Market Bulletin

Issue No. 220
September 9, 2013

Summary

Economic Analysis

- Canadian August jobs numbers 3x better than estimates represent another data point that suggests the economy may be recovering from a soft patch. **Assuming the Syrian wildcard situation is resolved favourably, the TSX should continue to benefit from its leverage to an improving global economy.**
- U.S. jobs numbers missed estimates for second month, but are not weak enough to derail Federal Reserve's taper plans.

Commentary

Syrian situation could potentially inflict severe damage on markets

Review portfolios urgently as the drums of war beat louder; initiate hedges to mitigate downside risk

Elvis Picardo, CFA

Our assertion in last week's Bulletin that Syria is the new focal point for the markets may have been a little premature, given that investors do not seem unduly concerned at present about the implications of the escalating situation in that nation. Perhaps investors have been lulled into complacency by the fact that geopolitical issues that have erupted from time to time in recent years – most of them in the Middle East – have hardly dented bullish sentiment. **However, the situation this time seems to be a little more serious because of the potential involvement of Russia**, if the U.S. does go ahead and launch military strikes on Syria as punishment for the Syrian government's use of the nerve-gas sarin in an August 21 attack on a Damascus suburb. The U.S. is inching towards its objective, with the Senate Foreign Relations Committee on Friday approving a resolution that authorizes President Obama to take action against the Bashar al-Assad regime. Meanwhile, Russian President Putin pledged that his country will continue supporting Syria, and said that Russia may resume deliveries of advanced S-300 anti-aircraft missiles to the nation if the U.S. attacks it.

Action Items

We recommend reviewing portfolios on an urgent basis to take some money off the table on profitable positions – especially in U.S. equities, with many stocks near record or multi-year highs – and initiate hedges to mitigate downside risk.

Volatility on the S&P 500 and TSX-60 was about 16% and 15% respectively as of Friday's close, based on their respective VIX indices. The cost of downside protection by buying short-term puts is moving higher but is still not too pricey. Based on October ATM puts at Friday's close, the cost of hedging was about 18.6% annualized (actual cost 2.2% for approx. 1½ months) for SPDR units (which track the S&P 500) and 16.0% annualized (actual cost 1.9% for approx. 1½ months) for the XIU units (which track the TSX-60). The best time for purchasing this portfolio insurance may be now, before things really start unravelling and volatility spikes.

Economic Analysis

Canadian August jobs numbers 3x higher than estimates trigger surge in loonie

The Canadian economy created jobs for the first time in three months, with an increase of 59,200 positions that was three times higher than economists' forecast of 20,000. Key points –

- Job gains in August were driven by part-timers and the private sector (Table 1). Part-time workers accounted for 41,800 positions, while full-time personnel made up the balance 17,400. Employee positions comprised 2/3rd of total job gains, with 39,900 in this category, of which 30,900 were in the private sector and 9,000 in the public sector.
- Most of the job creation was in the services sector (+40,600), as groups such as health care & social assistance, and information & recreation rebounded from July's losses. Goods producers added 18,600 jobs, almost all of them in construction (+17,700), while manufacturing also added 5,700 positions.
- Of the four biggest provinces, Quebec was the only one to record job losses (-5,000), while job gains in Ontario, Albert and BC were led by part-time positions. BC added 6,200 jobs, as an increase of 16,000 part-time positions offset a decline of 9,800 full-time positions. The BC unemployment rate fell to 6.6% (from 6.7% in July).

Table 1: Canadian employment metrics (Source: Statistics Canada)

	June '13	July '13	Aug. '13
Unemployment Rate	**7.1%**	**7.2%**	**7.1%**
Employment (net change)*	**-400**	**-39,400**	**59,200**
Full-time	-32,400	-18,300	17,400
Part-time	32,200	-21,200	41,800
Worker classificn. (net change)	**-400**	**-39,400**	**59,200**
Employees	-4,400	-42,500	39,900
Self-employed	4,000	3,200	19,200
Public/private sector (net chg.)	**-4,400**	**-42,500**	**39,900**
Public sector	1,000	-74,000	9,000
Private sector	-5,300	31,400	30,900

The jobs number is yet another data point that suggests the Canadian economy may be recovering from the soft patch it hit earlier this year. The loonie surged by more than a cent against the greenback on the employment data before paring some of its gains. The recent performance of the Canadian economy and TSX Composite is in line with the forecasts outlined in our June 26 Mid-Year Outlook report. In that report, we had posited that the Canadian economy was poised to regain momentum and the TSX would outperform the S&P 500 by a slim margin over the rest of 2013. In its July monetary report, the Bank of Canada forecast GDP growth of 3.8% in Q3 (compared with 1.7% in Q2), while the TSX hit a 3½-month high of 12,888 on Friday and has outperformed the S&P 500 so far in this quarter (5.7% vs. 3.0%). **If the situation in Syria (a wildcard that could disrupt markets, as noted in the earlier section) is resolved favourably, the TSX should continue to benefit from its leverage to an improving global economy**.

U.S. jobs numbers miss expectations for second straight month

Jobs numbers in the U.S. missed expectations for the second successive month in August. The economy added 169,000 jobs last month, compared with economists' average forecast of 180,000, while job gains for the preceding two months were revised lower by a combined 74,000 (July – from 162k to 104k, June – from 188k to 172k). The unemployment rate declined to 7.3% - the lowest since December 2008 – as more than 300,000 people left the workforce. Average hourly earnings for all employees rose by 0.2% from the previous month to $24.05, and are up a healthy 2.2% over the past 12 months.

The trend of U.S. job gains being driven mainly by the private sector has been entrenched for many months and August was no exception. The private sector added 152,000 jobs last month, while government jobs rose by 17,000. Private-sector job creation was largely in the service sector, with a total of 134,000 jobs added in areas such as retail/wholesale trade, education/health services, leisure/hospitality, and professional/business services. Goods producers added 18,000 positions, led by an increase of 14,000 jobs in the manufacturing sector (primarily motor vehicles and parts).

The tepid payroll numbers for the second straight month are probably not weak enough to derail the Fed's tapering plans, especially as recent economic data have been quite strong overall. As an example, the ISM reported on September 5 that its non-manufacturing index, a gauge of the outlook for the services sector, rose from 56.0 in July to 58.6 in August, the highest level since January 2005. The ISM manufacturing report released earlier last week showed U.S. manufacturing is growing at the fastest pace in more than two years, led by the housing recovery and robust automobile sales. Bond guru Bill Gross thinks the Fed will go ahead with its tapering agenda, and will probably reduce its bond-buying program by $10 billion. **We expect more news on this front at the conclusion of the FOMC meeting on Sept.18**.

Market Snapshot

At close on Friday, September 6, 2013

S&P TSX	12820.92	-24.14	Commodities			Yields (%)	Can.	US
TSX Venture	954.92	+7.14	Canadian $ (US cents)	96.03	+0.83	90 Day T-Bill	0.99	0.02
DJIA	14922.50	-14.98	Gold (Spot)-US$	1391.90	+24.40	2-Year Bond	1.29	0.45
S&P 500	1655.17	+0.09	Oil (WTI-Oct.)	110.53	+2.16	10-Yr.Bond	2.76	2.93
NASDAQ	3660.01	+1.23	CRB Index	293.34	+2.63	30-Yr. Bond	3.24	3.87

Thought for the Day

"There was never a good war, or a bad peace." – Benjamin Franklin

DISCLAIMER

IMPORTANT RESEARCH DISCLOSURES

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Strong Buy: Expected total returns of 20% or more over the next 6 – 12 months.
Buy: Expected total returns of 10% to 20% over the next 6 – 12 months.
Speculative Buy: Significant gains expected over the next 6 – 12 months, but entire investment may be at risk.
Hold: Expected total returns of 0% to 10% over the next 6 – 12 months.
Reduce: Expected total returns of up to -10% over the next 6 – 12 months.
Sell: Expected total returns of over -10% over the next 6 – 12 months.

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