THE VANCOUVER SUN

Mixed economic signals will mark 2013

Opinion: Flat stock markets, higher interest rates and lower real estate prices in store for next 12 months

BY MARK JASAYKO AND NEIL MCIVER, SPECIAL TO THE VANCOUVER SUN JANUARY 4, 2013

A year ago, Vancouver portfolio managers Mark Jasayko and Neil McIver correctly forecast the direction of nine of 10 major financial indicators related to investing and the economy. While they missed the decrease in U.S. interest rates, they accurately predicted the path of stock markets, gold and oil prices, among other measures. At the risk of besmirching their sterling track record, they take on the challenge again, making prognostications about 2013 against the backdrop of the United States' and Europe's perilous economies, fiscal cliffs and slowing Asian growth.

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The year 2012 was highlighted by U.S. election politics. The fourth year of the presidential cycle is usually a good year for stocks, and that was the case for 2012. As President Barack Obama and challenger Mitt Romney filled the headlines with their positive economic oratory and hope for the future, the mood of investors brightened. The U.S. election was also the perfect diversion from anxiety over the continued fiscal erosion in Europe. Although nothing has improved in Europe, promises of never-ending bailouts (punctuated by European Central Bank President Mario Draghi's "Whatever it takes" speech in August) soothed investors in eurozone bonds. Although the markets experienced some late-year fiscal cliff-induced volatility, the pledge by the U.S. Federal Reserve to double the rate of money printing helped to limit the downside. Last year saw more economic Band-Aid solutions similar to those applied in the previous few years. The markets in 2013 will depend on how well those Band-Aids hold.

CANADIAN STOCK MARKET: Flat

We anticipated a flat performance for the Canadian stock market in 2012. Despite a hot start followed by a mid-year dip, the year was indeed flat for Canadian equities. Resource demand from China did moderate as forecast and we expect that to continue into 2013, limiting the upside for stocks. Canada still has the foundation of strong financial institutions and reserves of energy and materials that are the envy of the world. However, with global economic growth stuck in neutral, we will have to wait awhile until our assets once again attract premium valuations. The Canadian market as a whole is trading close to fair value. Flat performance from now until the end of 2013 is still a reasonable expectation.

AMERICAN STOCK MARKET: Flat — weak start, strong finish

We foresaw U.S. stocks benefiting because of the fourth year of the presidential cycle and because of more central bank liquidity. All that came true. However, the first year of the four-year presidential cycle is historically not great, and investors and the economy are becoming more immune to the zero interest rate policy and increased money printing from the U.S. Federal Reserve. Also, there will be a slight trend toward austerity for the first time in decades, resulting from the aftermath of the fiscal cliff and more bitter negotiations surrounding the increase of the debt ceiling limit. This isn't good news for the U.S. economy, and stocks will have a tough time. We expect a mostly flat year in U.S. stocks, perhaps with a difficult first six months followed by a recovery in the second half.

U.S. DOLLAR: Higher

We had expected a good year for the U.S. dollar compared to the other major currencies because of its safe haven status. However, anxiety over the fiscal mess in Europe and the slowdown in China was not enough to drive the U.S. dollar higher over the entire 12 months of 2012, even though it did jump by about five per cent in the middle of the year. Since these concerns can't be swept under the rug indefinitely, the U.S. dollar should benefit from its safe haven status in 2013. In addition, the relative increase in austerity following the fiscal cliff and debt ceiling debates will make the U.S. dollar look more attractive to foreign investors. Increased taxes and reduced spending can make any currency look good.

CANADIAN DOLLAR: Slightly lower

Because of the massive U.S.-Canadian trade flows, we felt the Canadian dollar would remain range bound in 2012 between 95 cents and par relative to the U.S. dollar if there was no global financial panic to drive the U.S. dollar significantly higher. The Canadian dollar remained pretty close to our expected range, fluctuating between 96 and 103 cents. If there is heightened eurozone anxiety in 2013 and more austerity in the U.S., the Canadian dollar could approach 90 cents, but should hold in a range between 90 cents and par.

INTEREST RATES: Higher

This is the one forecast that has stymied us. As we expected, the U.S. Federal Reserve and the European Central Bank accelerated their liquidity and money printing in 2012. However, the Fed has done a very good job at keeping inflation expectations low. Enough investors are giving them the benefit of the doubt that they will be able to reverse the trillions of dollars of liquidity pumped into the economy once growth gets going again. If inflation expectations are held in check, interest rates stay low. However, the herculean effort of managing inflation expectations will eventually begin to show cracks. We don't think the Fed can fully reverse the liquidity because of pressure from citizens and politicians who fear the economic losses that would result. As a result, we should see a slow crawl upward in interest rates in 2013 as more investors acknowledge this reality. An increase of half a percentage point won't constitute a big move up, but considering how low rates are, half a per cent will have a noticeable impact.

GOLD: Higher

Our 2010 forecast was for $1,500 US an ounce. Our 2011 forecast was for $1,700. Our forecast for 2012 was for $1,900, and while it didn't reach that, it nudged $1,800 in October and ended the year at almost $1,700. Our forecast for 2013 is $1,900. We still don't have faith that politicians and policy-makers have the skill to find a clean solution for the overhang of burdensome debt in the world. However, we should not underestimate their ability to buy time and put on brave faces. Enough of the marketplace has been seduced by this, which has kept a lid on the gold price. That said, the government budgets of all the developed countries and the monetary policies of all developed and emerging countries are still pointing in the direction of higher future gold prices. Inflation is still the eventual destination, and there has not been a single policy change over the last year to suggest otherwise. Despite a relatively lacklustre year, gold is now up for 12 years in a row. But, over that period, it still lags behind the growth in government debt.

CRUDE OIL: Flat

For 2012, we forecast a range for oil (West Texas Intermediate) between $90 to $100 with the potential for a $5 to $10 unsustainable spike due to Mideast tensions and short-term supply issues. We were almost spot on with this, although the price fell to just below $90 as the end of the year approached. Sluggish global economic growth will make 2013 look almost the same as 2012.

NATURAL GAS: Flat

Excess supply at the end of last year led us to forecast the price of natural gas would continue to fall, and it did. With even more future supply coming from fracking and shale oil gas, the price should remain flat through 2013. The long-term price chart indicates the price is levelling out but there is no upside catalyst for the foreseeable future.

GRAIN/COMMODITIES: Higher

Increasing concern over food security continues to be a long-term secular trend as governments in emerging countries are mindful of the social and economic problems that could result if supply is interrupted. As a result, the premium paid for food commodities and for establishing a reliable future supply will persist in 2013. Mid-year saw a significant rise across most food commodities and most of those gains stayed in place through to the end of the year. At a minimum, the gains made in 2012 will be sustained in 2013.

CANADIAN REAL ESTATE: Lower

Rising debt, decreasing affordability, and Ottawa's change in the mortgage rules hammered the number of sales and sent prices down by between five and 10 per cent in Vancouver and Toronto, which we had predicted. However, prices elsewhere did not drop by quite as much as we thought. Vancouver condo and townhouse prices have fallen back to where they were more than five years ago. That's a pretty good correction. However, demographics and potentially rising interest rates, coupled with the ongoing impact of mortgage rule changes, will keep the downtrend in real estate prices intact. There won't be a crash of U.S. proportions, but the reality of the last decade and a half has changed.

CARBON CREDITS/CAP AND TRADE/ETC: More pipelines

Last year we stated that as long as unemployment is at unacceptably high levels, Obama would "relegate these policies to rhetoric and as far away as possible from implementation for the foreseeable future." In fact, the lack of buzz surrounding environmental issues and cap-and-trade polices during the campaign and the debates was absolutely deafening. Unemployment in the U.S. is still a big problem. Therefore, expect national green policies and initiatives to be kept on the back burner. And, the proposed Keystone XL pipeline from Canada to the U.S. Midwest will probably be approved by Obama during 2013.

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