



Economics

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THE WEEK AHEAD

May 14-18, 2018

Should We Lose Sleep Over Rising Corporate Debt?

by Benjamin Tal

The focus is mostly on ever-rising household debt, but behind the scenes, with less drama, corporate Canada has been piling up debt even faster. Non-financial corporate debt has risen by an average annual rate of just under 9% since the beginning of the recovery—3%-pts faster than the growth seen in household debt. The corporate debt-to-GDP ratio currently stands at 70%—up from 50% in 2010.

Of course everything is fine and well—until it isn't. So should we lose sleep over corporate debt? The fear of course is that higher interest rates will expose the vulnerability of highly indebted corporations, and will put at risk the current dividend growth trajectory—mainly in high-yield sectors such as utilities, that happen to see their debt load rising the fastest.

Clearly higher debt means higher vulnerability to rising rates, but here comes the *but*...

A quick glance at corporate Canada's balance sheet position suggests that this borrowing is hardly an act of desperation. The debt-to-equity ratio has been trending downward over the past two years and it is currently around a 20-year average, miles below the rates seen in the 1990s. Average profit margin, at north of 7%, has been trending higher over the past three years and it is almost a percentage point above its long-term average.

What's more, corporate treasurers have been doing a good job shielding themselves from higher rates, with the share of short-term debt (less than five years) falling from north of 27% between 2010 and 2014, to less than 20% over the past four years and only 16% in 2017.

But an even bigger *but* is the fact that, alongside debt, corporate Canada has also elevated its cash position. Since 2010 cash holdings by non-financial corporations have risen by an annual average rate of no less than 7%. As a share of assets and GDP, cash is now at a record-high. A good example here is the utility sector. Its debt load rose the fastest since 2010, but that sector also led the pack in terms of cash accumulation.

Now, we have to be a bit careful here as during the early stages of the recovery, the increase in cash position was offset by falling shares of other current assets such as inventories and receivables, as corporations needed to show the cash in order to access the credit market. This trend, however, came to an end a few years ago with the share of cash to other current assets rising notably recently.

Yes, higher rates will hurt, and some corporations will have to rethink their dividend policy, but from a macro perspective, corporate Canada is well positioned to take the hit.



Week Ahead Calendar And Forecast

| CANADA | | UNITED STATES | |
|----------------------------|--|------------------------------|----------------|
| | CIBC | Consensus | Prior |
| Monday May 14 | | | |
| Tuesday May 15 | AUCTION: 3-M BILLS \$7.4B, 6-M BILLS \$2.8B, 1-YR BILLS \$2.8B CASH MANAGEMENT BUYBACK (Aug 18 - Sep 19) - \$0.5B | | |
| | 9:00 AM EXISTING HOME SALES M/M (Apr) (M) | 1.3% | |
| | AUCTION: 3-M BILLS \$48B, 6-M BILLS \$42B | | |
| | Speaker: 9:40 AM James Bullard (President, St Louis) Speaker: 2:45 AM Loretta Mester (President, Cleveland) | | |
| | AUCTION: 4-WEEK BILLS \$45B (prev) | | |
| | 8:30 AM NEW YORK FED (EMPIRE) (May) (M) | 15.00 | 15.80 |
| | RETAIL SALES M/M (Apr) (H) | 0.3% | 0.6% |
| | RETAIL SALES (X-AUTOS) M/M (Apr) (H) | 0.4% | 0.2% |
| | RETAIL SALES CONTROL GROUP M/M (Apr) (H) | 0.7% | 0.4% |
| | 10:00 AM BUSINESS INVENTORIES M/M (Mar) (L) | 0.2% | 0.6% |
| | NAHB HOUSING INDEX (May) (L) | 69 | 69 |
| | 4:00 PM NET CAPITAL INFLOWS (TICS) (Mar) (L) | | \$49.0B |
| | Speaker: 1:00 PM John C. Williams (President, San Francisco) Speaker: 8:00 AM Rob Kaplan (Dallas, President) | | |
| Wednesday May 16 | 8:30 AM MANUFACTURING SHIPMENTS M/M (Mar) (M) | 1.2% | 1.9% |
| | Speaker: 12:00 PM Lawrence Schembri (Deputy Gov.) AUCTION: 5-YR CANADAS \$3B | | |
| Thursday May 17 | 8:30 AM INT'L SEC. TRANSACTIONS (Mar) (M) PAYROLL EMPLOYMENT, EARNINGS & HRS | \$4.0B | |
| | Speaker: 5:30 PM James Bullard (President, St Louis) Speaker: 8:30 AM Raphael Bostic (President, Atlanta) | | |
| | 7:00 AM MBA-APPLICATIONS (May 11) (L) | | -0.4% |
| | 8:30 AM HOUSING STARTS SAAR (Apr) (M) | 1325K | 1319K |
| | BUILDING PERMITS SAAR (Apr) (H) | 1282K 1350K | 1347K 1379K |
| | 9:15 AM INDUSTRIAL PRODUCTION M/M (Apr) (H) | 0.6% | 0.5% |
| | CAPACITY UTILIZATION (Apr) (M) | 78.4% | 78.0% |
| | Speaker: 8:30 AM Raphael Bostic (President, Atlanta) | | |
| Friday May 18 | 8:30 AM RETAIL TRADE TOTAL M/M (Mar) (H) | 0.4% | 0.4% |
| | RETAIL TRADE EX-AUTO M/M (Mar) (H) | 0.9% | 0.0% |
| | CPI M/M (Apr) (H) | 0.6% | 0.3% |
| | CPI Y/Y (Apr) (H) | 0.3% | 2.3% |
| | CPI Core- Common Y/Y% (Apr) (M) | 2.3% | 1.9% |
| | CPI Core- Median Y/Y% (Apr) (M) | 1.9% | 2.1% |
| | CPI Core- Trim Y/Y% (Apr) (M) | 1.9% | 2.0% |
| | Speaker: 9:15 AM Lael Brainard (Governor) Speaker: 9:15 AM Rob Kaplan (Dallas, President) Speaker: 3:00 AM Loretta Mester (President, Cleveland) | | |
| | 8:30 AM INITIAL CLAIMS (May 12) (M) | 215K | 211K |
| | CONTINUING CLAIMS (May 5) (L) | 1775K | 1790K |
| | PHILADELPHIA FED (May) (M) | 21.0 | 23.2 |
| | 10:00 AM LEADING INDICATORS M/M (Apr) (M) | 0.4% | 0.3% |
| | Speaker: 1:30 PM Rob Kaplan (Dallas, President) Speaker: 10:45 AM Neel Kashkari (President, Minneapolis) | | |
| | SAAR = Seasonally Adjusted Annual Rate | | |
| | H, M, L = High, Medium or Low Significance | | |
| | Consensus Source: Bloomberg | | |

Week Ahead's Market Call

by Andrew Grantham

In the US, a solid gain in retail sales could look a little better further into the detail given that the headline pace will be dampened by a slight tick down in autos. Colder than normal April weather could boost utilities output within industrial production, supporting an above-consensus call there, but on the reverse, see housing starts disappoint for the same month.

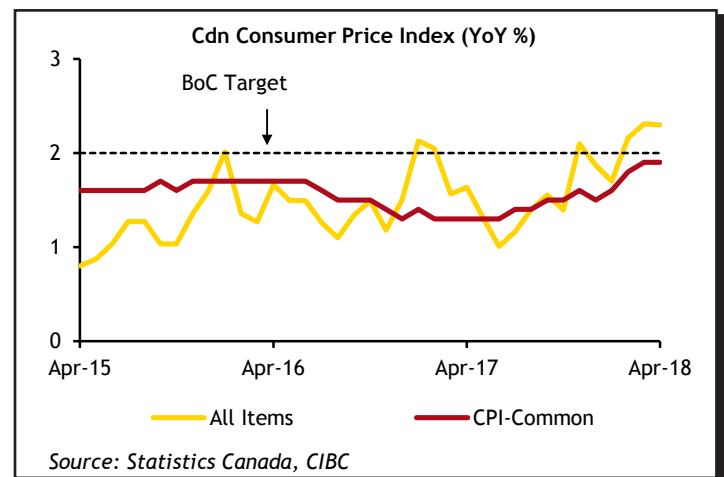
In Canada, we'll get confirmation if the apparent good news contained within the trade report translated into industry activity reports. Higher exports hint at another solid gain in manufacturing shipments, while strong imports of consumer goods could be a sign that retailing will see an acceleration. Inflation data for April is likely to show a modest gain on the month with the annual rate staying at 2.3%, and core readings close to 2%, none of which should change expectations regarding the pace of BoC rate hikes.

Week Ahead's Key Canadian Number:**Consumer Price Index—April**

(Friday, 8:30 a.m.)

Royce Mendes (416) 594-7354

| | CIBC | Mkt | Prior |
|-------------|------|-----|-------|
| CPI m/m NSA | 0.3% | na | 0.3% |
| CPI yr/yr | 2.3% | na | 2.3% |
| CPI-common | 1.9% | na | 1.9% |



Faster inflation is on the horizon, but it won't be until next month that an acceleration shows up in the data. While motorists saw higher fuel costs in April, gasoline prices always tend to rise during this time of the year, and therefore won't add much to either the year-over-year or seasonally adjusted monthly readings. After losing ground last month, food prices are unlikely to be a drag again, but are still facing a headwind from stiff competition among grocery stores, and therefore won't provide much of a lift either.

Excluding food and energy, prices have risen at a 0.2% clip in each of the last four months, and five out of the last six. There's no reason to believe that trend changed in April, something that will nudge the BoC's core common component measure up a tick to 2% and leave headline inflation stuck at 2.3%.

Forecast Implications—Monetary policymakers aren't going to overreact to the upcoming rise in inflation in the coming year. And the lack of acceleration in April will give Governor Poloz another reason to leave rates unchanged in May.

Other Canadian Releases:**Manufacturing Survey—March**

(Wednesday, 8:30 a.m.)

The factory sector is beginning to run out of capacity, but that didn't hamper shipments in March. Already released trade data showed healthy growth in manufactured exports, and suggest that overall sales rose another 1.2% after posting a nice rebound in February. Shipments have been on an uptrend since early 2016 and should continue on that path in the near term. But, future activity could be restrained unless investments are made to add capacity.

Retail Trade—March

(Friday, 8:30 a.m.)

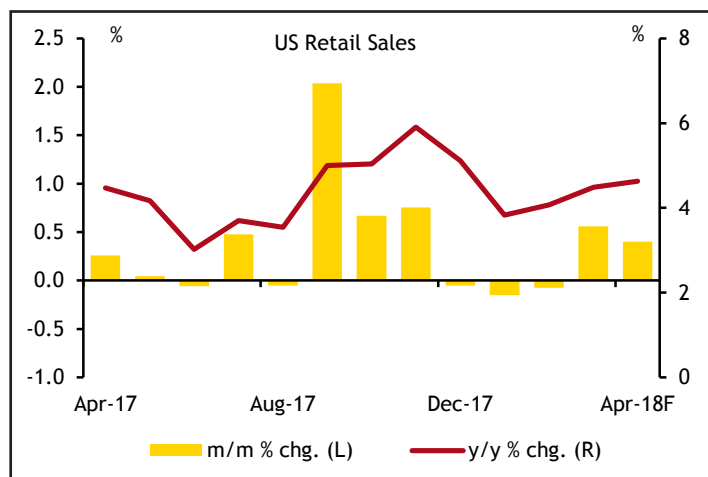
The first two retail sales reports of 2018 were clear evidence that momentum across the sector has slowed. After stripping out price changes, retail sales have been trending sideways in recent months. The sector likely bucked that trend and advanced a decent 0.9% in March on the back of stronger auto sales. But that still leaves the first quarter tracking a decline over the prior three months. As a result, we're only expecting a modest contribution to growth from households in the first quarter.

Week Ahead's Key US Number:**Retail Sales—April**

(Tuesday, 8:30 a.m.)

Andrew Grantham (416) 956-3219

| | CIBC | Mkt | Prior |
|------------------------------|------|------|-------|
| Retail Sales | 0.4% | 0.4% | 0.6% |
| Retail Sales - ex auto | 0.7% | 0.5% | 0.2% |
| Retail Sales - control group | 0.4% | 0.4% | 0.4% |



After breaking out of their funk in March, US retail sales should have made further gains in April. However, the drivers will be different, with auto sales having slipped into a lower gear but higher gasoline prices supporting the nominal data.

In terms of wider spending, again the results could be somewhat mixed. The boost to disposable incomes from tax cuts may now be more noticeable to households. But with cooler than normal weather potentially dampening seasonal purchases of clothing and building materials, growth could be limited to areas such as appliances, electronics and online sales. The Conference Board's survey showed spending intentions were up significantly in April, and some of that optimism could come through in these figures.

Forecast Implications—Even though consumer spending growth slowed dramatically in the first quarter, that was partly due to the fact that Q4 was flattered by replacement spending following hurricanes. With disposable incomes getting a boost from tax reform and solid job creation, we expect consumer spending to accelerate again in Q2 and maintain decent momentum later in the year as well.

Market Impact—We are a touch above expectations, but maybe not by enough to see a large market reaction.

Other U.S. Releases:**Housing Starts—April**

(Wednesday, 8:30 a.m.)

Tight inventory levels and rising prices should signal further modest increases in homebuilding over the remainder of the year. However, colder and snowier weather than normal in parts of the country could have restrained building in April to a pace below that signaled by permit applications. As such, we expect a deceleration to a 1282K pace for starts, but with permits holding up better at a 1350K rate.

Industrial Production—April

(Wednesday, 9:15 a.m.)

US industrial production should get support from all three broad areas in April. Cooler than normal spring weather should boost utilities production, while rig counts suggest another leg up in mining as well. Aggregate working hours in manufacturing from the payrolls report also hint at a positive contribution from manufacturing, although after two very strong months a retreat in autos could weigh on that area. Overall, we expect a healthy 0.7% gain in industrial production.

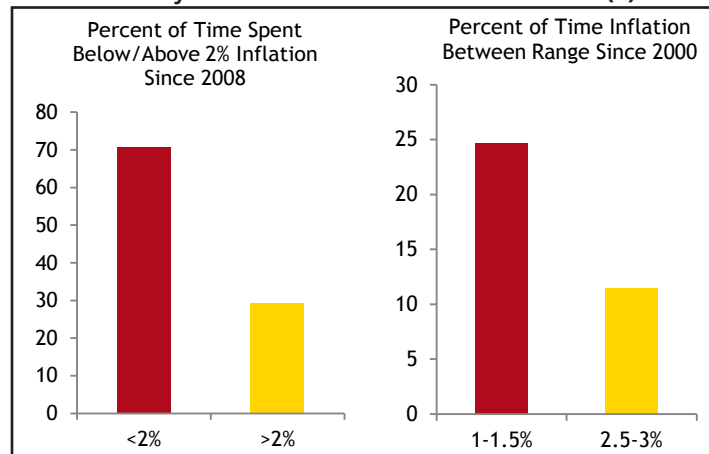
Currency Currents

Royce Mendes and Katherine Judge

Canadian Inflation: Let It Burn

When thinking about things like inflation, it's easy to fall into the trap of recency bias. Since the crisis, Canadian inflation has spent far more time below 2% than above. So when we talk about it averaging 2½% over the next 12 months some might be alarmed. But, rest assured, in some respects a period like this is quite healthy. In having the imbalance of inflation running in the 1-1½% range far more often than it has 2½-3% since 2000 central bankers have lost some credibility, a vital tool for monetary policymakers when the economy hits a rough patch. So expect policymakers to take the upcoming bout of slightly above-target inflation in stride. The lack of aggressive action from the BoC is one reason for the loonie to weaken in the months ahead.

Canadian Inflation Has Undershot Target Since Crisis (L), Inflation Briefly Around 2½% Could Provide Balance (R)

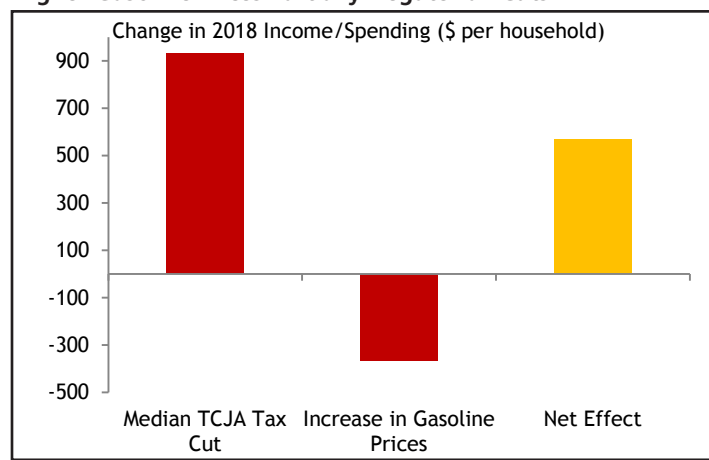


Source: Statistics Canada, CIBC

Higher Gas Prices Eating Away Tax Benefits

The recent run-up in oil prices heading into peak driving season is set to eat away at the gain households were poised to receive from tax cuts. Although the median household will get a tax break of \$930 this year, roughly \$350 of that may be used to offset higher prices at the pump. That will dampen the effect of tax cuts on real consumption as spending is diverted away from discretionary purchases. And while higher oil prices might eventually lead to additional capital spending from oil companies, that will take longer to happen in comparison to a change in consumption. That supports our slightly below-consensus growth forecast for the year and risks disappointing dollar-bulls who have been riding high as of late.

Higher Gasoline Prices Partially Negate Tax Cuts

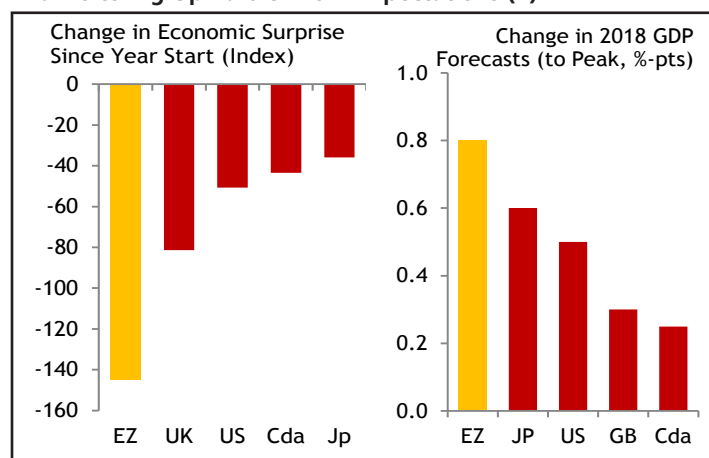


Source: Tax Policy Center, EIA, CIBC

Euro: From Hero to Zero and Back Again?

In 2017, Eurozone growth was surprising to the upside and the euro was flying higher. In the past couple of months, however, things have changed, with some big downside surprises in economic data weighing on expectations for ECB stimulus withdrawal. That trend, though, is more a reflection of how over-optimistic expectations became rather than any significant weakening of the data, as Eurozone GDP forecasts for 2018 were raised by almost a full percent. With those expectations now starting to be edged down to more realistic levels, there's now scope for some upside data surprises and, later in the year, a return to the euro appreciating against the US\$.

Big Change in Economic Surprise Index in EZ (L), Thanks to Big Upward Shift in Expectations (R)



Source: Bloomberg, Citi, CIBC

CANADIAN RELEASE AND EVENT DATES May/June 2018



| MONDAY | TUESDAY | WEDNESDAY | THURSDAY | FRIDAY |
|---|---|--|---|--|
| 7 | 8 HOUSING STARTS 8:15 AM 000's (AR) FEB 231 MAR 225 APR 214 TOTAL 58 SINGLES 63 57 | 9 BUILDING PERMITS (\$) 8:30 AM M M (RES) (NON-RES) JAN 5.3 4.9 FEB -0.7 -6.4 MAR 2.3 4.5 | 10 NEW HOUSING PRICE INDEX 8:30 AM | 11 LABOUR FORCE SURVEY 8:30 AM AVG HRLY EMPLOY UNEMP RATE EARN (HSHOLD) % Y M Y % Y FEB 0.1 1.5 5.8 3.1 MAR 0.2 1.6 5.8 3.1 APR 0.0 1.5 5.8 3.3 |
| 14 | 15 | 16 SURVEY OF MANUFACTURING SHIPMENTS 8:30 AM M Y JAN -1.3 2.5 FEB 1.9 4.6 MAR Bank of Canada Dep. Governor Schembri speaks @ 12:00 PM ET in Ottawa | 17 INT'L TRANSACTIONS IN SECURITIES C\$BN, NET 8:30 AM BONDS MONEY STOCKS TOT MARKET JAN -3.3 6.1 2.9 5.6 FEB -0.9 2.0 2.9 4.0 MAR ADP EMPLOYMENT SURVEY 8:30 AM | 18 CPI 8:30 AM M Y FEB 0.6 2.2 MAR 0.3 2.3 APR RETAIL TRADE 8:30 AM (Current\$) M Y JAN 0.1 2.5 FEB 0.4 3.5 MAR |
| 21 VICTORIA DAY (HOLIDAY) (Markets Closed) | 22 WHOLESALE TRADE 8:30 AM | 23 | 24 QUARTERLY FINANCIAL STATISTICS 8:30 AM | 25 |
| 28 | 29 | 30 BALANCE OF INT'L PAYMENTS 8:30 AM CURR. ACCT. BAL. \$BN(QR) \$BN(AR) 17:Q3 -18.6 -74.4 17:Q4 -16.3 -61.3 18:Q1 INDUSTRIAL PRICES 8:30 AM M (NSA) Y FEB 0.3 2.3 MAR 0.8 2.3 APR Bank of Canada Interest Rate Announcement | 31 GDP BY INDUSTRY 8:30 AM (2002\$) GDP IND.PROD. M M JAN -0.1 -0.9 FEB 0.4 1.4 MAR NATIONAL ACCTS 8:30 AM REAL PRICE GDP DEFLATOR %ch AR %ch AR 17:Q3 1.5 0.0 17:Q4 1.7 5.0 18:Q1 PAYROLL EMPLOYMENT, EARNINGS & HOURS 8:30 AM Bank of Canada Dep. Governor Leduc speaks @ 12:20 PM ET in Ottawa | 1 |
| 4 | 5 INTERNATIONAL RESERVES 8:15 AM \$BN \$BN CHANGE LEVEL MAR -3.191 83.3 APR -1,074 82.2 MAY LABOUR PRODUCTIVITY 8:30 AM | 6 MERCHANDISE TRADE 8:30 AM \$MN 12 MO. BALANCE FEB -2,932 -26,603 MAR -4,140 -30,088 APR BUILDING PERMITS (\$) 8:30 AM M M (RES) (NON-RES) FEB -0.7 -6.4 MAR 2.3 4.5 APR IVEY PURCHASING MANAGERS' INDEX 10:00 AM | 7 Bank of Canada Governor Poloz & Sr. Dep. Gov. Wilkins speak @ 11:30 AM ET on the Financial System Review | 8 HOUSING STARTS 8:15 AM 000's (AR) MAR 225 APR 214 MAY TOTAL 58 SINGLES 63 57 LABOUR FORCE SURVEY 8:30 AM AVG HRLY EMPLOY UNEMP RATE EARN (HSHOLD) % Y M Y % Y MAR 0.2 1.6 5.8 3.1 APR 0.0 1.5 5.8 3.3 MAY CAPACITY UTILIZATION 8:30 AM LEVEL (%) TOTAL MANUF. 17:Q3 85.1 85.4 17:Q4 86.0 86.1 18:Q1 |

All data seasonally adjusted except where noted "NSA". M: per cent change from previous month. Q: per cent change from previous quarter at annual rates. Y: per cent change from year earlier. AR: Annual Rate. YTD: Year to date. Release dates are provided by sources outside CIBC World Markets Inc. Dates are subject to change. Sources for historical data: Statistics Canada, CMHC, Human Resources Development Canada and the Bank of Canada.

U.S. RELEASE AND EVENT DATES May/June 2018



| MONDAY | TUESDAY | WEDNESDAY | THURSDAY | FRIDAY |
|--|---|--|--|--|
| 7 CONSUMER CREDIT 3:00 PM | 8 Fed Chair Powell speaks in Zurich @ 3:30 AM ET 3-Yr NOTE AUCTION BOT (9:00) REDBOOK (8:55) | 9 PPI 8:30 AM M (SA) Y (NSA) FEB 0.2 2.9 MAR 0.3 3.0 APR 0.1 2.7 10-Yr NOTE AUCTION | 10 CPI 8:30 AM M(SA) Y (NSA) FEB 0.2 2.2 MAR -0.1 2.4 APR 0.2 2.5 TREASURY BUDGET 2:00 PM 30-Yr BOND AUCTION INITIAL JOBLESS CLAIMS (8:30) | 11 MICHIGAN SENTIMENT (P) 10:00 AM |
| 14 | 15 RETAIL SALES 8:30 AM M Y FEB -0.1 4.1 MAR 0.6 4.5 APR BUSINESS INVENTORIES 10:00 AM NET CAPITAL INFLOWS TICS 4:00 PM 30-Yr BOND SETTLEMENT 3, 10-Yr NOTE SETTLEMENT BOT (9:00) REDBOOK (8:55) | 16 HOUSING STARTS 8:30 AM Mn. M/M FEB 1.295 -3.3 MAR 1.319 1.9 APR CAPACITY UTIL/IND. PROD. 9:15 AM LEV M Y FEB 77.7 1.0 4.3 MAR 78.0 0.5 4.4 APR | 17 PHILADELPHIA FED INDEX 8:30 PM LEADING INDICATOR 10:00 AM 2, 5-, 7-Yr NOTE ANNOUNCE. INITIAL JOBLESS CLAIMS (8:30) | 18 |
| 21 | 22 2-Yr NOTE AUCTION BOT (9:00) REDBOOK (8:55) | 23 NEW HOME SALES 10:00 AM 5-Yr NOTE AUCTION FOMC Minutes | 24 EXISTING HOME SALES 10:00 AM 7-Yr NOTE AUCTION INITIAL JOBLESS CLAIMS (8:30) | 25 DURABLE GOODS ORDERS 8:30 AM M Y FEB 3.5 9.3 MAR 2.6 9.5 APR MICHIGAN SENTIMENT (F) 10:00 AM |
| 28 MEMORIAL DAY (HOLIDAY) (Markets Closed) | 29 S&P CORE LOGIC/CASE-SHILLER HOUSE PRICE INDEX 9:00 AM CONSUMER CONFIDENCE 10:00 AM | 30 ADP SURVEY 8:15 AM GDP 8:30 AM (AR) REAL IMPLICIT GDP DEFLATOR 17:Q4(F) 2.9 2.3 18:Q1(A) 2.3 2.0 18:Q1(P) ADV. TRADE IN INTERNATIONAL GOODS 8:30 AM CORPORATE PROFITS 8:30 AM Beige Book BOT (9:00) REDBOOK (8:55) | 31 PERS. INC & OUT. 8:30 AM SAVING INCOME CONS RATE M M AR FEB 0.3 0.0 3.0 MAR 0.3 0.4 3.1 APR CHICAGO PMI 9:45 AM INITIAL JOBLESS CLAIMS (8:30) | 1 EMPLOY. SITUATION 8:30 AM NON- CIV AVG FARM UNEMP HRLY PAYROLL RATE EARN MAR 135 4.1 2.6 APR 164 3.9 2.6 MAY ISM MFG SURVEY 10:00 AM COMP. PRICES INDEX INDEX MAR 59.3 78.1 APR 57.3 79.3 MAY LIGHT VEHICLES SALES MIL (AR) Y MAR 17,366 3.9 APR 17,069 0.6 MAY |
| 4 FACTORY ORDERS 10:00 AM M(SA) Y(NSA) FEB 1.6 7.5 MAR 1.6 8.1 APR | 5 ISM NON-MFG SURVEY 10:00 AM BOT (9:00) REDBOOK (8:55) | 6 GOODS & SERV. BALANCE (BOP) \$B 8:30 AM GDS SERV TOT FEB -77.0 19.2 -57.7 MAR -69.5 20.5 -49.0 APR NON-FARM PRODUCTIVITY 8:30 AM Q/Q (AR) Y/Y 17:Q4 (F) 0.3 1.2 18:Q1 (P) 0.7 1.3 18:Q1 (F) | 7 CONSUMER CREDIT 3:00 PM 30-Yr BOND ANNOUNCEMENT 3, 10-Yr NOTE ANNOUNCEMENT INITIAL JOBLESS CLAIMS (8:30) | 8 |

All data seasonally adjusted except where noted "NSA". M: per cent change from previous month. Q: per cent change from previous quarter at annual rates. Y: per cent change from year earlier. AR: Annual Rate. YTD: Year to date. Release dates are provided by sources outside CIBC World Markets inc. Dates are subject to change. Sources for historical data: U.S. Department of Commerce, U.S. Department of Labor and U.S. Federal Reserve Board.

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