ECONOMIC MONITOR

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HIGHLIGHTS

Financial Markets Overview (Page 3)
Although the Fed is preparing markets for a possible interest rate increase later this year, our baseline forecast is for the Fed to hold off until 2016 (if not later). The Bank of Canada is forecast to reduce rates mid-year due to low inflation, hints of wage deceleration and slowing investment.

The Canadian and US Dollars – Some Fundamentals (Page 5)
The volatility in the Canadian dollar results from the fact that Canada is a resource economy and heavily reliant on the extraction and export of resources. When the prices of these resources decline in US dollar terms the Canadian dollar also declines. The US dollar is also a floating currency but other countries have "pegged" their currencies to the US dollar, which is one of the reasons for its persistent overvaluation. This article explores specific economic variables that influence the Canadian and US dollars and provides our outlook for the currencies.

The Canadian Economy (Page 9)
Economic growth is forecast at 2.0% in 2015 down from 2.4% in 2014. House prices are likely to soften in energy dependant provinces and inflation is likely to turn negative in 2015. The Canadian dollar is forecast to weaken further.

The US Economy (Page 18)
Our forecast is for US growth to remain at about 2.4% in 2015. The stronger dollar is likely to have a weakening effect on exports. Headline inflation in the US is forecast to turn negative for most of 2015, putting downward pressure on wages.

Also Inside:
Commodity Price Charts (Page 34)
Equity Market Charts (Page 37)

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Financial Markets Overview

The Fed is preparing markets for a possible rate increase later this year. June 17 or July 29 would appear to be the earliest dates for an increase, should they eventually decide to raise rates. But the Fed also says that any policy tightening will be data dependent, and recent data have been consistently disappointing.

To wit, consumers, an expected source of strength, don't seem very keen on spending their gasoline price windfall. Inflation is set to dip below zero for much of the year, meaning headline inflation will have a dampening effect on wage settlements (crimping consumers' income). The disinflation is not all due to lower energy prices either; the sharp rise in the US dollar is contributing to import price deflation.

Indeed, the rise in the US dollar is, in itself, tantamount to a tightening of monetary policy, and any rise in US interest rates would bring a renewed surge in the US currency. In short, although a US rate increase this year cannot be ruled out we continue to forecast (base case) that the Fed will forego raising rates in 2015.

1. ▶ The **FED FUNDS RATE** is expected to remain in the range of 0% to 0.25% in 2015. Since we expect forthcoming economic data to remain on the soft side and inflation to fall further below target (with not all of the reduction transitory), a sensible time to raise interest rates is sometime after 2015.

2. ▶ The **BANK OF CANADA** is unlikely to be satisfied with a single rate cut. Though Governor Poloz has hinted that there won't be one in March, we expect at least one more cut this year. Our reasons include very weak inflation, hints of wage deceleration, slowing investment and a US economy that looks to be less robust than many have been predicting.

3. ▶ Longer term **BOND YIELDS** are forecast to slip further on the back of weaker inflation and weaker growth. Canadian and foreign investors will also want to take advantage of the relatively high US yields. The risks of Greece leaving the Eurozone and a wider conflict in Ukraine have moderated, which have allowed US yields to rise in recent weeks, but these risks will return. Assuming headline inflation picks up towards the end of the forecast period, and subject to these potential event risks (and a further slowing of Chinese growth and more financial problems in Russia, etc.) yields are forecast to rise somewhat further out.

4. ▶ We continue to have a negative bias toward the **CANADIAN DOLLAR** (see pages 4-5). We don't think energy prices will soon rise on a sustained basis with inventories continuing to rise, and it looks doubtful that China's growth is close to recovering (which affects copper and other commodity prices). And the Bank of Canada is likely to cut rates again … in May?

5. ▶ The **US DOLLAR** is expected to rise against most currencies because central banks abroad are cutting interest rates and/or have adopted QE (the ECB and BoJ). Even if, as forecast, the Fed decides against raising interest rates this year, US growth rates and bond yields will be higher than elsewhere, attracting capital inflows (see pages 6-7).

Updated Forecast - Base Scenario

	Actual				Projected						
	14-II	14-III	14-IV	25-Feb	Mar	Apr	May	15-II	15-III	15-IV	16-I
CURRENCIES	***Scenario B: Very Weak Eurozone, Slowing Chinese Growth; Moderate US Growth***										
US Dollar Index*	79.62	81.08	87.08	93.99	94.93	95.95	96.47	96.53	98.48	99.25	99.70
Can. Dollar: CDN/US	***1.091***	***1.094***	***1.136***	***1.244***	***1.258***	***1.275***	***1.283***	***1.285***	***1.310***	***1.310***	***1.300***
Can. Dollar: US/CDN	91.66	91.41	88.03	80.39	79.49	78.43	77.94	77.82	76.34	76.34	76.92
Japanese Yen	***102.1***	***104.3***	**114.8**	**119.0**	**119.7**	**120.5**	**121.0**	**121.0**	**122.5**	**123.0**	**124.0**
British Pound	168.3	166.9	158.3	155.1	153.3	152.0	151.3	151.3	147.4	144.3	141.8
Euro	***1.371***	***1.325***	***1.249***	***1.136***	***1.125***	***1.115***	***1.110***	***1.110***	***1.080***	***1.055***	***1.035***
Australian Dollar	93.30	92.48	85.53	78.90	77.90	76.86	76.38	76.26	74.81	74.81	75.38
Chinese Yuan/Rmb	***6.158***	***6.160***	***6.138***	***6.260***	***6.250***	***6.250***	***6.250***	***6.250***	***6.250***	***6.250***	***6.235***
Indian Rupee	59.80	60.61	61.92	61.89	61.75	61.25	61.00	60.40	60.00	59.50	59.00

** Index based on CDN$, Euro, Pound, Yen*

INTEREST RATES	***Scenario B: Growth Modest - Inflation Well Below Target***										
	14-II	14-III	14-IV	25-Feb	Mar	Apr	May	15-II	15-III	15-IV	16-I
Canada											
Treasury Bill (91-day)	0.94	0.94	0.90	0.50	0.51	0.47	0.40	0.40	0.40	0.40	0.40
Government Bond (10-yr)	2.29	2.12	1.92	1.32	1.28	1.23	1.15	1.15	1.30	1.50	1.70
Prime	3.00	3.00	3.00	2.88	2.88	2.88	2.75	2.75	2.75	2.75	2.75
Target Overnight Rate	***1.00***	***1.00***	***1.00***	***0.75***	***0.75***	***0.75***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***
Spread: 10-yr - T Bills	1.35	1.18	1.02	0.82	0.77	0.76	0.75	0.75	0.90	1.10	1.30
United States											
Treasury Bill (90-day)	0.03	0.03	0.02	0.02	0.02	0.03	0.03	0.03	0.03	0.03	0.03
Treasury Bond (10-yr)	2.57	2.49	2.23	2.00	1.85	1.80	1.75	1.75	1.95	2.15	2.35
Prime	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Fed Funds Target	***0.09***	***0.09***	***0.10***	***0.13***	***0.13***	***0.13***	***0.13***	***0.13***	***0.13***	***0.13***	***0.13***
Spread: 10-yr - T Bills	2.54	2.46	2.21	1.98	1.83	1.77	1.72	1.72	1.92	2.12	2.32
Interest Rate Differential (Canada-US)											
Treasury Bill	0.91	0.91	0.88	0.50	0.49	0.44	0.37	0.37	0.37	0.37	0.37
Bonds-10yr	-0.28	-0.37	-0.31	-0.68	-0.57	-0.57	-0.60	-0.60	-0.65	-0.65	-0.65

Source: Wall Street Journal, Federal Reserve, DCM Economics

This is our “baseline” scenario for the next four quarters. It is updated monthly. For alternative scenarios the reader should consult the *Currency and Interest Rate Forecast*.

The Canadian and US Dollars – Some Fundamentals

by Martin Murenbeeld

The Canadian Dollar

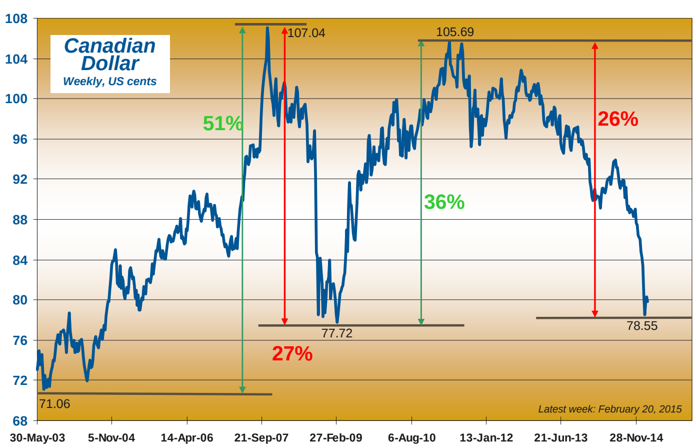
The Canadian dollar has been very volatile in recent years (see Chart 1). This volatility results from the fact that Canada is a resource-rich economy, heavily dependent upon resource extraction and export. Indeed, more than 50% of Canada's exports are raw and semi-fabricated materials (commodities/resources/foodstuffs)!

The Canadian dollar isn't the only volatile "*commodity currency*"; the Aussie dollar has been equally – even more – volatile than the Canadian dollar in recent years.

"*Commodity currency*" volatility is an unfortunate fact of life. Thankfully the Bank of Canada no longer follows a policy of official intervention (a.k.a. a policy of "*leaning against the wind*"). Official intervention not only adds another level of uncertainty to foreign exchange market transactions – that of when and by how much the Bank of Canada will intervene - but it also tends to lead to profitable speculation when market forces are only dampened and not actually reversed.

Chart 1: The Canadian Dollar

Has been quite volatile in recent years …



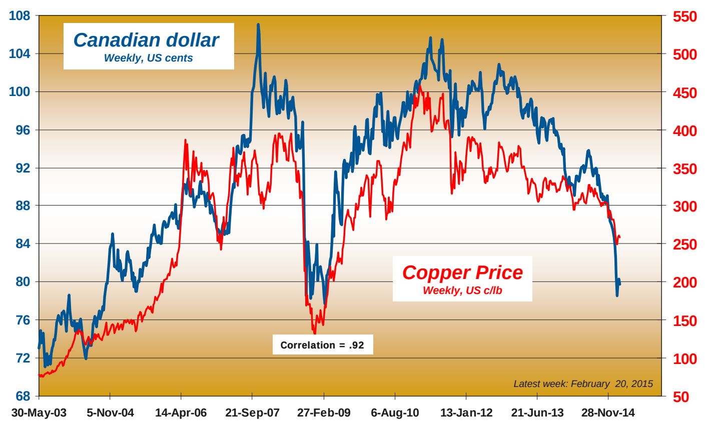
Source: Thomson Reuters Datastream, WSJ, DCM Economics

In our opinion the Bank's hands-off dollar policy is the right policy; the dollar floats freely and assists in the process of economic adjustment to changes in global developments (i.e., plunging commodity prices). A country like Greece does not have an independent exchange rate, much less a floating one; Greece must accordingly adjust to changing developments in the Eurozone and abroad with domestic fiscal policies (including structural policies). We have seen how much more difficult this has turned out to be!

(Imagine for a moment that the Canadian dollar was fixed at par with the US dollar; today, with plunging resource prices, domestic wages and prices would have to decline in order to keep unemployment rates from rising into double digits. Provincial and federal governments would have to borrow heavily to maintain their current expenditure levels and to provide counter-cyclical economic support; or they would have to cut back on services – including, of course, social services and other transfer payments! Canada's bond rating would likely decline too because, most assuredly, Canada's foreign debt levels would rise substantially as the government borrowed US dollars to arrest speculation that the Canadian dollar would have to be devalued. In short order the fixed exchange rate scenario would begin to look a little like the scenarios facing the southern Eurozone!)

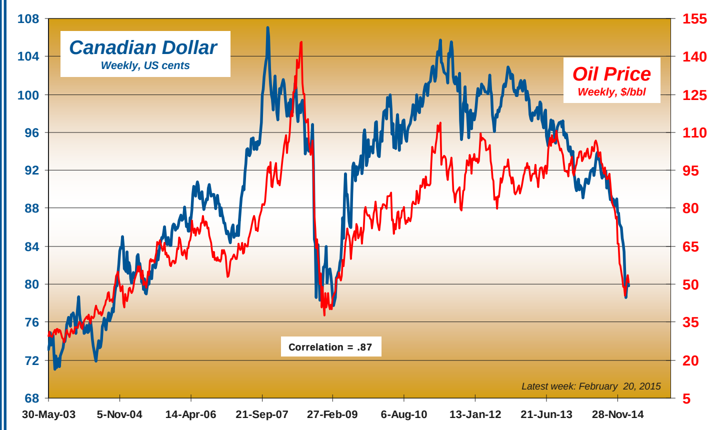
Charts 2 and 3 overleaf compare the Canadian dollar with copper and oil prices respectively. The relationship is stark: lower commodity prices beget a lower dollar. (Although Canada does have an impact on the global supply of copper and oil, it has limited control over the US dollar price of these commodities. Accordingly the causality runs from commodity prices to the dollar and not the other way around.)

Chart 2: The Canadian Dollar
… is very sensitive to commodity prices…



Source: Thomson Reuters Datastream, WSJ, DCM Economics

Chart 3: The Canadian Dollar
… and oil prices have tumbled …

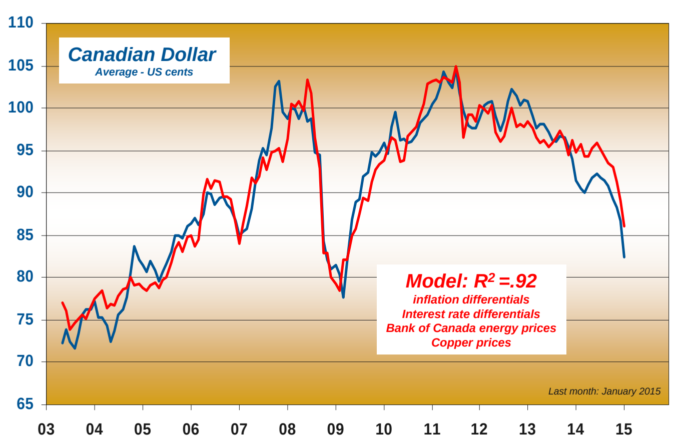


Source: Thomson Reuters Datastream, WSJ, DCM Economics

This analysis can be stepped up by including more variables in a model of the Canadian dollar, as in Chart 4. This chart highlights the monthly average prices of the Canadian dollar with a model that includes the Bank of Canada's Energy Commodity Price (which includes both oil and gas prices), the copper price, Canada-US inflation differentials, and Canada-US long-term yield differentials.

The model in Chart 4 is quite robust, the R^2 is 0.92, but the period of time is relatively short – 2003/05 to 2015/01 (so it may be compared to Charts 1-3). The relatively short time period means that the coefficients in the model, although statistically very significant, will likely change over time. (Accordingly, we update these models often!)

Chart 4: The Canadian Dollar
Model based (in part) on commodity prices …



Source: Thomson Reuters Datastream, DCM Economics

The model in Chart 4 suggests that the dollar will rise when:

1. Oil/gas prices rise
2. Copper prices rise
3. Canadian yields rise relative to US yields
4. Canadian inflation declines relative to US inflation

So how likely are such developments in 2015? With respect to points 1 and 2, it is doubtful either price will rise fundamentally in 2015, but by 2015 year-end both energy prices and copper prices may well have bottomened. At this stage, we probably need to wait for 2016 before we get more clarity on the strength of the eventual upturn in commodity prices.

As for point 3, it is most likely that the Canadian-US yield differential will continue to move in favor of the US in 2015, i.e., Canadian yields will decline relative to US yields – either because Canadian yields decline or because US yields rise on the back of ongoing speculation of a Fed rate hike sometime this year.

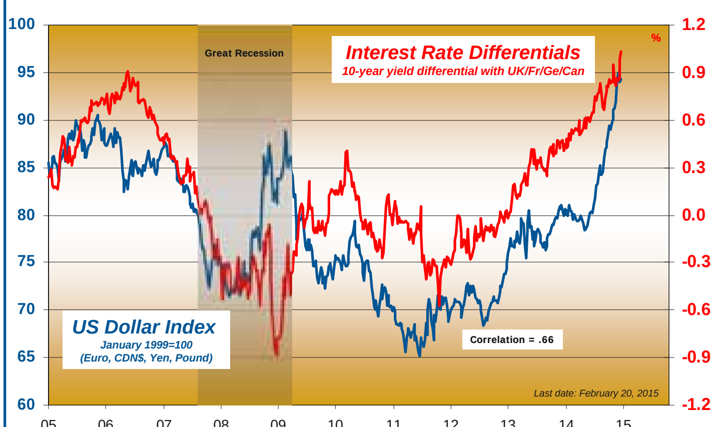
The inflation factor is always a bit tricky because it has a direct impact on Bank of Canada and Fed policy. Yes, higher Canadian inflation undermines the Canadian dollar, but that is under the assumption of *"all else constant"*. The lower Canadian dollar also has a tendency to affect inflation after the fact, and of course any rise in inflation in Canada will affect the Bank's thinking on whether it will cut rates further. All in, we do not think inflation will be a significant dollar factor this year – in light of the other three factors. As a result, the Canadian dollar forecast is mildly negative for 2015, even from the current 80-cent level.

The US Dollar

The US dollar is also a floating currency. The Federal Reserve Bank of New York (which is the US central bank when it comes to matters of international finance) does not intervene in foreign exchange markets. Unfortunately however, other central banks do intervene! One of the costs of the dollar being a reserve currency is its persistent overvaluation; foreign central banks will manipulate the value of their own currencies in terms of the dollar - most often by simply buying the dollar in local foreign exchange markets and selling their own currencies.

Chart 5: The US Dollar

Sensitive to interest rate differentials …



Source: Thomson Reuters Datastream, DCM Economics

So the US dollar floats, but it does not float freely; it floats freely against the Canadian dollar, but not, for example, against the renminbi. That said, there are still a number of variables that will affect the US dollar.

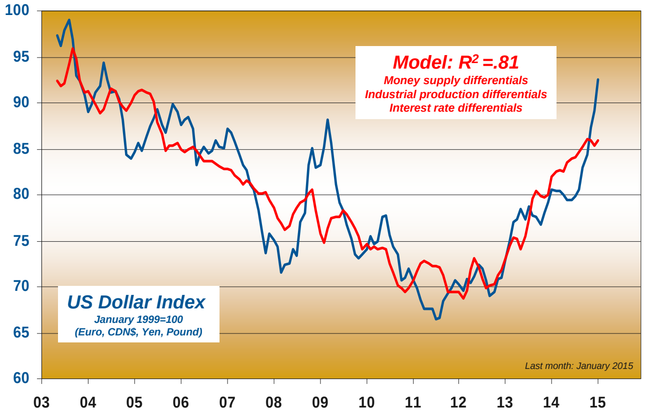
(All references to the US dollar from this point forward are references to an index for the US dollar based on a basket of currencies. In our work we set the dollar's index to 100 for January 1999; when that index is below 100, as currently, it means that the US dollar has declined against the currencies in the basket since January 1999. Different banks and agencies will construct different currency baskets for the US dollar, but at a minimum these baskets all include the Canadian dollar, the yen, the euro and the pound.)

One factor that affects the dollar's value is the US-Overseas yield differential, see Chart 5. The correlation of the yield differential with the dollar's index (based on the aforementioned four currencies) is a robust .66, despite the brief breakdown during the Great Recession.

The chart suggests that the dollar index is likely to rise when the yield differential rises in favor of the US. One key reason – there are others - many forecasters call for a firmer US dollar in 2015 is because US interest rate differentials are expected to widen further in favor of the US (either because the Fed will indeed raise interest rates or because overseas interest rates will decline yet further, or both).

Chart 6 highlights a model of the US dollar index; the explanatory variables include US-G-7 industrial production differentials, US-EU money supply differentials, and US-G-7 long and short-term interest rate differentials.

Chart 6: The US Dollar
model based on "differentials" with G-7 countries …



Source: Thomson Reuters Datastream, DCM Economics

The model indicates that the US dollar index will rise when:

1. Interest rate differentials (long-term/short-term) widen in favor of the US
2. US industrial production rises more rapidly relative to that abroad
3. US money supply growth rises relative to that abroad

These results are not surprising; indeed, the first point is consistent with the results of the Canadian dollar model in Chart 4: the Canadian dollar will decline against the US dollar when US yields rise relative to Canadian yields, all else constant.

So what do we see for 2015?

The interest rate differential has moved in favor of the US Dollar, and we think it will continue to move in favor of the dollar – though not necessarily at the same rate as that reflected in Chart 5. Overseas yields are certainly about as low as they are likely to go (they are at century lows in Europe for example), but with deflation gripping the continent it is conceivable Eurozone rates will drift lower yet. And we shouldn't forget about the ECB's €60 billion monthly QE, which will last through at least September 2016. So even if US yields do not drift higher the yield differential will likely still widen somewhat in favor of the dollar.

As for point 2: industrial production, the US economic expansion may not be strong, but it is stronger than that abroad (or that in Canada). So this is definite plus for the US dollar!

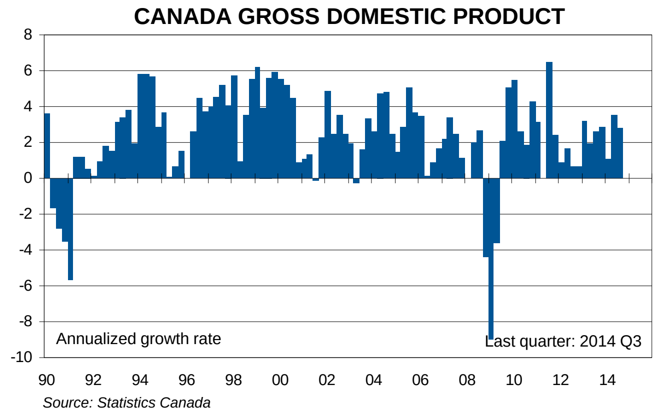
Money supply growth, as per point 3, reflects economic growth (much of which is not captured by industrial production) and credit growth; the US has the advantage here. Excess money supply growth is inflationary, but this is not a consideration at this time. If/when inflation in the US does pick up as a result of accelerated US money supply growth however, the market will expect the Fed to become much more aggressive on the interest rate front. We don't think point 3 will be an issue of consequence in 2015, but it may become one thereafter.

In short, the factors in the model suggest that the US dollar index will be firm in 2015. Because it is an index made up of four currencies however, the US dollar need not rise against all four currencies in 2015 for the index to rise. The US dollar index can rise even if, for example, the Canadian dollar hangs around the 80-cent level; all that is required is for the US dollar to rise significantly against one or two of the four currencies!

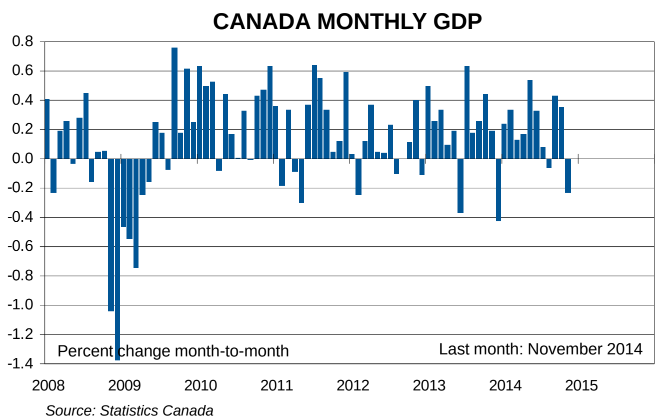
MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Economic growth is expected to be 2.4% in 2014, fading to 2.0% or less in 2015.

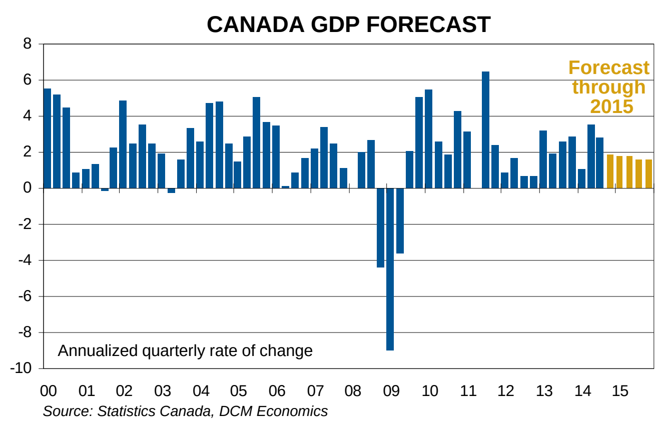
Rebounding from a weather-depressed first quarter, growth was temporarily above trend in the second and third quarters.



In the twelve months through November, growth was only 1.9%.

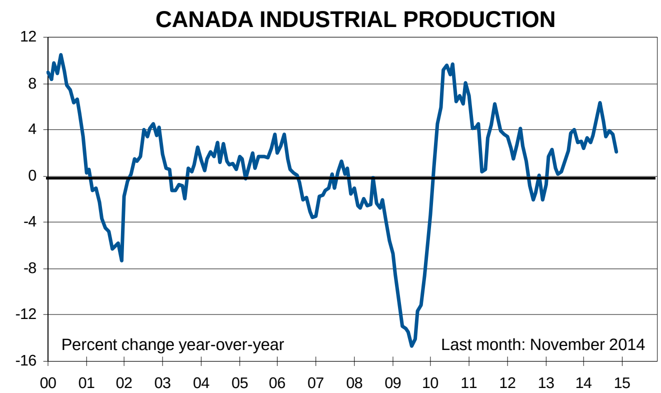


The lower Canadian dollar and lower mortgage rates will help growth somewhat in 2015, but not enough to offset energy sector weakness.



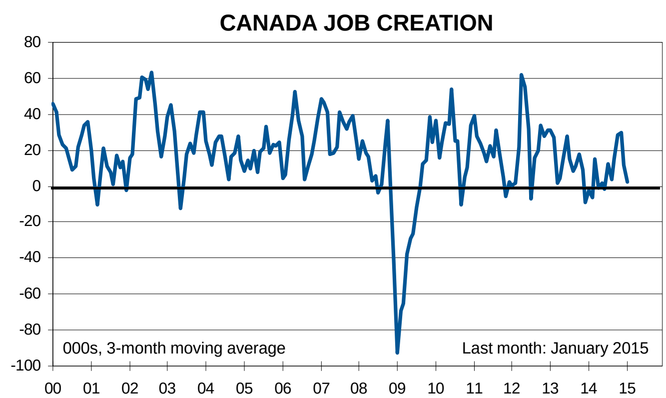
MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Industrial production grew by 2.1% in the twelve months through November.



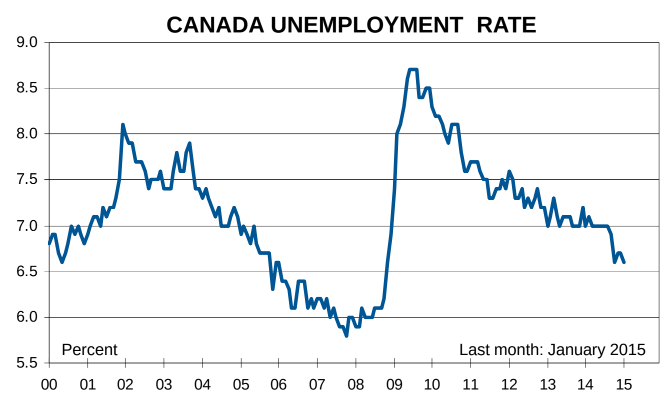
Source: Statistics Canada

Job creation has slowed.



Source: Statistics Canada

At 6.6% the unemployment rate is the lowest in years.

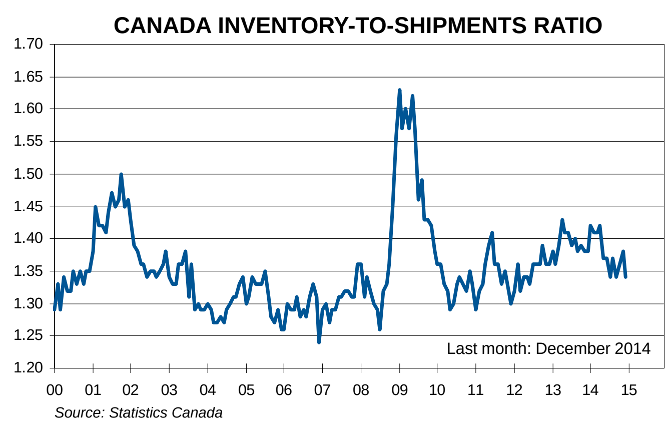


Source: Statistics Canada

Manufacturing shipments rose somewhat in December ...

... and although new orders increased from November to December, gains have been fairly modest since spiking in February 2014.

Inventories have fallen back but still look a bit high relative to shipments.

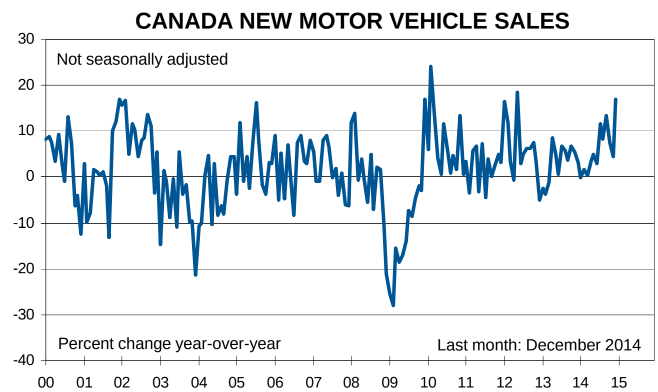


MONTHLY REVIEW ► CANADA – ECONOMIC GROWTH

Retail sales have been fairly strong, despite a disappointing December. The weak Canadian dollar has kept Canadian shoppers at home, boosting domestic sales.

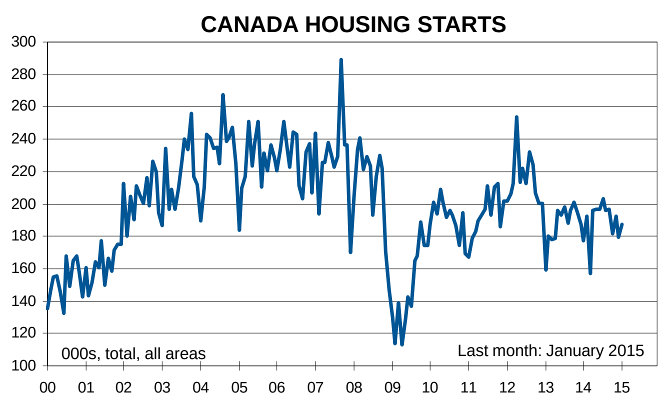
Source: Statistics Canada

Canadian vehicle sales have been strong.



Source: Statistics Canada

Housing starts were unexpectedly strong in January. At some point the numbers are likely to come down and reflect the current weakness in energy-producing provinces.

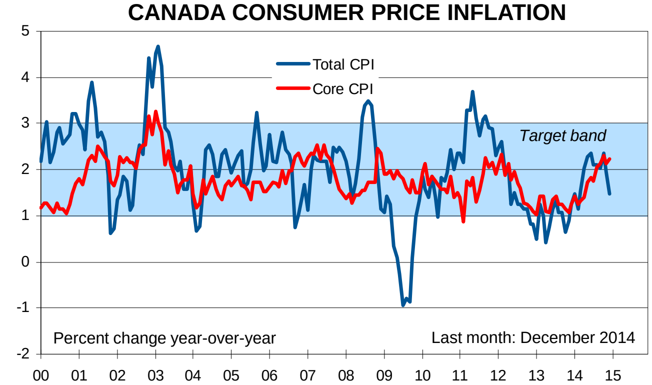


Source: Canada Mortgage & Housing Corporation

MONTHLY REVIEW ►
CANADA – INFLATION

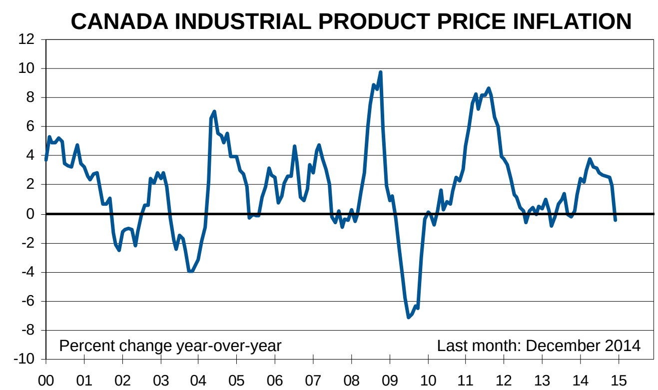
With energy prices down, Canada's CPI could well turn negative for some of 2015.

Headline inflation was 1.5% in December, though the core rate nudged up to 2.2%.



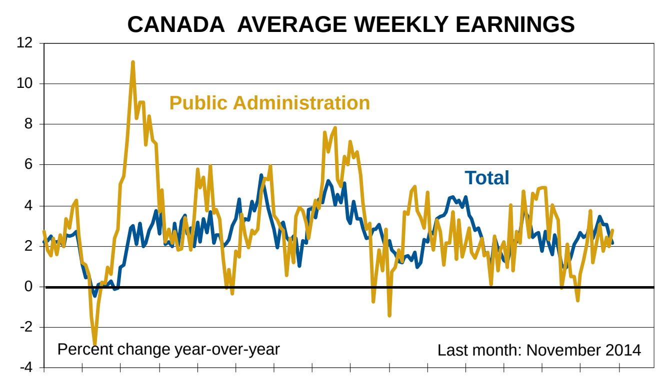
Source: Statistics Canada

Industrial product price inflation turned negative in December.



Source: Statistics Canada

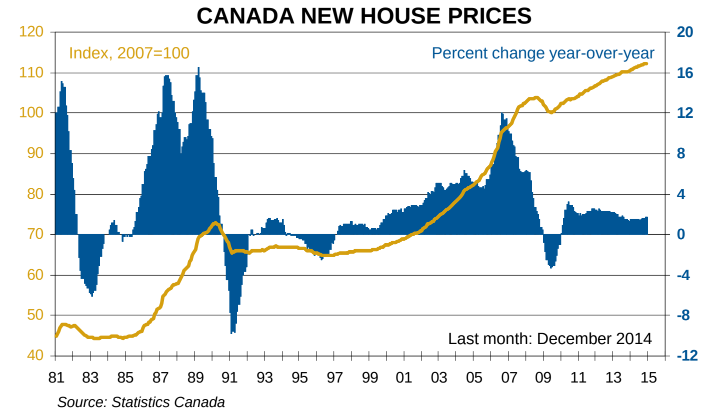
Wage increases decelerated to 2.2% in November.



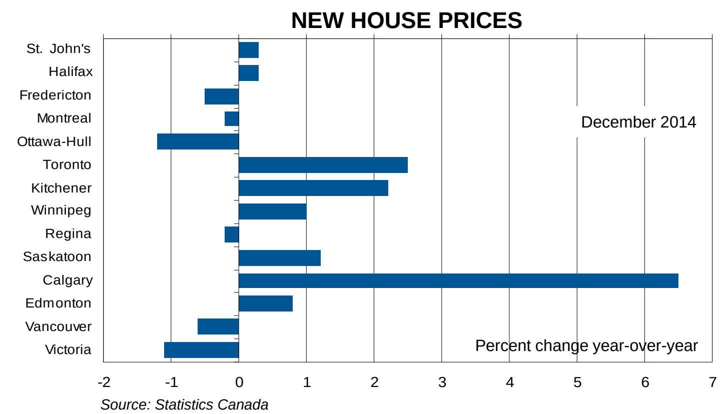
Source: Statistics Canada

MONTHLY REVIEW ► CANADA – INFLATION

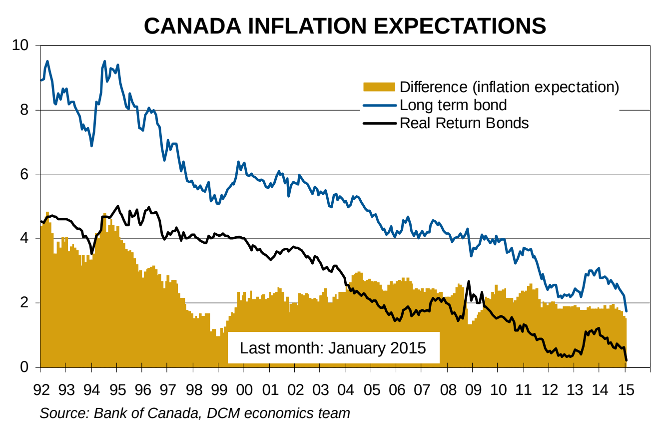
New house prices, up 1.7% year-over-year, show signs of continued deceleration.



Calgary is morphing from the once hottest market into something much cooler.

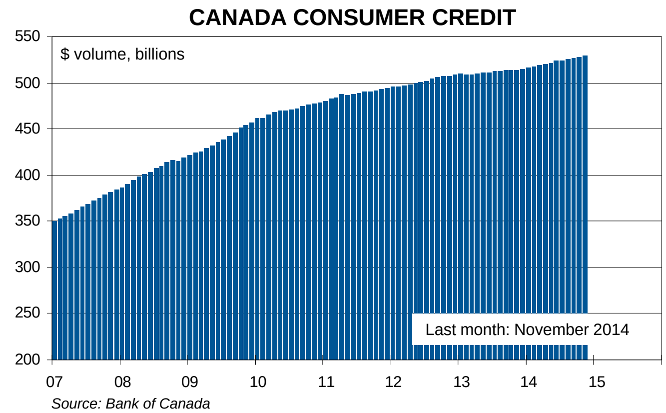


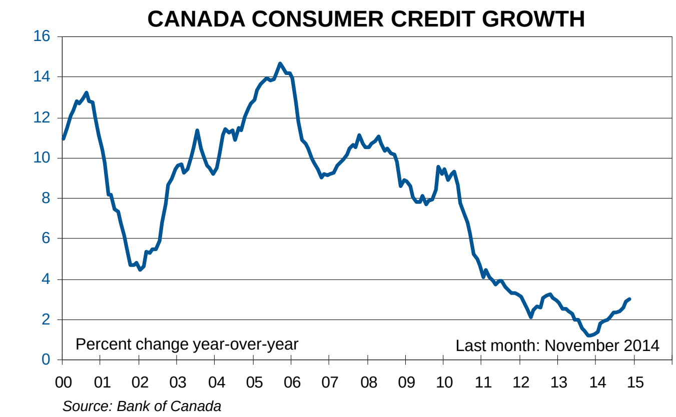
Inflation expectations are falling.

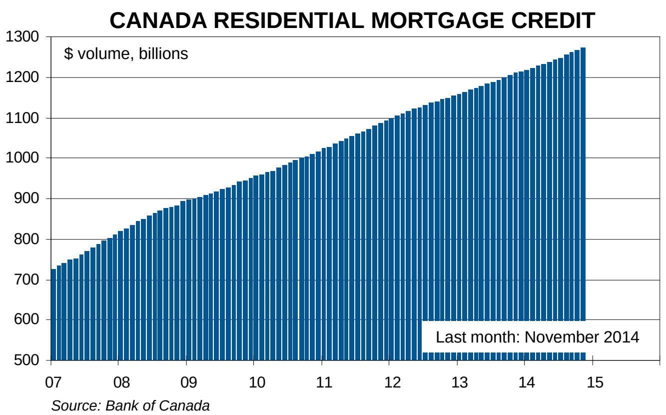


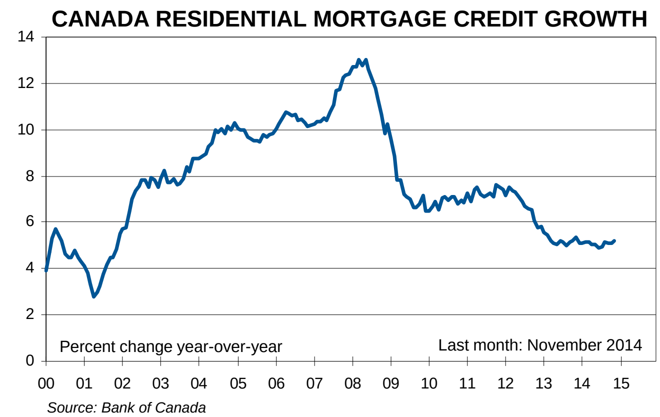
MONTHLY REVIEW ►
CANADA – DEBT AND CREDIT

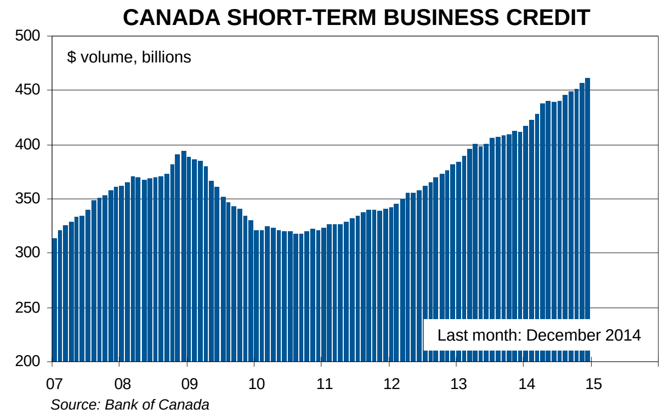
Consumer credit growth is slow but accelerating; mortgage credit growth remains modest while business credit growth has been strong.

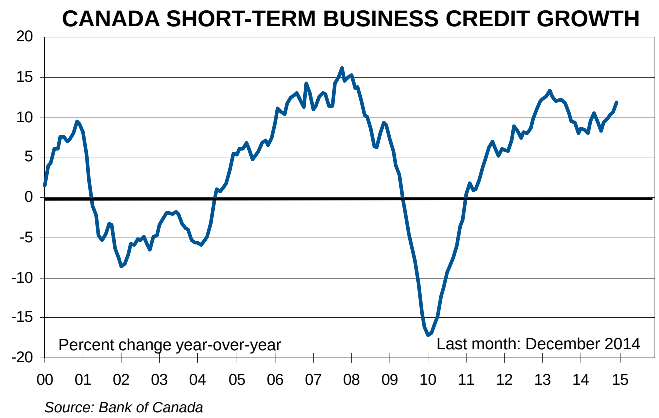






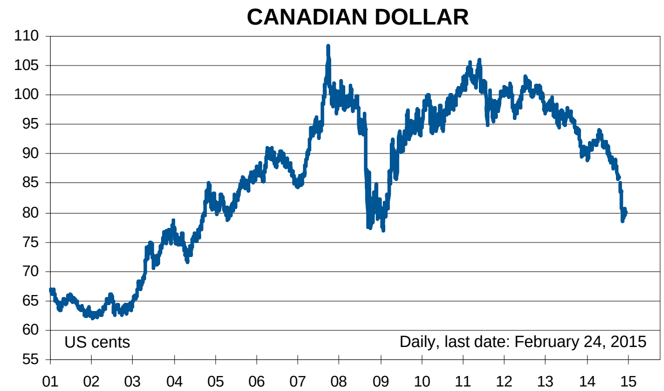






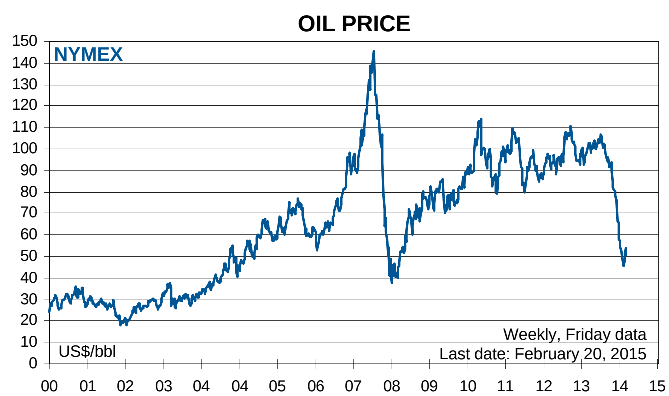
MONTHLY REVIEW ►
CANADA – FINANCIAL MARKETS

The Canadian dollar has shown some stability near 80 cents - but we think it likely has further downside.



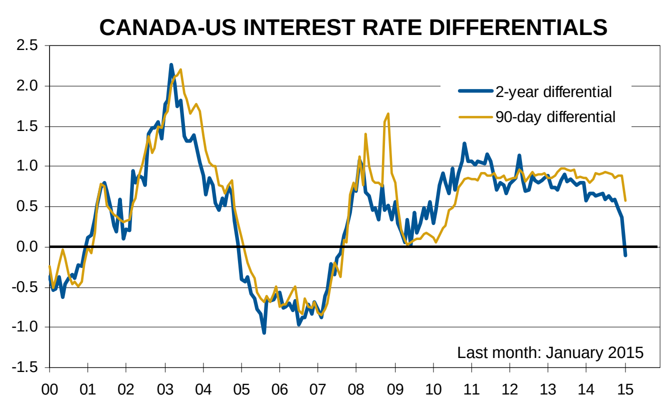
Source: Wall Street Journal

Oil prices show some stability at $50+, but here too there would appear to be further downside potential as oil and natural gas markets are still in surplus (i.e. high inventories).



Source: Wall Street Journal

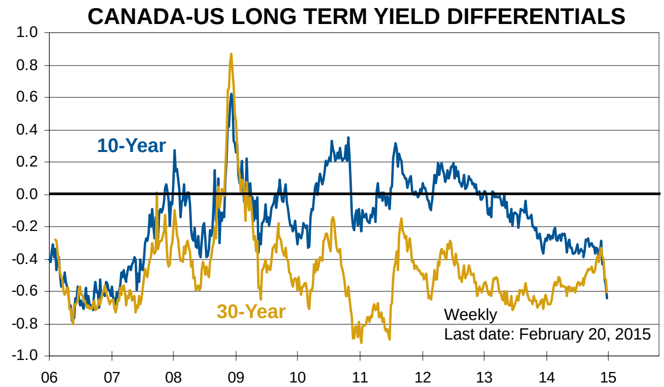
Short-term Canada-US differentials have plunged and probably have further to go.



Source: Bank of Canada, Federal Reserve

MONTHLY REVIEW ►
CANADA – FINANCIAL MARKETS

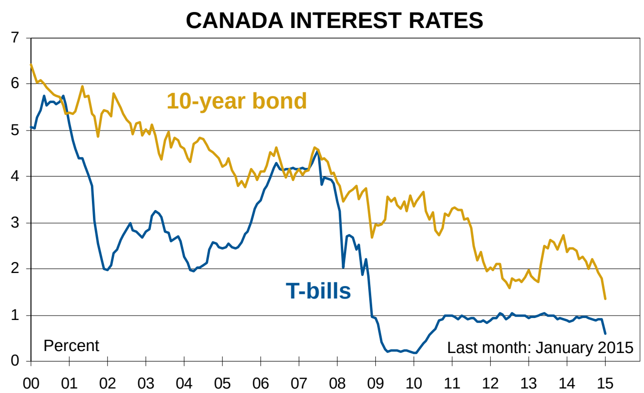
Longer term Canadian yields have fallen further behind their US counterparts.



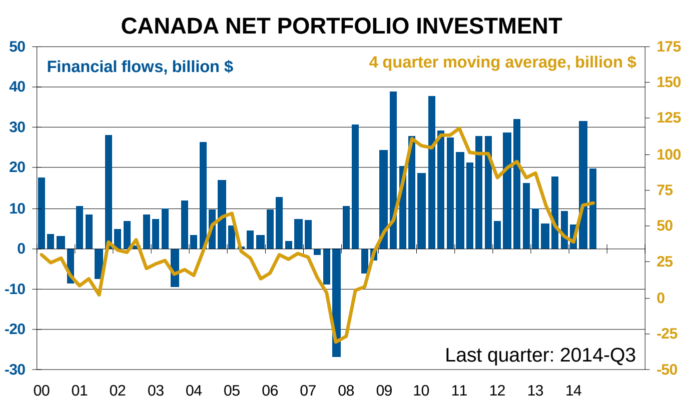
Source: Bank of Canada, Federal Reserve

We expect at least one additional rate cut by the Bank of Canada later this year.

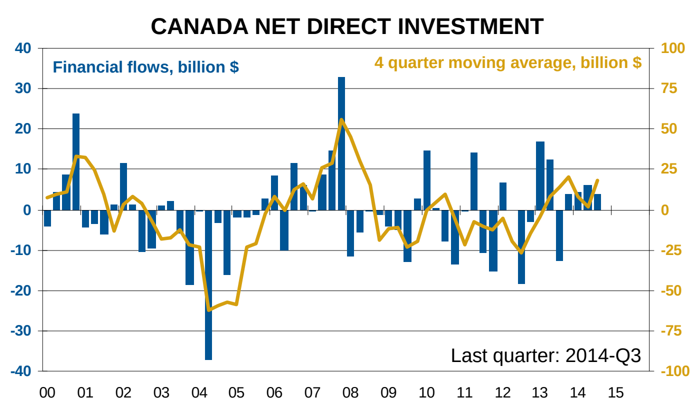
While net capital inflows into Canada have looked constructive in recent quarters, significant outflows were reported in December (not shown in the chart).



Source: Bank of Canada



Source: Statistics Canada

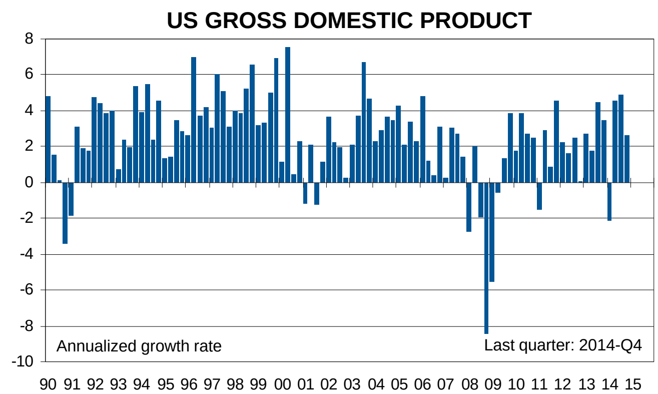


Source: Statistics Canada

MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

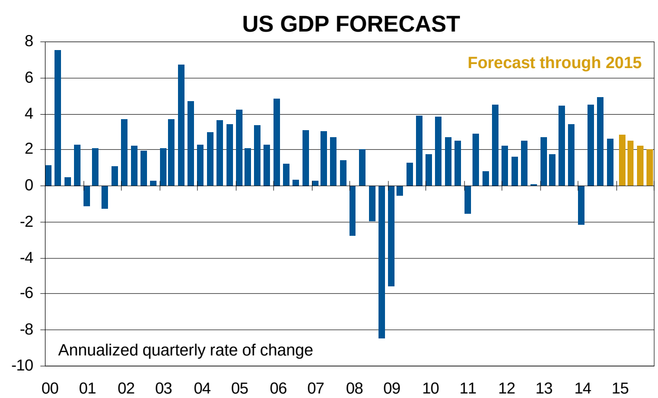
Growth for 2014 looks to have been about 2.4%; we expect a similar pace in 2015.

Despite strong second and third quarters, growth for the full year was only 2.4% (first estimate).



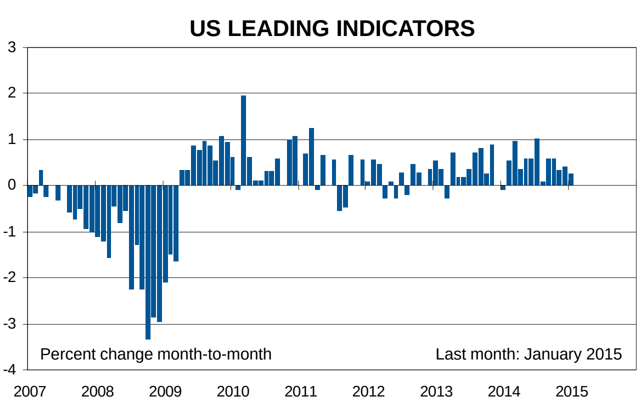
Source: US Bureau of Economic Analysis

Future growth is apt to be subdued because of weaker energy investment and deteriorating net exports. There will be a boost from lower gasoline prices, but ageing consumers may save much of the windfall.



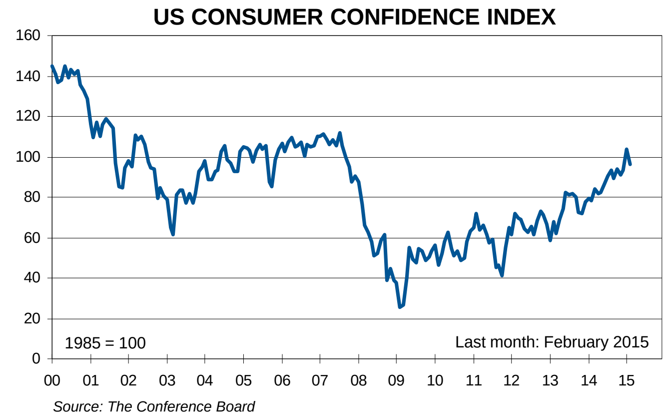
Source: US Bureau of Economic Analysis, DCM Economics

The leading indicators are looking a little less bullish.

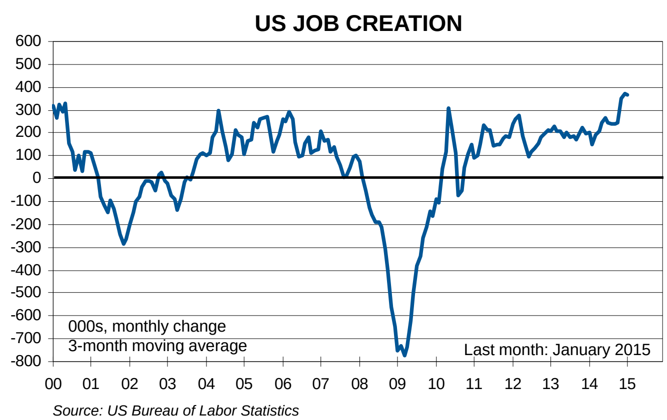


Source: The Conference Board

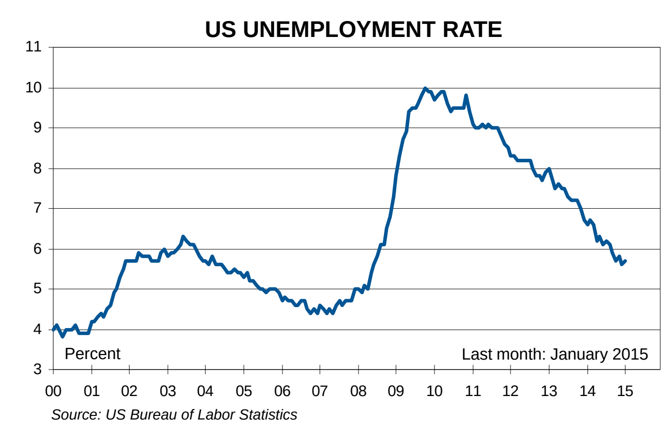
Consumer confidence jumped in January but fell back in February on stock market weakness.



Job creation has been extremely strong, with numbers for recent months revised up. The strength has fed speculation of a Fed rate hike later this year. However labour market data are lagging indicators and other recent economic data have turned weaker than expected.

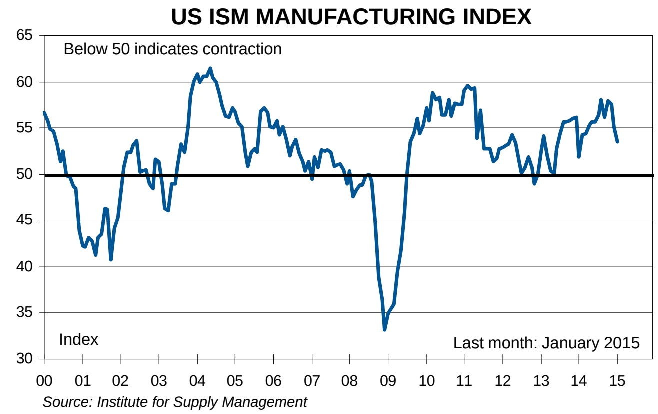


The unemployment rate is near a low since the recession.

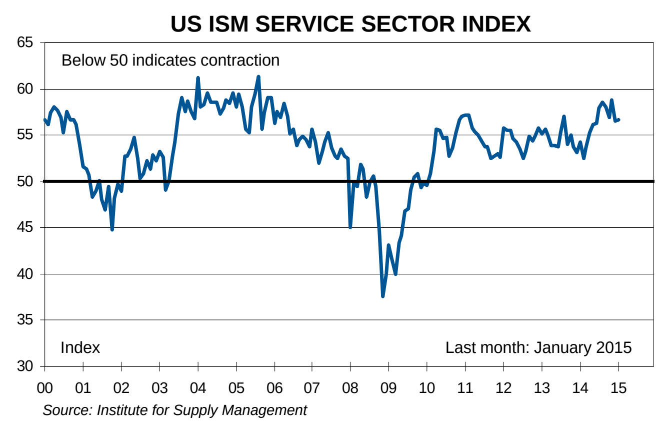


MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

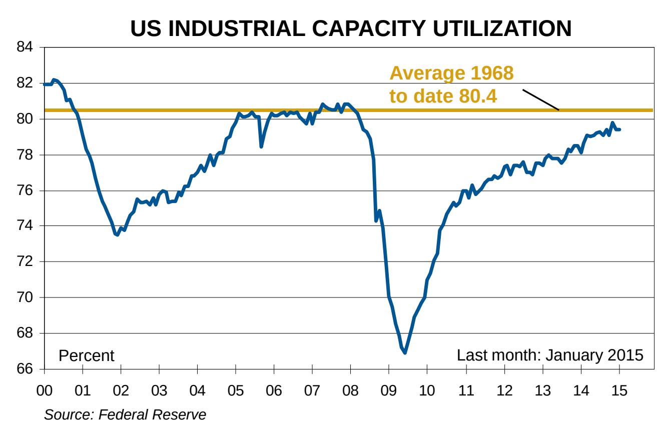
The manufacturing index fell sharply for a second straight month in January.



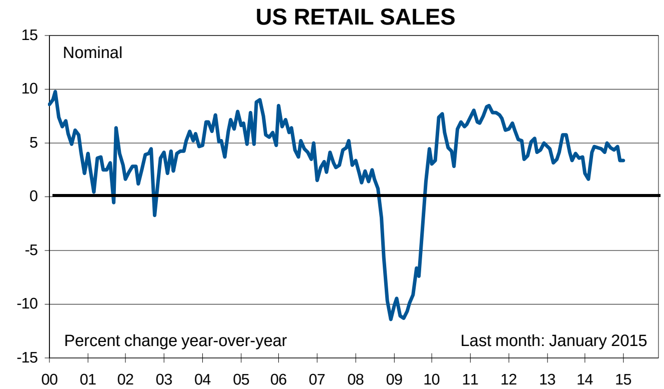
The service sector activity index is also off its peak.



Capacity utilization remains below average, hinting that inflationary pressures remain minimal.

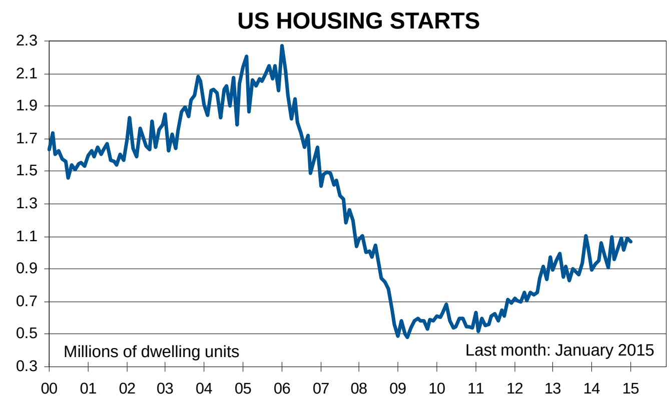


Retail sales disappointed in January, with little sign that consumers were spending the lower gasoline price windfall.



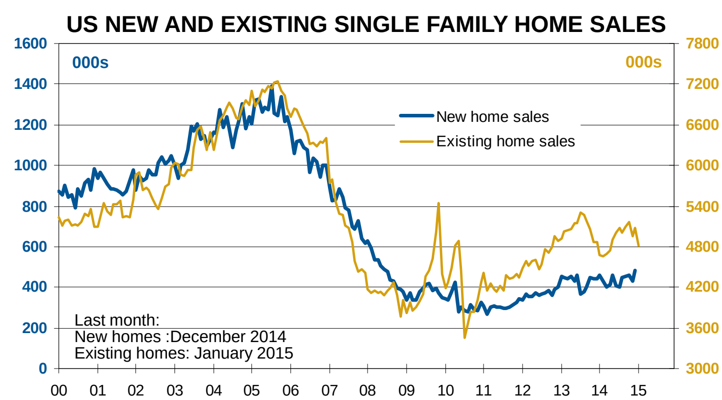
Source: US Census Bureau

Housing starts slipped in January.



Source: US Census Bureau

Sales of existing homes disappointed in January. New home sales remain fairly sluggish.

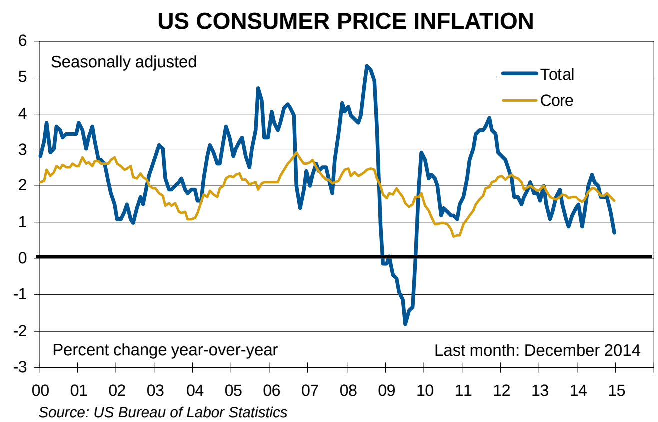


Source: US Census Bureau, National Association of Realtors

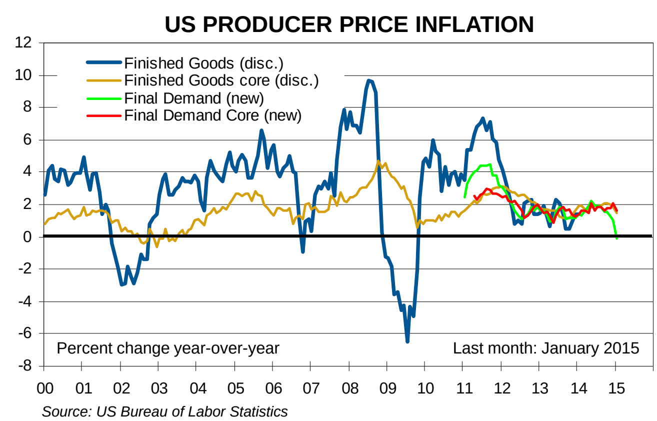
MONTHLY REVIEW ►
UNITED STATES – INFLATION

CPI looks set to turn negative but may climb back above zero by late 2015.

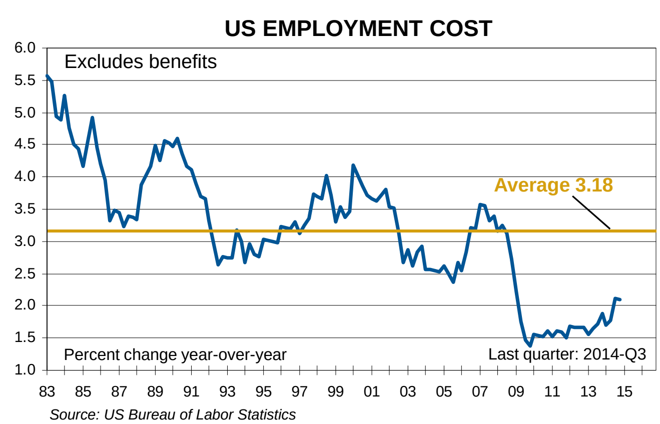
Headline CPI was down to 0.7% in December, with core inflation slipping to 1.6%.



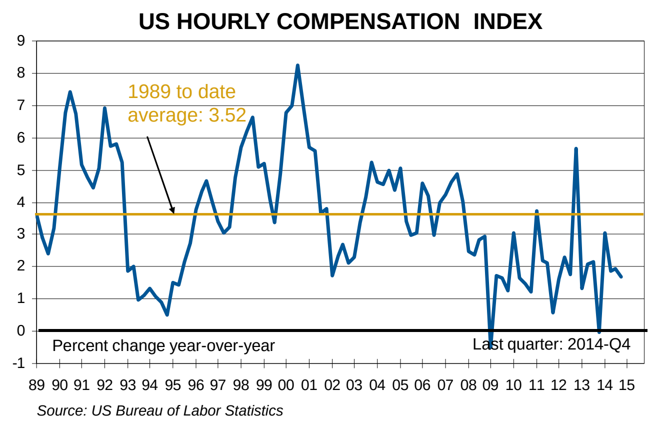
Producer price inflation was -0.1% in January. Core producer price inflation has retreated to 1.5%.



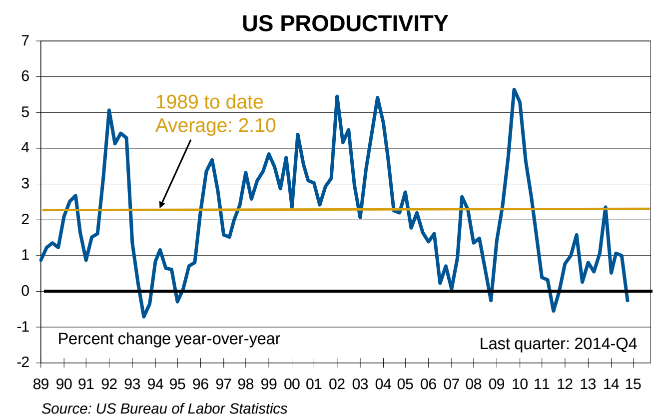
Wage increases have risen 2.1% over the latest four quarters - accelerating somewhat, though still very low.



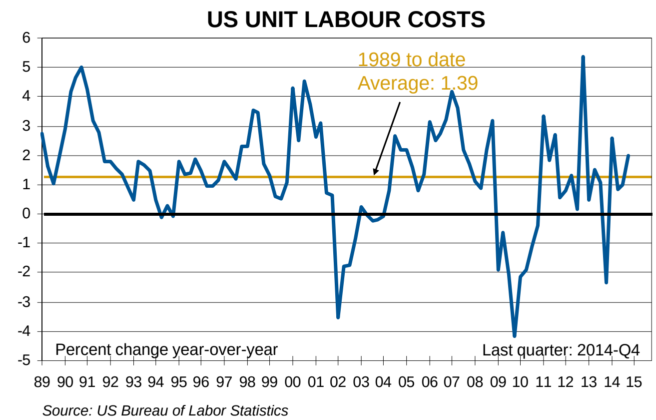
Hourly compensation gains have averaged 2.1% over the past four quarters.



Productivity over the past four quarters rose by a disappointing 0.6%.

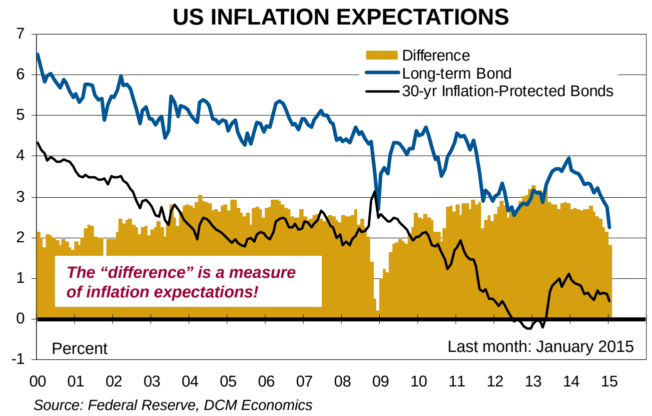


Unit labour costs increased 1.6% over the past four quarters.

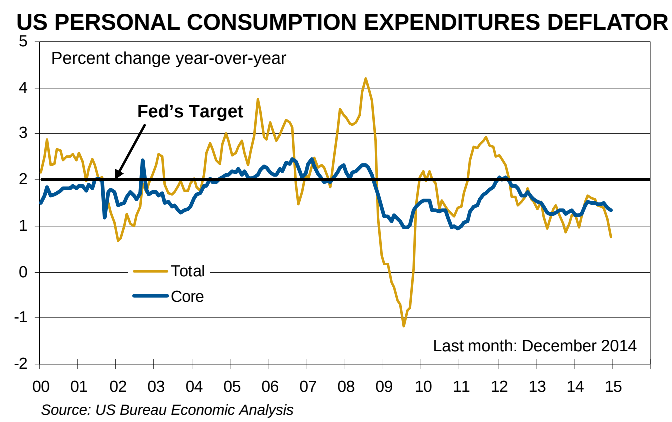


MONTHLY REVIEW ►
UNITED STATES – INFLATION

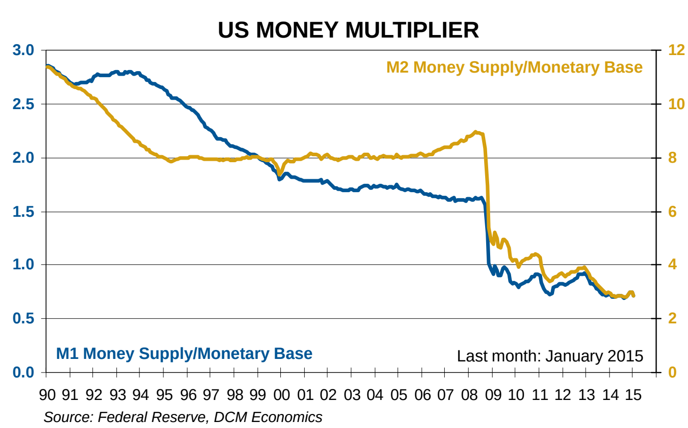
Declining inflation expectations are becoming a worry for the Fed.



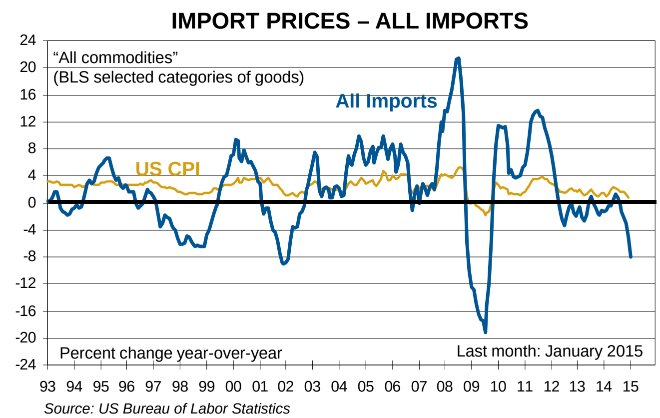
The headline PCE deflator rose 0.8% in the twelve months through December, while the core rate rose 1.3% (the slowest since March).



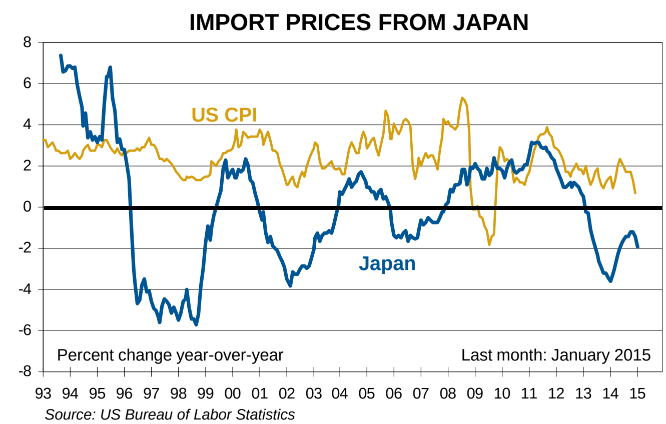
The money multipliers appear stuck at record lows.

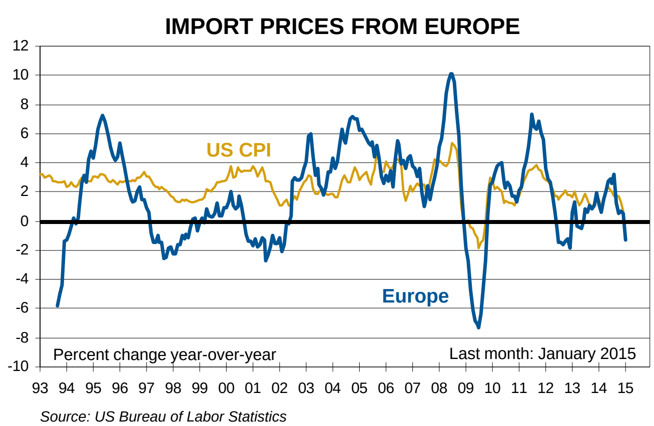


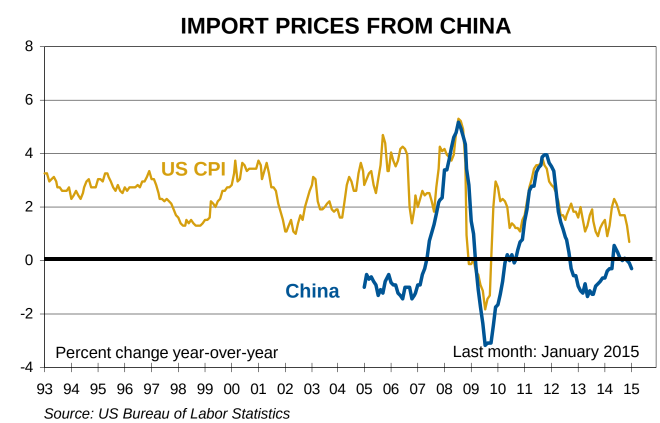
Import prices are being led down by the falling cost of oil and natural gas.



Asian import prices are also falling (weak currencies), and European import prices are now falling too (on the back of the weak euro).

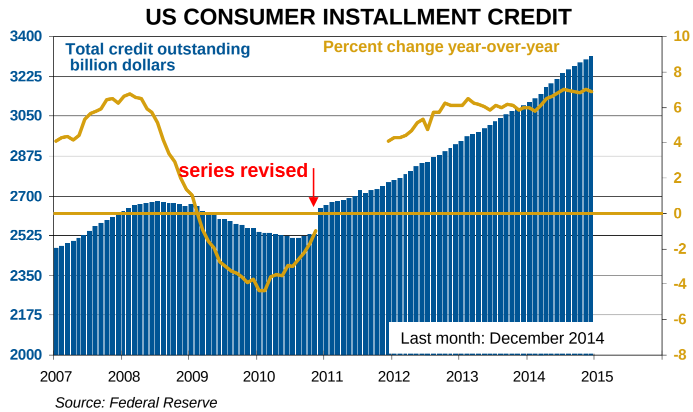


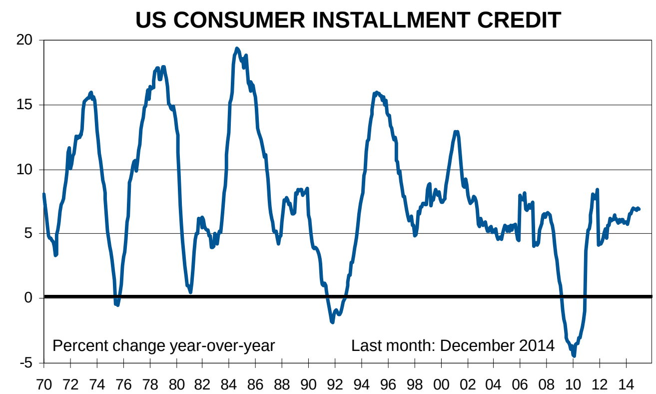


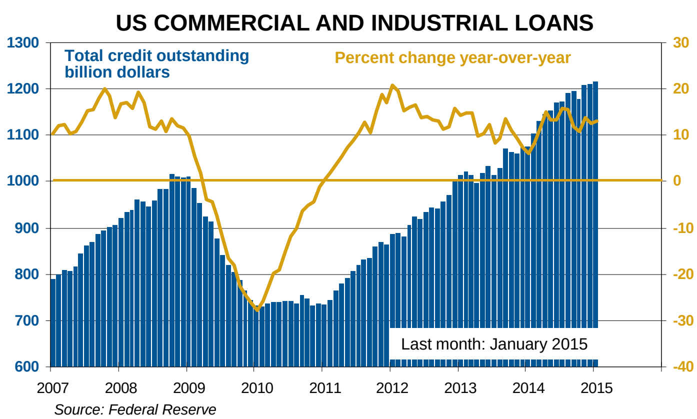


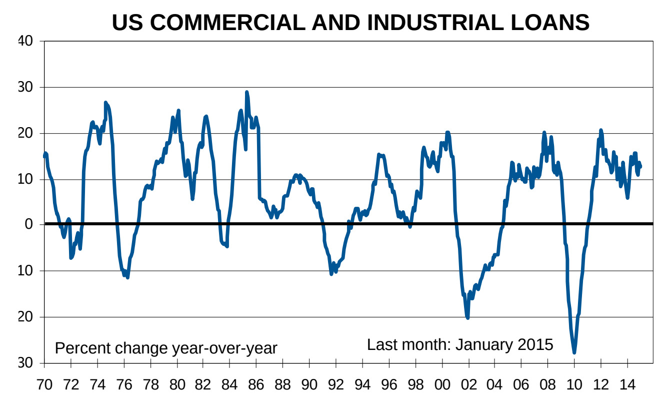
MONTHLY REVIEW ►
UNITED STATES – CREDIT GROWTH

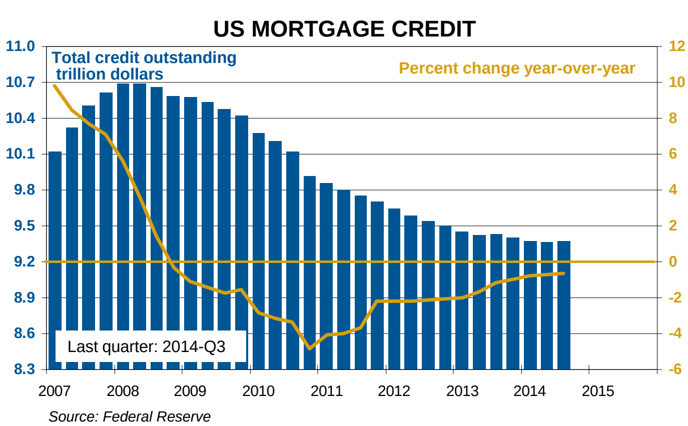
Credit growth remains somewhat limp compared with past cycles. Mortgage credit was still contracting in the third quarter. Delinquencies have also recently risen somewhat in the two fastest growing consumer debt categories - auto loans and student loans.

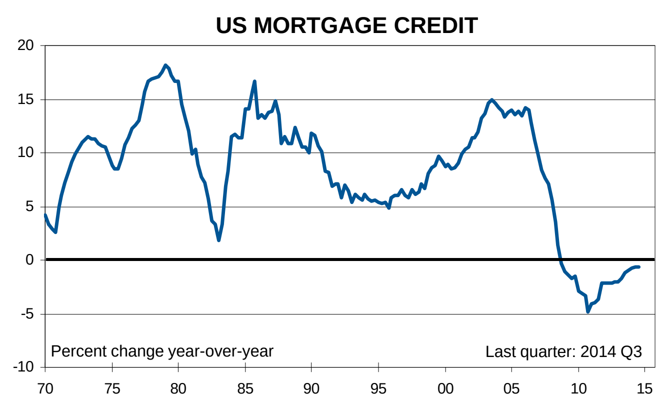






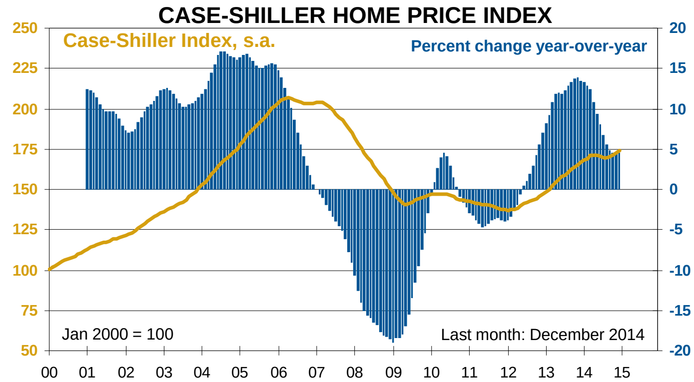




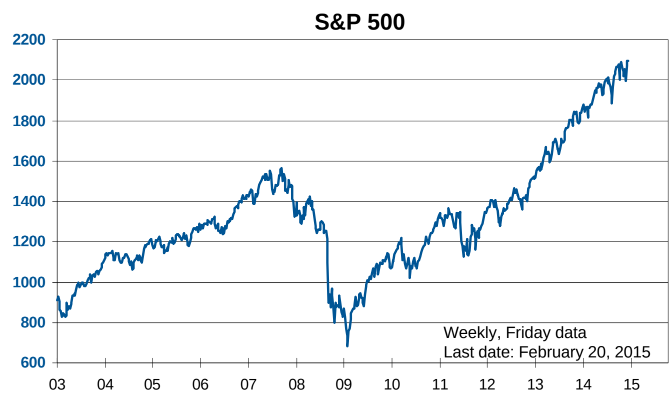


MONTHLY REVIEW ►
UNITED STATES – WEALTH CREATION

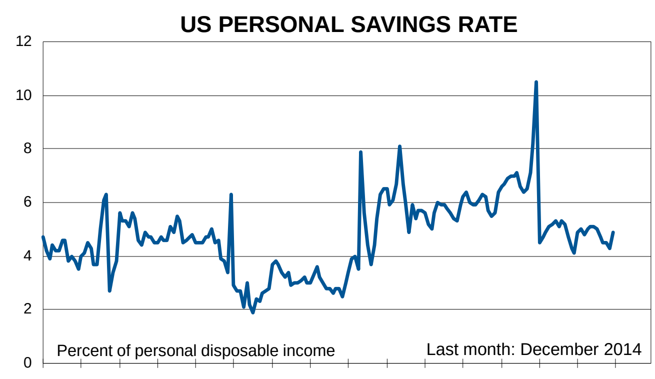
The contraction in year-over-year home price comparisons appears to have ended.



The S&P 500 is looking a bit toppy as the market adjusts to earnings disappointments. Apart from weaker natural resource prices, the main influence has been the rising US dollar on multi-national corporate profits.



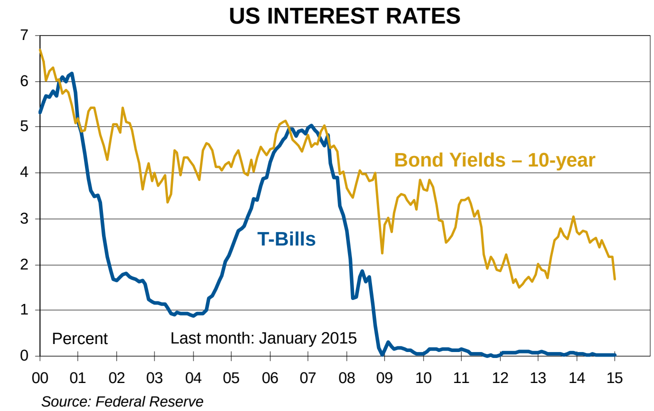
The savings rate turned up in December. Will ageing boomers continue to save rather than spend much of the gasoline price windfall?



Source: US Bureau of Economic Analysis

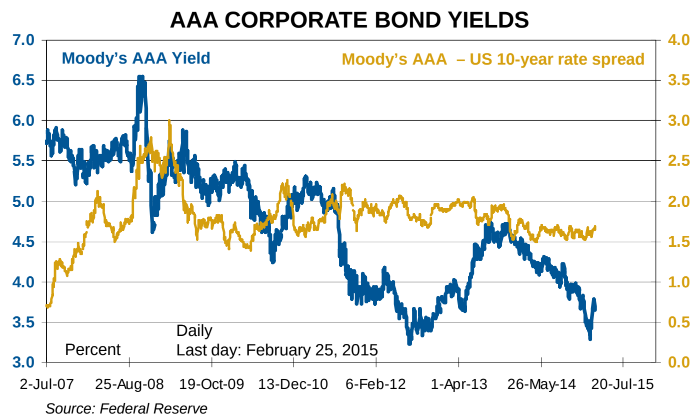
MONTHLY REVIEW ►
UNITED STATES – FINANCIAL MARKETS

We continue to think that the odds of a Fed rate hike this year are below 50%.



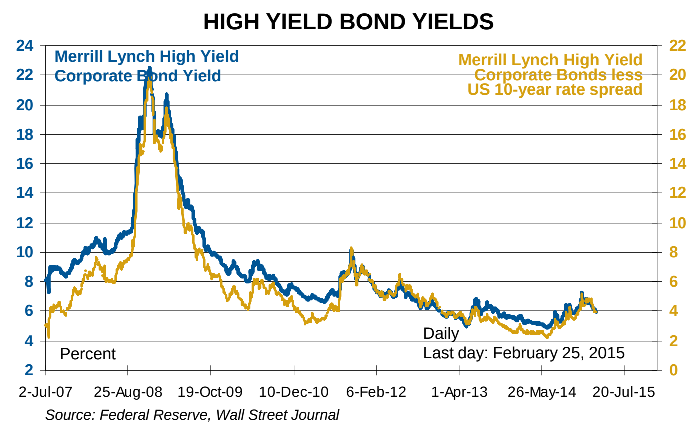
Source: Federal Reserve

AAA bond yield spreads to Treasuries have been quite stable in recent quarters.



Source: Federal Reserve

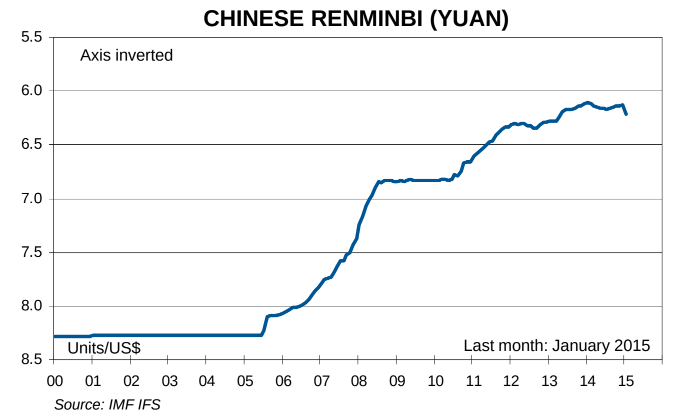
Lower quality bond yields/spreads have risen, largely because of default fears in the energy sector.



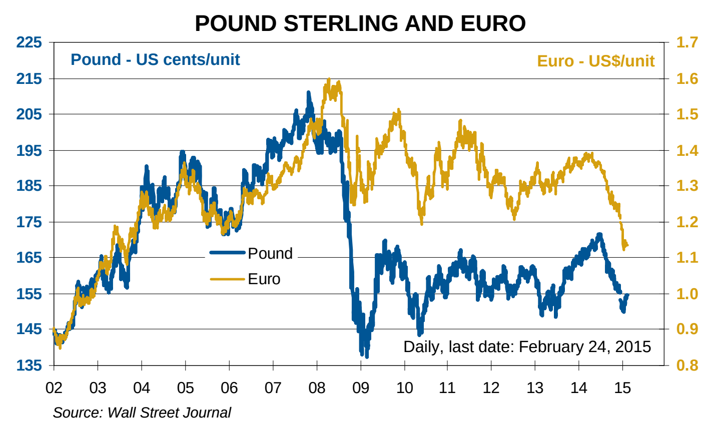
Source: Federal Reserve, Wall Street Journal

MONTHLY REVIEW ►
FOREIGN EXCHANGE RATES

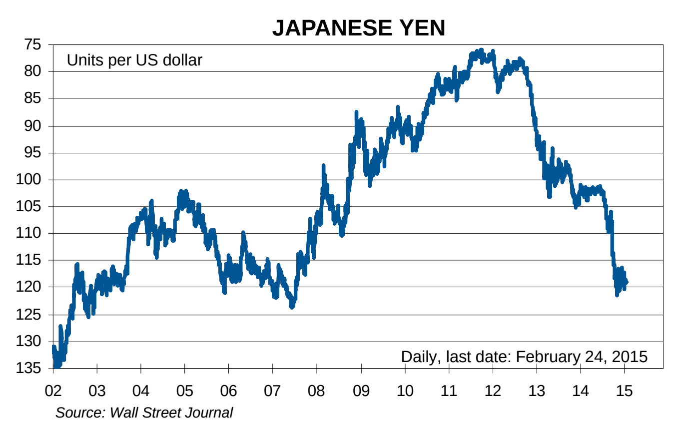
Capital flight from China has weakened the renminbi somewhat.



Though somewhat stable in recent weeks, the European currencies still have significant downside risk.

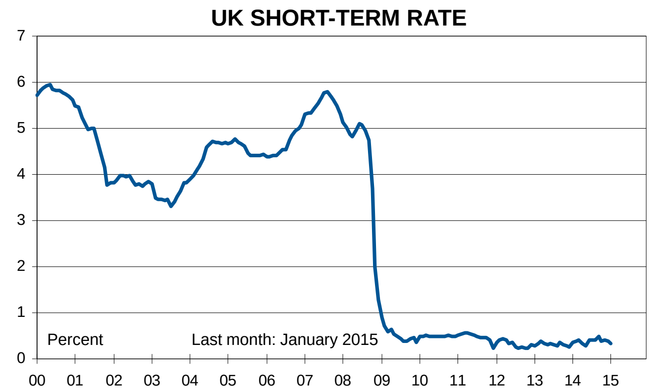


The yen has been forming a base near 120. We worry it could resume falling again later in 2015.



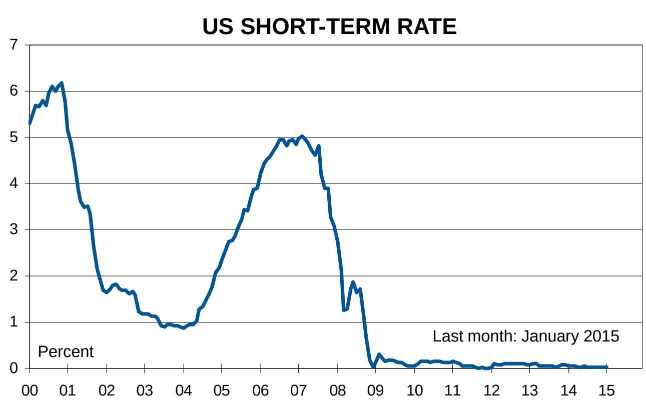
MONTHLY REVIEW ► INTERNATIONAL SHORT-TERM RATES

Short-term rates remain on the floor. It is doubtful that either the US or the UK will raise rates this year, although both have seen somewhat stronger wage gains. Meanwhile, Europe and Japan are still in policy-loosening mode.

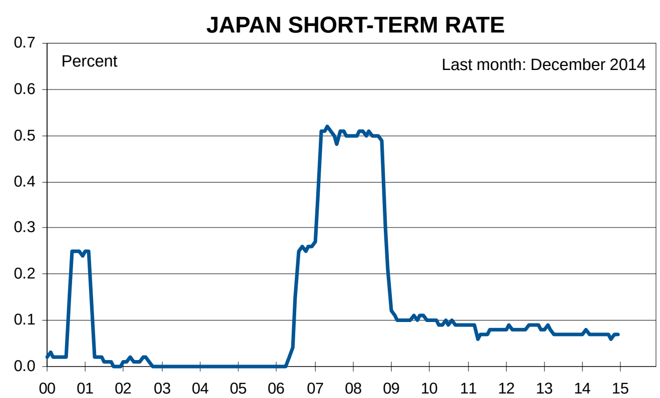


Source: Thomson Reuters Datastream

Source: Thomson Reuters Datastream

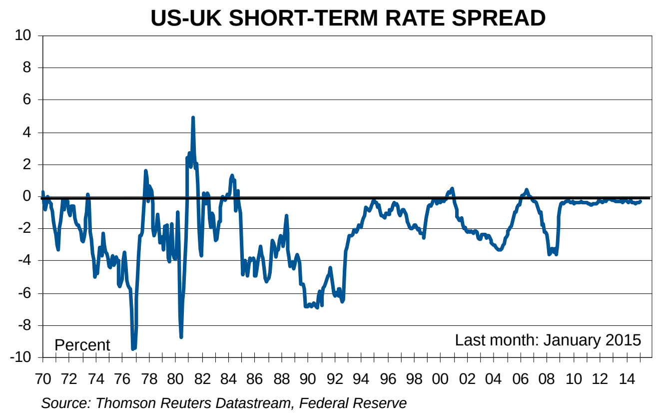


Source: Federal Reserve

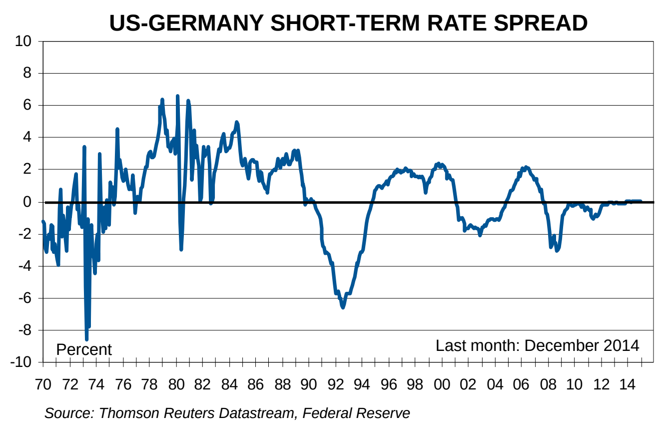


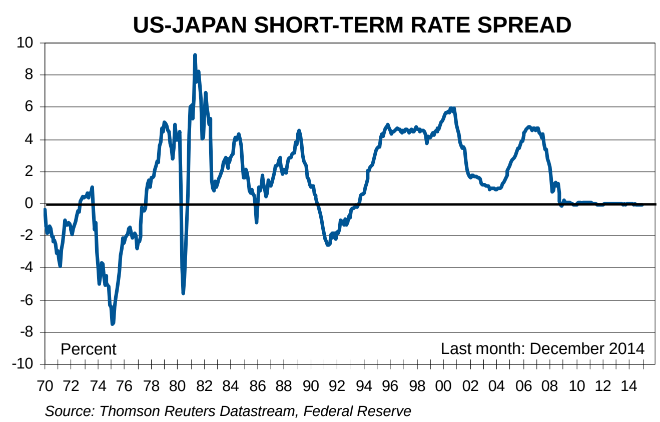
Source: Thomson Reuters Datastream

MONTHLY REVIEW ►
INTERNATIONAL SHORT-TERM SPREADS

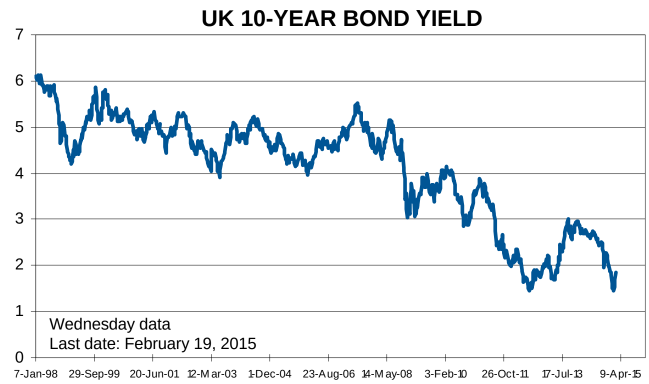


All three charts show spreads near zero – and we expect them to stay there for all of 2015.





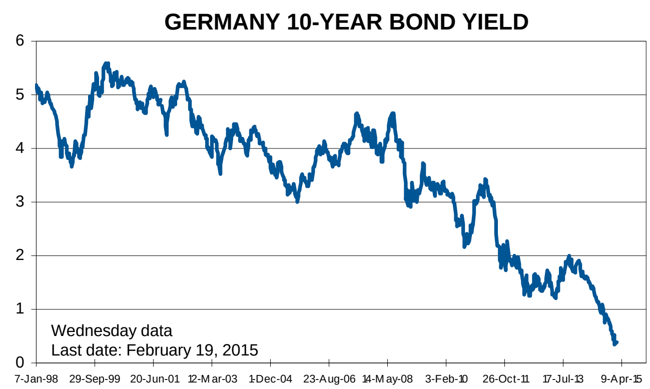
MONTHLY REVIEW ►
INTERNATIONAL 10-YEAR YIELDS



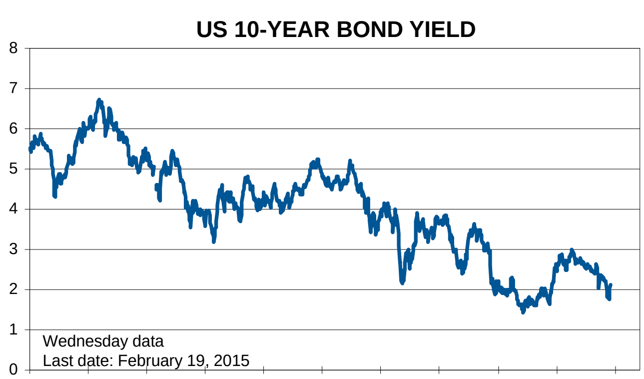
Source: Financial Times

Weak growth and ultra-low inflation continue to depress yields in the industrialized countries.

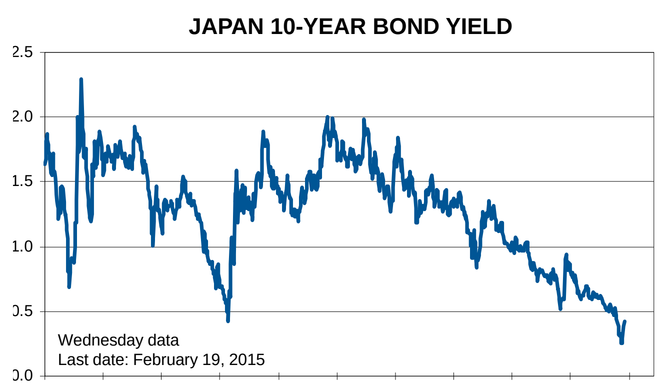
Relatively high US yields are attracting foreign bidders.



Source: Financial Times



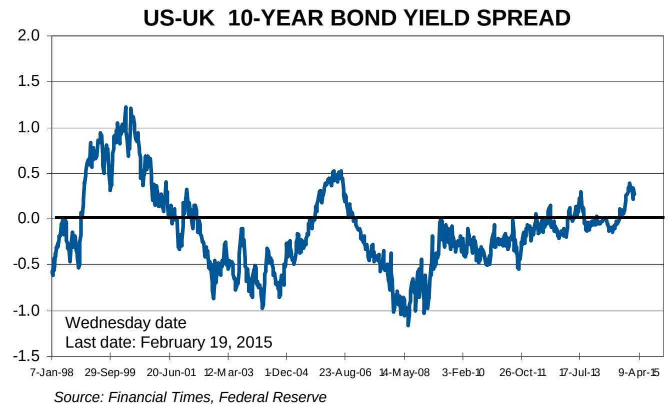
Source: Financial Times



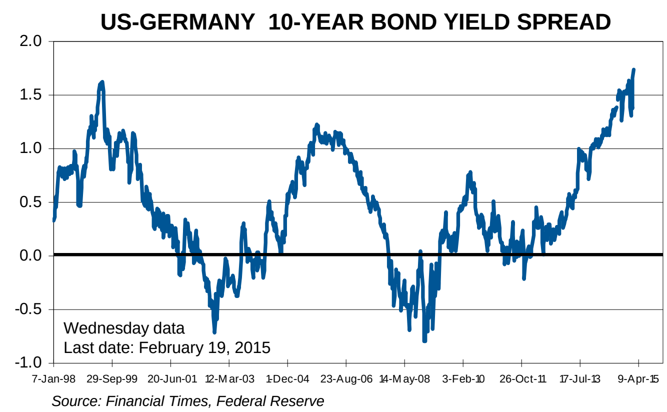
Source: Financial Times

MONTHLY REVIEW ►
INTERNATIONAL 10-YEAR SPREADS

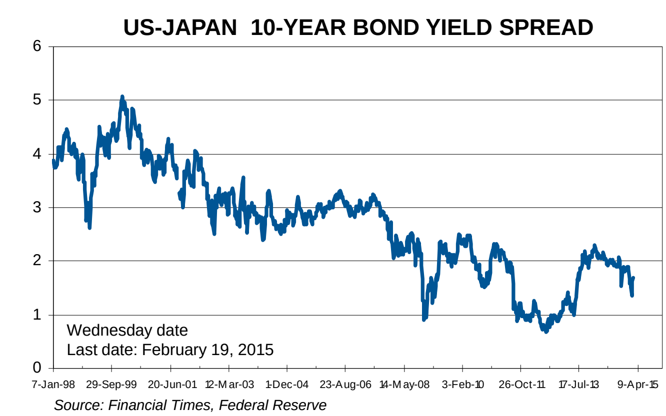
The US has become more attractive relative to Britain...



...the US has become much more attractive relative to Germany...



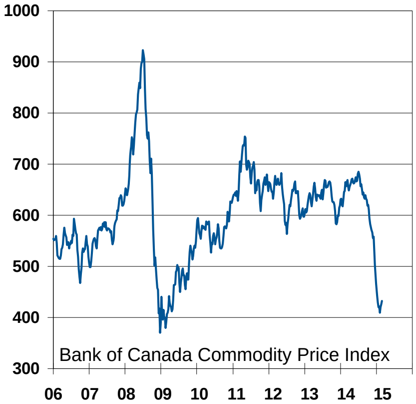
... but the US has become less attractive relative to Japan.



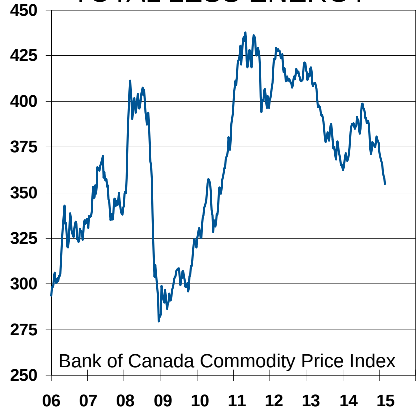
COMMODITY PRICES

1. Bank of Canada Commodity Price Indices (Weekly data to February 20, 2015)

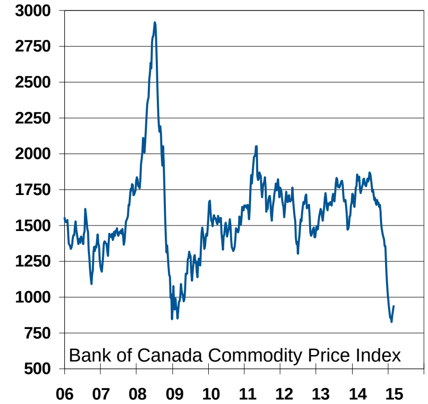
TOTAL COMMODITY



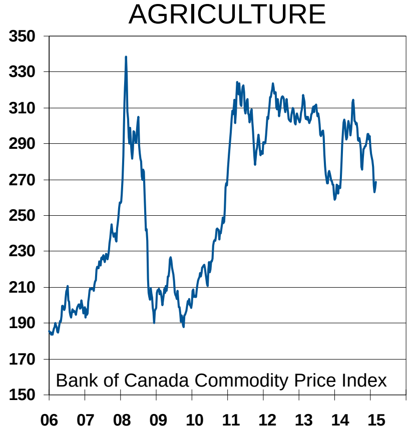
TOTAL LESS ENERGY



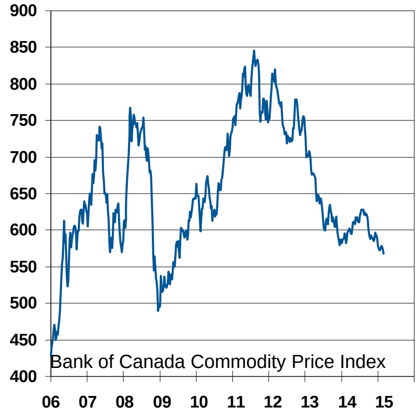
ENERGY



AGRICULTURE



METALS AND MINERALS

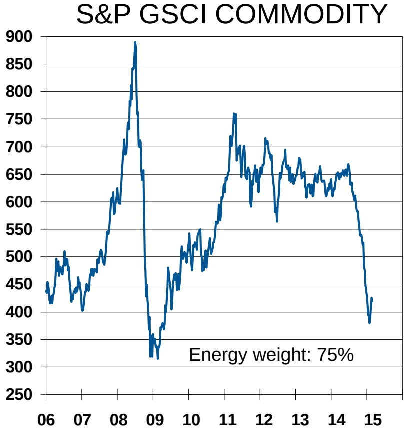


Commodity prices are searching for a “bottom”.

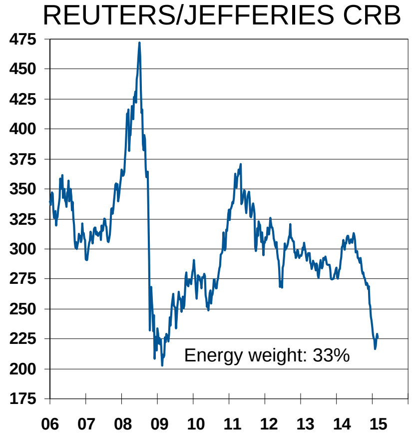
Weak global growth is not helpful in this regard.

2. Other Indices (Weekly data to February 20, 2015)

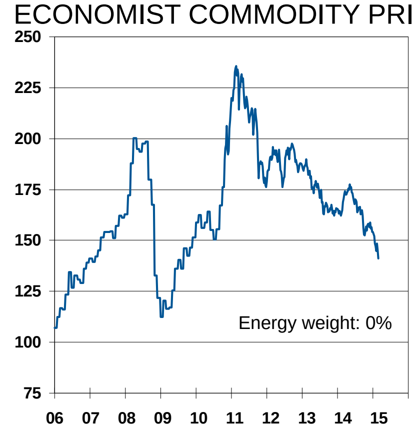
S&P GSCI COMMODITY



REUTERS/JEFFERIES CRB



ECONOMIST COMMODITY PRICE



Sources: Bank of Canada, Thomson Reuters Datastream, The Economist

COMMODITY PRICES

3. Metals (Weekly data to February 20, 2015)

NICKEL

COPPER

ZINC

ALUMINUM

LEAD

GOLD

PLATINUM

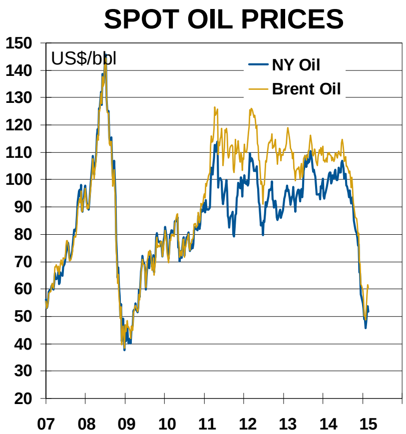
SILVER

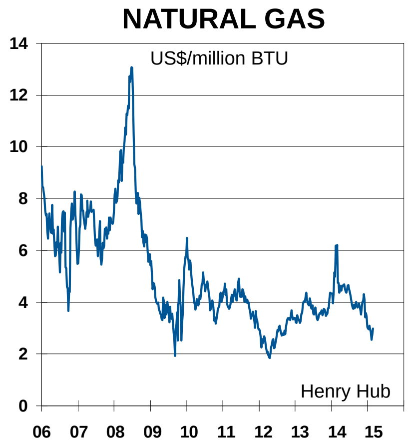
Sources: LME, LBMA, Wall Street Journal

We think 2015 could be the year when prices “bottom”. At this stage any upturn in 2016 is likely to be subdued however.

COMMODITY PRICES

4. Energy (Weekly data to February 20, 2015)

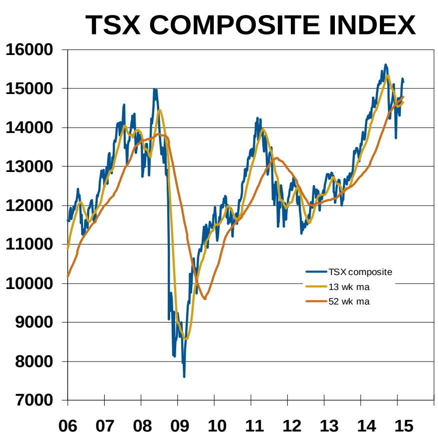


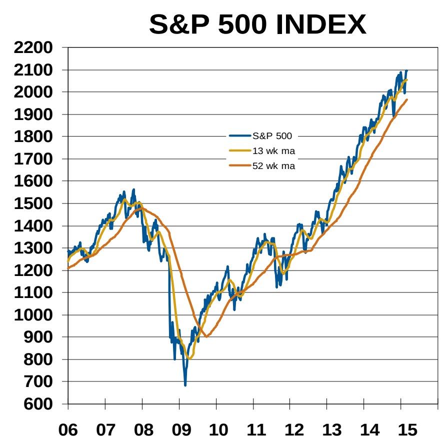


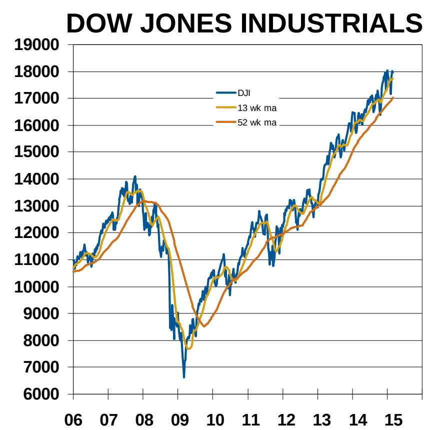
We continue to expect low oil prices for at least the first half of 2015!

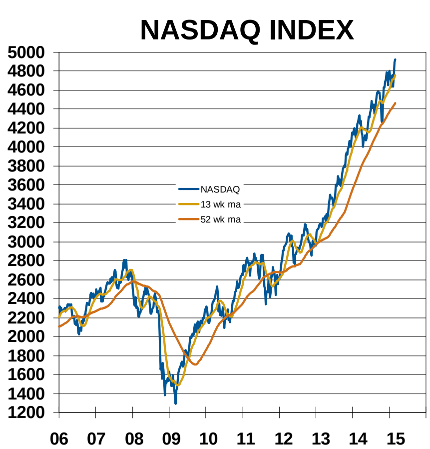
EQUITY MARKETS

5. North America (Weekly data to February 20, 2015)









Source: Thomson Reuters Datastream

The outlook for US equity markets remains broadly constructive; policy interest rates will remain low and a US recession is not on the horizon. That said, the earnings growth rate is declining and we expect further volatility as the markets debate if/when the Fed will raise interest rates.

The decline in oil prices has been hard on the S&P/TSX, but since its recent decline the market has become more attractive.

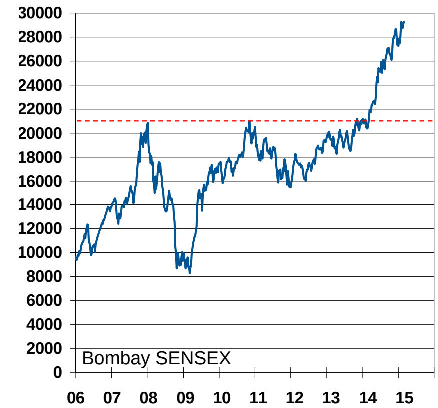
Overseas, large oil-importing countries have seen gains in their equity markets!

EQUITY MARKETS
6. Around the world (Weekly data through February 20, 2015)

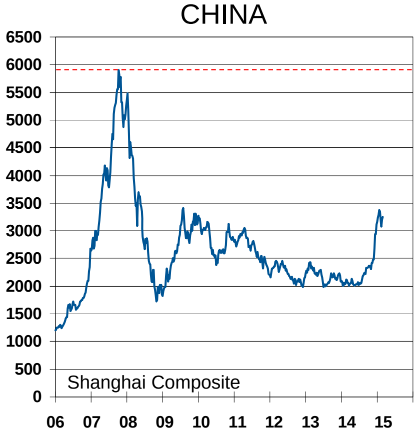
JAPAN

GERMANY

INDIA



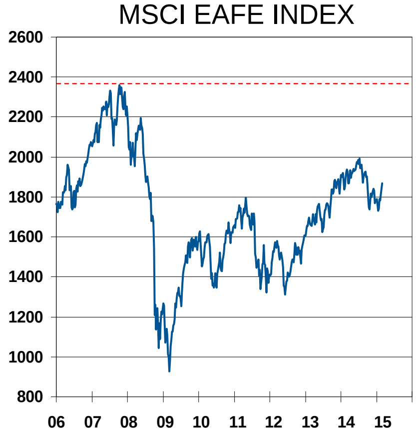
CHINA



RUSSIA

MEXICO

MSCI EAFE INDEX



BRAZIL

MSCI WORLD INDEX

Source: Thomson Reuters Datastream

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