Weekly Trends

PRIVATE CLIENT SOLUTIONS

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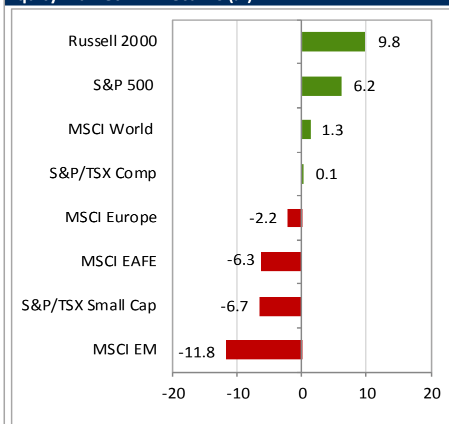
Talkin' Turkey

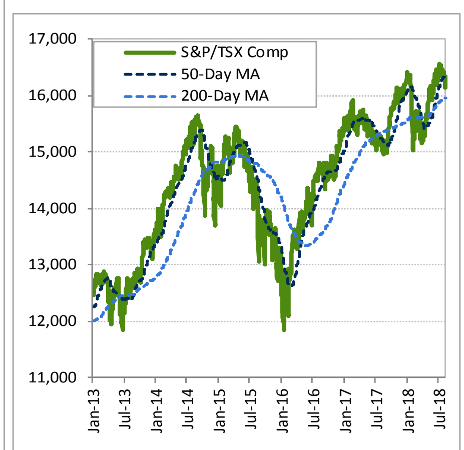
In recent weeks, the market's attention has shifted from concerns over trade to the potential contagion risk associated with the growing economic crisis in Turkey. The Turkish stock market has slipped over 25% year to date, credit investors are fleeing the country in droves and the currency experienced a freefall. This week we take a closer look at the unfolding crisis.

- Turkey's inflation rate has been running well within the double-digit range for all of 2018. In July, the annual inflation rate increased to 15.9%, the highest rate since January of 2004. Inflation has been driven by several years of easy monetary and fiscal policies, and now a weaker currency will only serve to accelerate the advance in consumer prices given the country's dependence on imports.
- The market's primary concern is that a worsening crisis may result in a default, which would negatively impact financial institutions holding Turkish debt. Last week, the ECB cautioned that various banks within the EU had significant exposure to the Turkish market. French, Spanish and Italian banks' total exposure to Turkey amounts to ~2% of GDP (Canadian and US banks have very limited exposure).
- The Turkish stock market has clearly broken down from a technical perspective with price action in absolute terms below a key support level. Further, the index has downward-sloping 50- and 200-day moving averages indicative of the bearish momentum dynamics. From a valuation perspective, the market trades one standard deviation below its long-term average on both a price-to-book and price-to-earnings basis.

Equity Market YTD Returns (%)

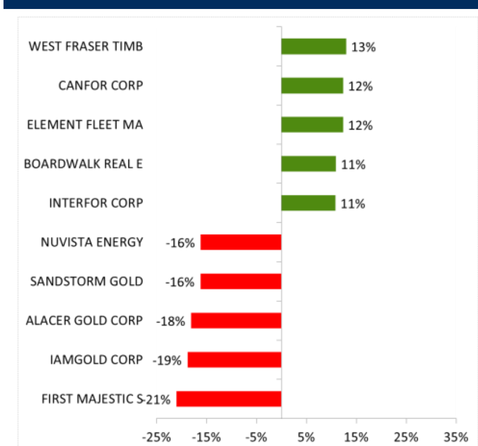


Canadian Sectors	Weight	Recommendation
Consumer Discretionary	5.6	Market weight
Consumer Staples	3.5	Underweight
Energy	19.3	Overweight
Financials	34.3	Market weight
Health Care	1.3	Market weight
Industrials	10.5	Overweight
Technology	4.0	Market weight
Materials	10.2	Overweight
Communications	4.5	Market weight
Utilities	3.8	Underweight
Real Estate	2.9	Market weight
Technical Considerations	**Level**	**Target**
S&P/TSX Composite	16,226	17,650



Source: Bloomberg, Raymond James Ltd.
Sectors are based on Bloomberg classifications

S&P/TSX Top 5 Gainers/Laggards*



S&P/TSX Market Internals

Weekly Advance	84	33%
Weekly Decline	159	63%
Advance-Decline	-75	
New 52 wk high	11	4%
New 52 wk low	15	6%
No. Stocks Above 50-d	117	47%
No. Stocks Above 200-d	119	47%
Arms Weekly Index	1.45	Neutral
RSI (14-day)	44.1	Neutral
50-DMA	16,354	Downtrend
200-DMA	15,955	Uptrend

*Source: Bloomberg, Raymond James Ltd; * 5-day price return*

Please read domestic and foreign disclosure/risk information beginning on page 5

Talkin' Turkey

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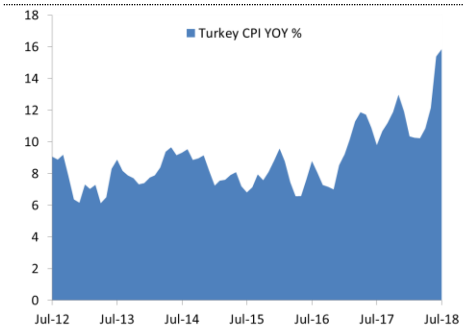
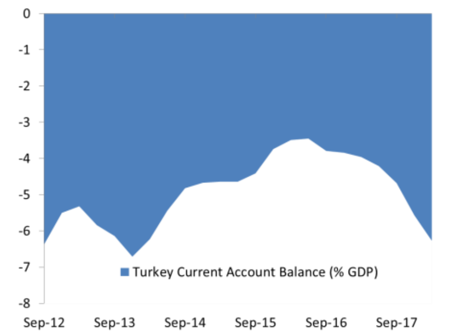
Economic Facts about Turkey

- Following a financial crisis in the 1990s the government implemented a number of reforms that brought inflation under control, increased employment and restored investor confidence.
- Prior to the global financial crisis, Turkey was one of the fastest growing economies in the world. Last year, the Turkish economy grew 7.4% annually.
- Turkey is the 18th largest economy in the world and its GDP value represents 1.4% of the world economy.
- Turkish GDP per capita adjusted by purchasing power was US$29.1k, or 35% below the EU average in 2017
- Turkey ran a current account deficit of 5.5% of GDP in 2017 making the country heavily reliant on foreign capital. The latest data show that the country has a negative balance equivalent to about 7.3% of GDP. Further, Turkey has foreign currency denominated debt equivalent to 40% of its GDP making it vulnerable to capital outflows.

Turkish Annual Inflation Rate



Turkish Current Account



Source: Bloomberg, Raymond James Ltd.

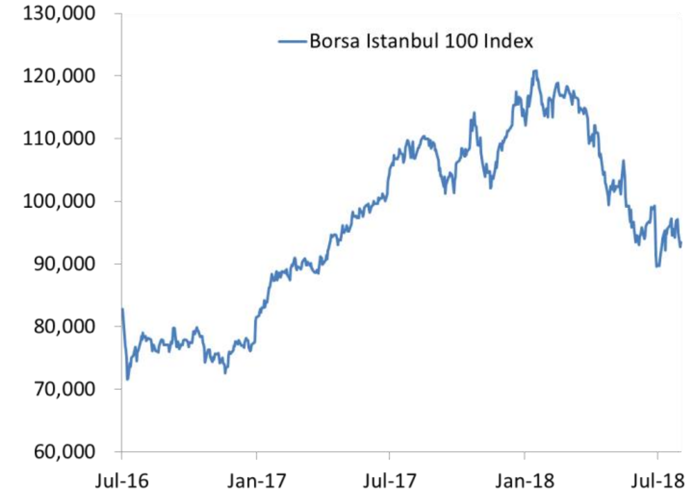
The Crisis

Turkey's inflation rate has been running well within the double-digit range for all of 2018. In July, the annual inflation rate increased to 15.9%, the highest rate since January of 2004. Inflation has been driven by several years of easy monetary and fiscal policies, and now a weaker currency will only serve to accelerate the advance in consumer prices given the country's dependence on imports.

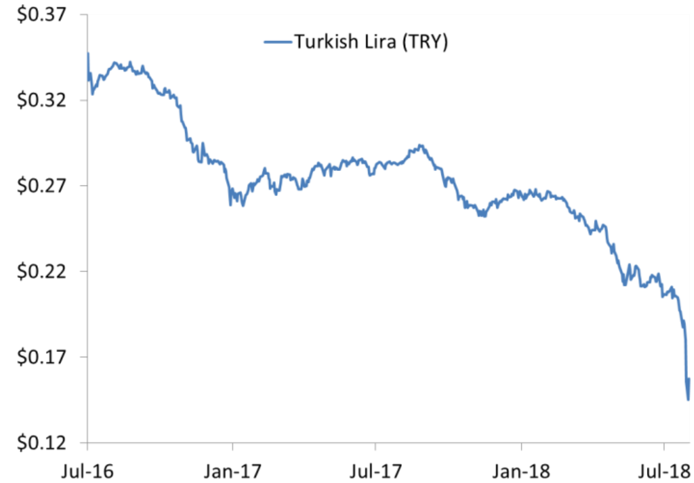
Typically, during periods of high inflation a country's central bank would reduce the money supply by raising interest rates. However, President Recep Tayyip Erdogan and his son-in-law Berat Albayrak, now Treasury and Finance Minister, have failed to act. The market had anticipated the central bank to take action in July to arrest the rapid advance in consumer prices. However, the unwillingness of the central bank to act has put additional pressure on the Turkish lira exacerbating the financial stress in the country. Further, at the time when the bank failed to act, Albayrak said, "We will see inflation and interest rates decline in the coming period." This comment was a real headscratcher given what we know about the relationship between inflation and interest rates. Central banks must first break the back of inflation by raising interest rates followed by a reduction in rates once conditions are warranted.

Adding to the confusion, President Erdogan gave himself the lone power to name the new governor of the central bank, ensuring continued policy uncertainty in the near term. Investors are now fleeing Turkey as policy makers appear unwilling to squash runaway inflation that surely will deepen the financial crisis within the domestic economy.

Turkish Borsa Istanbul 100 Index Under Pressure….



…but not as Bad as the Lira!

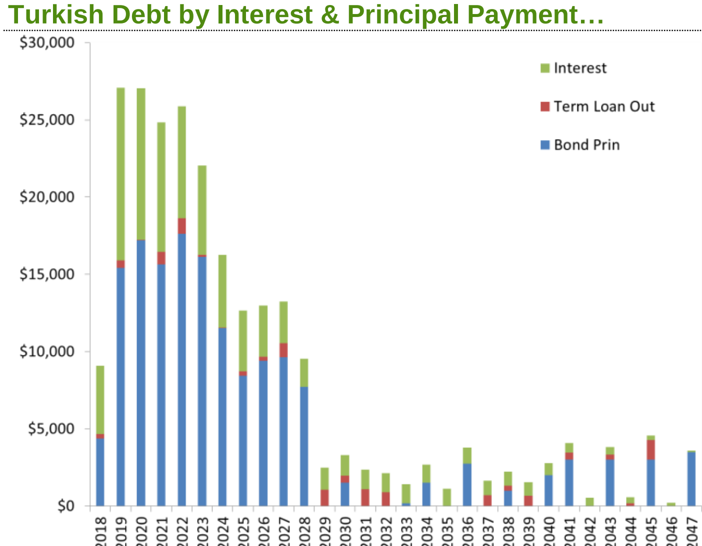


Source: Bloomberg, Raymond James Ltd.

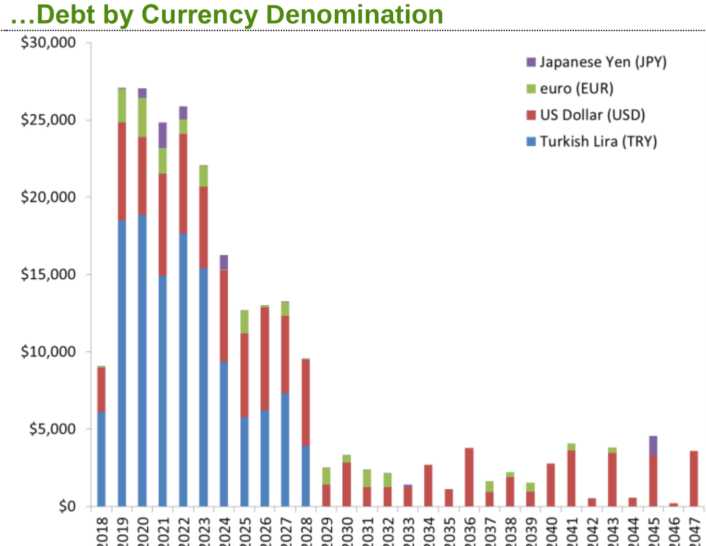
The Concern

The market's primary concern is that a worsening crisis may result in a default, which would negatively impact financial institutions holding Turkish debt. Last week, the ECB cautioned that various banks within the EU had significant exposure to the Turkish market. French, Spanish and Italian banks' total exposure to Turkey amounts to ~2% of GDP (Canadian and US banks have very limited exposure). Further, a loss of investor confidence may freeze Turkey out of raising capital to refinance debt maturities. The country required about US$200 bln annually to finance its current account deficit and maturing debt. The crisis has also caused investors to sell other emerging markets assets, which has disrupted financial markets.

Turkish Debt by Interest & Principal Payment…



…Debt by Currency Denomination



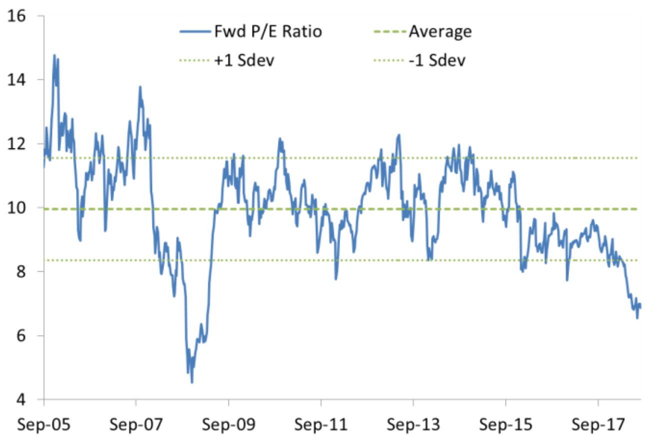
Source: Bloomberg, Raymond James Ltd.

What to Do

It's unclear whether the Turkish central bank will take decisive action to fend off a deepening domestic financial crisis. The Turkish stock market has clearly broken down from a technical perspective with price action in absolute terms below a key support level. Further, the index has downward-sloping 50- and 200-day moving averages indicative of the bearish momentum dynamics. From a valuation perspective, the market trades one standard deviation below its long-term average on both a price-to-book and price-to-earnings basis; however, we note the market was at larger extremes during the global financial crisis. Given the political and monetary policy uncertainty and negative price momentum, we believe these factors outweigh the attractive valuation levels.

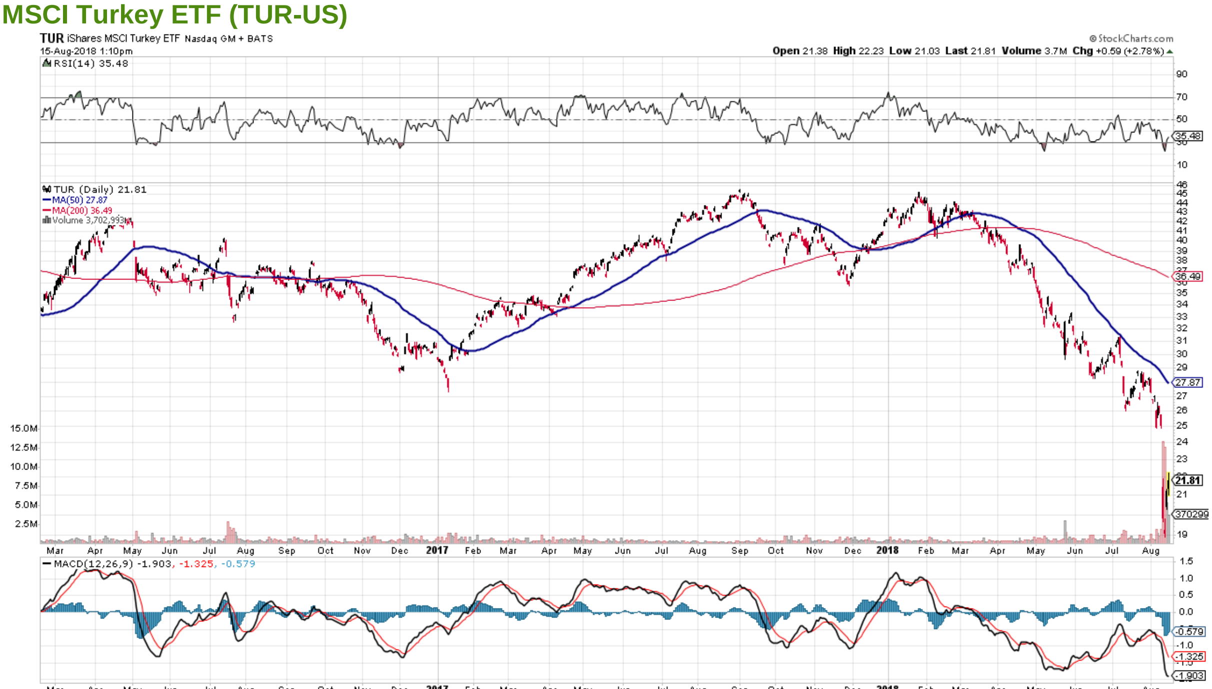
Borsa Istanbul 100 Index Price to Book…

…And Price to Earnings Ratio



Source: Bloomberg, Raymond James Ltd.

iShares MSCI Turkey ETF (TUR-US)



Source: Stockcharts.com

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