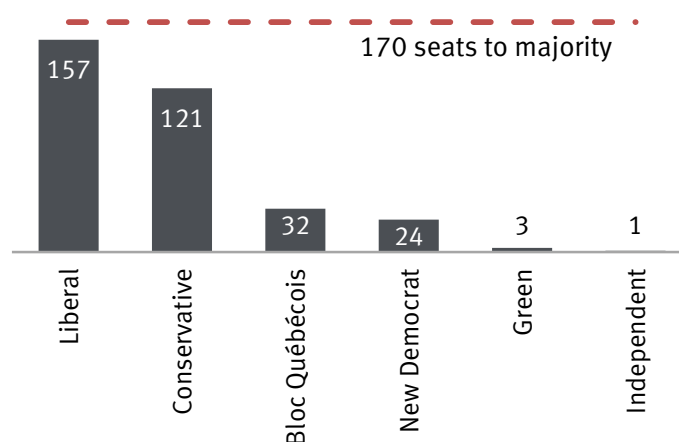
### Negative sentiment to persist in Energy industry pending tangible pipeline progress

The Liberal Party's weakened position in Ottawa will do little to assuage fears amongst oil & gas investors and those who derive their livelihood from the industry. At the forefront of a range of issues impacting oil & gas development in Western Canada remains the fate of the Trans Mountain Expansion, which the industry hopes will address the shortage of crude oil pipeline capacity and help diversify crude exports away from the U.S. market. RBC Capital Markets believes that the expansion project is still likely to move forward but with more uncertainty than before the election.

We believe that the Liberal Party remains committed to the project, particularly after spending CA\$4.5 billion to purchase the existing Trans Mountain Pipeline and the related 690,000 barrels per day expansion project just last year. However, under a Liberal minority government, tangible construction progress may be delayed by a need to consult with other parties such as the NDP that campaigned on a promise to cancel the project.

The Liberal Party win failed to claim enough seats to form a majority government

Canadian election 2019 final seat tally



Source - Elections Canada

### Market pulse

- 3 Q3 U.S. earnings beat rates start strong
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- 4 Brexit endgame in sight?
- 4 Hong Kong unleashes yet another stimulus package

Click [here](#) for authors' contact information. Priced (in USD) as of 10/24/19 market close, EST (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see [page 6](#)**  
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The Trans Mountain Expansion does not require parliamentary approval to move forward, but it will be incumbent on the Liberals to ensure that their pursuit of the project does not lead opposition parties to stymie their ability to conduct other parliamentary business. As the Liberals will need to find the necessary compromises on other issues to gain support (or a lack of resistance) for the expansion project, we believe the Trans Mountain Expansion could see further delays, with potential completion in 2022 or 2023.

### Heated campaign rhetoric likely to be tempered but headline risk remains for Telecom industry

The Telecom industry often finds itself having to weather political storms, and this campaign proved true to type as politicians across party lines promised to reduce Canadians' wireless and internet bills. Past precedent suggests that these promises tend to be more bark than bite, but we must acknowledge elevated risk amid the Canadian Radio-television and Telecommunications Commission's (CRTC) ongoing review of the wireless industry.

RBC Capital Markets believes that incremental measures to increase wireless competition and/or lower pricing are a virtual certainty but that the review is unlikely to be overly disruptive. While lower wireless pricing makes for good campaign fodder, we believe a directive to mandate wireless network access to upstart competitors would make for bad policy at a time when the industry is making critical investments in rural connectivity, next-generation 5G networks, and wireless spectrum.

Concerns regarding wireless pricing in the wake of the introduction of unlimited data plans earlier this year and the CRTC wireless review have proven to be an overhang for Telecom equities despite a supportive interest rate environment. We believe the prospect of cooperation between the Liberal minority government and the NDP increases the risk that populist rhetoric remains aimed at the industry.

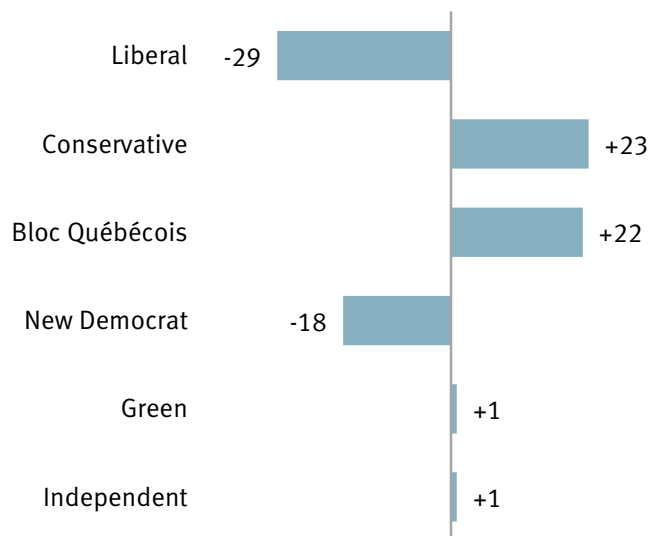
While our base case is that any changes to market structure should be manageable for incumbent operators, the industry will likely remain subject to headline risk until the conclusion of the wireless review in the first half of 2020.

### Need for cooperation raises the prospects for wider fiscal deficits

Potential cooperation between the Liberals and the NDP suggests wider fiscal deficits as these two parties stood out as the most ambitious with respect to their spending targets. The Liberals projected a deficit in the range of CA\$27 billion in the first year of their new government on the back of tax cuts and various investments, while the NDP proposed a roughly CA\$33 billion deficit due to expanded social programs and a national pharmacare plan.

### Despite net losses, the Liberals and NDP retain enough seats to set the agenda

Seats gained and lost in the 2019 Canadian election from the 2015 election



Source - CBC

If cooperation involves the pursuit of new spending initiatives from both parties, it could conceivably result in wider deficits than either had projected. Such an outcome would be supportive for the economy and bond yields, all else equal.

### Reiterate Market Weight on Canadian equities

Domestic-specific challenges including stretched household finances and a lack of crude oil pipeline capacity will remain in place for the foreseeable future, in our view. We continue to see these issues reflected in discounted valuations and, as such, maintain a Market Weight stance on Canadian equities. Our outlook does not materially change in the wake of the election as we continue to monitor recession risks for their potential impact on household finances and a resource-heavy Canadian equity market.



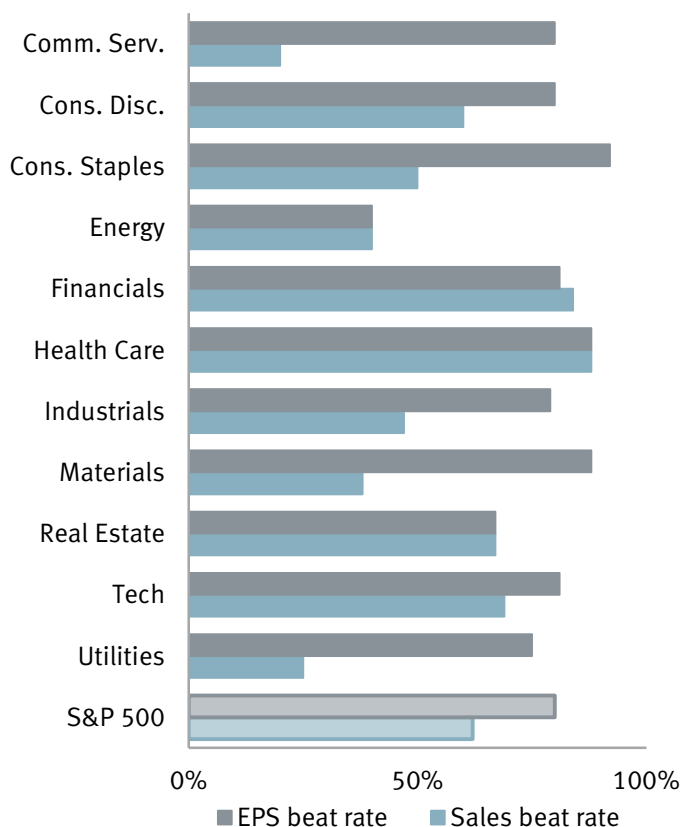
## United States

Ben Graham, CFA – Minneapolis

- U.S. equity markets are generally higher so far this week as **earnings season gains momentum and quarterly results are generally better than expected**, in aggregate. The NASDAQ is leading major U.S. indexes with a weekly gain of more than 1%. The S&P 500 and Russell 2000 are close behind, while **the Dow Jones Industrial Average lags on a few companies that have had challenging developments in the last week**. Most notable are the ongoing 737 MAX 8 developments at Boeing and disappointing quarterly results from Caterpillar Inc. and 3M—all companies that have outsized impacts on the price-weighted index.
- As earnings season evolves, consensus **estimates are looking for 3.3% quarterly sales growth from the S&P 500, coupled with an earnings contraction of 2.3%**, per Refinitiv I/B/E/S. The EPS number in particular compares favorably to the expectation of -3.2% before the start of earnings season. This expectation has improved as Financials, Industrials,

### Q3 beat rates start strong

S&P 500 constituent results, relative to consensus



Note: 34% of the S&P 500 has reported results as of 10/24/19  
Source - RBC Wealth Management, Refinitiv I/B/E/S; data as of 10/24/19

and Consumer Discretionary stocks lead the initial wave of reporters, with EPS beat rates for these three sectors ranging from 79%–81%. Similar but smaller trends are evident in the quarterly sales data. Lori Calvasina, RBC Capital Markets, LLC Head of U.S. Equity Strategy, notes that **the Financials and Industrials sectors appear relatively attractive when valuations are coupled with earnings trends**. However, she remains cautious that the current pace of companies beating expectations is at risk of slowing as the constituents reporting quarterly results transition to Tech, Communication Services and the internet side of Consumer Discretionary. Given the backdrop of better-than-feared quarterly results and the possible deceleration in beat rates, **we continue to believe a Market Weight position in U.S. equities with a focus on high-quality businesses is appropriate**.

- Economic data continued the pattern of mixed weekly results. **Existing home sales declined more rapidly than expected** with September's 2.2% m/m fall from August's level, while **new home sales were better than consensus expectations** at -0.7% m/m. Meanwhile, **the Richmond Fed's Manufacturing Index positively surprised** with its October reading of 8 relative to consensus expectations of -7, and the Kansas City Fed's Manufacturing Index registered -3, exactly in line with expectations.



## Canada

Ryan Harder – Toronto

- **Justin Trudeau's Liberal Party secured a second term this week, albeit with a weakened mandate in a minority government**; the Liberals will now require the support of the left-leaning New Democratic Party (NDP) to gather the votes necessary to pursue their legislative agenda. There was minimal reaction in bond markets, with the Canadian dollar unchanged on the day near its three-month high and yields moving slightly lower.
- **Fiscal spending is likely to see a boost under the new minority government**, as both the Liberals and NDP went into the election with ambitious plans requiring a wider deficit. Transit investments, an expanded pharmacare program, and increased child benefits are some areas where the two parties are likely to find common ground. **Given a slowing global growth backdrop, a deficit in the CA\$30 billion range should provide modest support to inflation and GDP growth, in our view**.
- The results of the Bank of Canada's (BoC) Business Outlook Survey, released this week, suggested that **Canadian sentiment has improved slightly, with firms expecting modest sales growth in the coming year**. However, the outlook in the oil-producing provinces was notably negative

amid a challenging environment for the Energy sector. **The relatively neutral results are unlikely to alter the BoC's policy plans;** Canada's central bank has so far stayed put while most others have embarked on a series of rate cuts.



## Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- **The UK Parliament voted to agree in principle to Prime Minister Boris Johnson's deal to take the UK out of the EU**—the first time the House of Commons has accepted such a proposal. However, Members of Parliament **rejected the accelerated timeline proposed by Johnson** for the bill's passage through the Commons, making clear they need more than three days to debate the bill. The Prime Minister's response was to “pause” the bill.
- Having requested an extension of the UK's EU membership beyond October 31, the Prime Minister is now waiting for the EU to announce whether an extension will be granted, as widely expected, and for how long. Whether or not an extension is forthcoming, **a general election within the next six months is increasingly likely, in our view.**
- An election is widely seen as a mechanism to break the current impasse, even if the result might be a hung Parliament. After all, new MPs would be signed up to their party's approach, limiting the impact of rebels.
- With the risk of a no-deal Brexit now mostly mitigated, **the British pound largely maintained recent gains at 1.29 vs the U.S. dollar**, up 7% from its summer low. Currency strength has held back performance in equities, with the FTSE All Share Index, which is biased to international stocks, up a mere 1.5% over the same period.
- **We recommend remaining Market Weight UK equities.** We believe investors should continue to hold quality stocks that can deliver resilient growth over the long term at the core of their UK equity allocations; these are typically multinational companies. In the short term, however, given recent developments have significantly reduced the probability of a no-deal Brexit, we see scope for domestically focused UK stocks' recent outperformance over their international counterparts to continue over the coming months. Accordingly, we would recommend **tactically increasing exposure to select domestically focused stocks.**



## Asia Pacific

Jasmine Duan – Hong Kong & Nicholas Gwee, CFA – Singapore

- **China announced Q3 2019 GDP grew 6% y/y, the slowest pace in almost three decades** and weaker than the consensus estimate of 6.1%. Trade tensions and weak global trade were the main culprits, while the government's efforts to pare back massive debt levels also had an impact. However, **policymakers have an array of options to facilitate growth**, including further reductions in the reserve requirement ratio, infrastructure projects, and additional tax cuts. Besides, any confirmation of a trade truce with the U.S. should alleviate downside risks to the economy.
- Even though **the Hang Seng Index has recovered to a degree** over the past fortnight, **significant improvements in fundamentals have yet to be seen.** Despite the IHS Markit Hong Kong Purchasing Managers' Index making a slight comeback in September to 41.5 (from 40.8 in August), escalating clashes in the city do not bode well for the local economy.
- **The Hong Kong government has rolled out further stimulus—the third package in three months—in an attempt to prevent the city from falling into a recession.** The HK\$2 billion relief package targets the tourism and logistics industries, including subsidies for travel agencies and fuel subsidies for commercial vehicle drivers. Authorities previously announced a HK\$19.1 billion stimulus package in August, followed by another HK\$1.4 billion last month. In total, the government expects the injections to lift the economy by 2%.
- **Japan and South Korea agreed they must ease the tensions** that have spilled over into trade and security over the past year. Following a 20-minute meeting in Tokyo between Japanese Prime Minister Shinzo Abe and South Korean Prime Minister Lee Nak-yeon, both sides issued statements expressing hope to repair the relationship between the two countries. **The meeting sent some positive signals, but further actions need to be seen.** Following the meeting equity indexes in both countries closed slightly higher.
- **China Mobile, the largest telecom services provider in China, reported net profit fell 14% y/y** in the first three quarters of the year. The Chinese government's request to lower fees and increase transmission speeds on networks eroded profitability. Competition on unlimited data plans with no speed caps also dampened average revenue per user.



## MARKET SCORECARD

Data as of October 24, 2019

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,010.29	1.1%	20.1%	13.3%	17.2%
Dow Industrials (DJIA)	26,805.53	-0.4%	14.9%	9.0%	14.3%
NASDAQ	8,185.80	2.3%	23.4%	15.2%	24.1%
Russell 2000	1,550.18	1.8%	15.0%	5.5%	3.3%
S&P/TSX Comp	16,369.32	-1.7%	14.3%	9.8%	2.9%
FTSE All-Share	4,033.51	-0.7%	9.8%	5.7%	-2.3%
STOXX Europe 600	397.37	1.1%	17.7%	12.5%	2.1%
EURO STOXX 50	3,621.37	1.5%	20.7%	15.7%	0.3%
Hang Seng	26,797.95	2.7%	3.7%	6.1%	-4.8%
Shanghai Comp	2,940.92	1.2%	17.9%	13.0%	-13.2%
Nikkei 225	22,750.60	4.6%	13.7%	3.0%	4.3%
India Sensex	39,020.39	0.9%	8.2%	14.7%	19.7%
Singapore Straits Times	3,168.87	1.6%	3.3%	4.5%	-5.0%
Brazil Ibovespa	106,986.10	2.1%	21.7%	28.8%	40.1%
Mexican Bolsa IPC	43,776.60	1.8%	5.1%	-4.7%	-12.7%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	1,502.69	2.1%	17.2%	21.8%	17.7%
Silver (spot \$/oz)	17.80	4.7%	14.8%	21.2%	5.4%
Copper (\$/metric ton)	5,859.50	2.9%	-1.5%	-5.3%	-16.4%
Oil (WTI spot/bbl)	56.02	3.6%	23.4%	-16.1%	7.1%
Oil (Brent spot/bbl)	61.48	1.2%	14.3%	-19.3%	5.4%
Natural Gas (\$/mmBtu)	2.33	0.0%	-20.8%	-26.4%	-21.7%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	1.770%	10.5	-91.5	-133.4	-64.9
Canada 10-Yr	1.522%	16.1	-44.5	-91.9	-54.3
U.K. 10-Yr	0.625%	13.7	-65.2	-83.2	-73.2
Germany 10-Yr	-0.404%	16.7	-64.6	-80.0	-88.0
Fixed Income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	2.31%	-0.2%	8.3%	10.7%	9.0%
U.S. Invest Grade Corp	2.91%	0.0%	13.2%	14.1%	11.5%
U.S. High Yield Corp	5.60%	0.4%	11.8%	8.0%	9.3%
Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	97.6870	-1.7%	1.6%	1.3%	4.2%
CAD/USD	0.7649	1.3%	4.3%	-0.1%	-3.0%
USD/CAD	1.3075	-1.3%	-4.1%	0.1%	3.2%
EUR/USD	1.1101	1.9%	-3.2%	-2.6%	-5.6%
GBP/USD	1.2846	4.5%	0.7%	-0.3%	-2.2%
AUD/USD	0.6817	1.0%	-3.3%	-3.4%	-12.3%
USD/JPY	108.6600	0.5%	-0.9%	-3.2%	-4.6%
EUR/JPY	120.6200	2.4%	-4.1%	-5.7%	-10.0%
EUR/GBP	0.8641	-2.6%	-3.9%	-2.3%	-3.5%
EUR/CHF	1.1019	1.3%	-2.1%	-3.1%	-5.5%
USD/SGD	1.3636	-1.3%	0.1%	-1.3%	0.1%
USD/CNY	7.0690	-1.1%	2.8%	1.8%	6.5%
USD/MXN	19.1380	-3.0%	-2.6%	-2.4%	-0.5%
USD/BRL	4.0414	-2.8%	4.3%	8.2%	24.5%

Source - Bloomberg. Note: Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Wednesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing. Data as of 8:43 pm GMT 10/24/19.

Examples of how to interpret currency data: CAD/USD 0.76 means 1 Canadian dollar will buy 0.76 U.S. dollar. CAD/USD 4.3% return means the Canadian dollar rose 4.3% vs. the U.S. dollar year to date. USD/JPY 108.66 means 1 U.S. dollar will buy 108.66 yen. USD/JPY -0.9% return means the U.S. dollar fell 0.9% vs. the yen year to date.



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			Count	Percent
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Hold [Sector Perform]	618	42.74	126	20.39
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