THE VANCOUVER SUN

Higher interest rates, gold prices predicted for 2014

Opinion: Canadian dollar, our stock market, crude oil and natural gas will be affected

BY MARK JASAYKO AND NEIL MCIVER, SPECIAL TO THE VANCOUVER SUN JANUARY 11, 2014

This coming year will be a crossroads for quantitative easing, the brainchild of the U.S. Federal Reserve under departing board chairman Ben Bernanke.
Photograph by: Alex Wong , Getty Images

The U.S. policy of money-printing, or quantitative easing (QE), was the major driver behind global capital markets in 2013. In lieu of significant earnings growth, QE pushed U.S. stocks and — to some extent — Japanese and European stocks higher.

Anxiety over whether money-printing would continue at its previous fast pace was also the determining factor in bond market activity during 2013, sending interest rates higher and bond prices lower.

If policy-makers fail to reduce massive government debt burdens, governments will again lean on central banks, including America’s, to print money in 2014.

While money-printing has not solved the core causes of the 2008 credit crisis and great recession, it has been an effective temporary solution. Stock prices are higher, Canadian real estate has held on to previous gains, and U.S. real estate has made a minor comeback.

However, 2014 will be a crossroads for QE. If it is “tapered,” as it appears it will be, all the asset classes and investments that benefited (income-oriented investments, emerging markets, offshore real estate destinations) will face big challenges.

Even if the current rate of money-printing is maintained, investors will wonder why it is not re-igniting economic growth and lowering unemployment to non-recessionary levels. As confidence in money-printing as a solution is reduced, investors may begin to seek protection and sell investments in areas that are economically sensitive, such as industrials and technology.

Given these upcoming central bank challenges, and barring any surprising geopolitical or natural disaster-type events, here are our predictions for 2014:

CANADIAN STOCK MARKET: Flat

Resource demand from a slowing China will continue to moderate, limiting the upside for Canadian stocks. Our economy was naturally positioned to take advantage of China’s economic emergence. However, China’s growth has slowed to a pace not seen in two decades. On the plus side, the Canadian dollar will continue to weaken, helping manufacturing exporters and the tourism industry.

AMERICAN STOCK MARKET: Slightly higher

U.S. corporate earnings growth has been anemic. Apart from bank earnings, which have benefited greatly from free U.S Treasury cash, corporate earnings have been flat for two years. Earnings ultimately drive stock prices. Their future cash flows and dividends make investors buy a stock. Despite a lack of earnings, U.S. stock prices have rocketed higher over the past year on the promise of money-printing and policies designed to keep interest rates artificially low. But the U.S. can’t print its way to prosperity. Market normalization and poor earnings will work to keep U.S. stock prices in check. From a Canadian perspective, however, our falling dollar will justify continuing to hold U.S. equity positions.

U.S. DOLLAR: Range-bound

There are plenty of reasons why the U.S. dollar should weaken (slowing growth, growing debts, poor bond market performance), but it is still the least ugly of all the currencies out there. That fact alone will keep the U.S. dollar in a fairly tight range in 2014.

CANADIAN DOLLAR: Lower

With struggling global and Chinese economic growth, Canadian natural resource exports won’t grow. Also, the new Bank of Canada governor, Stephen Poloz, appears to favour manufacturing exporters and may keep the Canadian dollar lower for their benefit. He has been dovish so far and does not seem inclined to raise rates anytime soon to shore up the loonie. Expect a range between 87 and 93 cents U.S. for the Canadian dollar.

INTEREST RATES: Higher

Less money-printing, or a loss of faith in the efficacy of money-printing, will push rates in North America higher. Following a 30-year bull market in bonds, fuelled by falling interest rates, the long-term trend reversed over 18 months ago. Rates may fluctuate from month to month, but the underlying secular trend will continue to push them higher over 2014, and for years to come.

GOLD: Higher

Gold is a long-term game and long games have intermissions. After 12 consecutive years of gains, 2013 was its intermission. However, physical bullion purchases by individuals and states like China continue at a brisk pace. And

not one notable world government is pursuing a policy detrimental to gold. Excessive borrowing, excessive spending and the dependence upon money-printing are all music to the bullion market. 2014 will be the year gold resumes its slow climb and makes up for some of the losses over the last 18 months.

CRUDE OIL: Flat

Forces driving global supply and demand for crude won't change much next year, keeping oil in a relatively tight range. Potential geopolitical hot spots (especially Iran, the South China Sea and the East China Sea) are the wild cards.

NATURAL GAS: Flat

Despite the impending shale gas boom that could position the U.S. most of the way to energy self-sufficiency, the infrastructure needed to extract, transport, and use the gas is still years away. As a result, the factors that drove the natural gas market in North America will persist and hold gas prices at current levels.

FOOD COMMODITIES: Higher

The premium paid for food commodities and for establishing a reliable future supply has quietly risen over the last two years. Food security concerns continue to be a long-term trend for governments in emerging countries.

CANADIAN REAL ESTATE: Lower

The Bank of Canada may try to keep a lid on short-term rates, but market-determined longer rates will rise. While it does not necessarily portend a significant sell-off in housing, it won't help the real estate market.

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