



## Economics

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# THE WEEK AHEAD

July 22-26, 2019

## No Convergence

by Benjamin Tal

The Fed is set to cut rates by 50 bps by year-end, and the market is expecting additional 50 bps of easing during 2020. However, we're under the impression that the market is too dovish. A relatively early move by the fed should eliminate the need to cut further next year. We also differ from the market on the future trajectory of the Bank of Canada rate. While we agree that the Bank will sit on its hands in the coming quarters, we believe that it will eventually ease by 25 bps during the course of 2020. Here's why.

The BoC is telling us that monetary policies are diverging due to the fact that the Canadian and the US economies are converging. That might be true from a short-term cyclical perspective, as the dismal performance of the fourth and first quarters in Canada gives way to a strong rebound in Q2. But from a more structural perspective we see no convergence.

Let's start with the savings rate. At under 2%, Canada's rate has been in free fall since 2012, and is miles below the 7% seen south of the border. The inability of the savings rate to recover despite a significant softening in spending means that the pace of credit growth recently is alarming, and suggests limited room for consumer spending to save the day.

An important factor behind that weakness is the disappointing trajectory of income growth in Canada, despite a strong labour market. Over the past five years, annual real disposable income growth in Canada averaged less than 2% - a full percentage point below the pace seen in the US. A similar trend can be seen over the past year, as US wages rose notably faster.

What's more, despite some improvement lately, the average annual volume of exports over the past three years is rising more slowly than the BoC's foreign activity index, building on the huge gap with the US established since 2010. And it won't get better anytime soon. With President Trump viewing the fog of uncertainty as a positive for US business, we do not foresee any quick resolution to ongoing trade disputes.

In Alberta, the pipeline saga is resulting in a situation in which oil inventories are relatively unchanged from late last year's levels, despite the curtailing of production - limiting energy's contribution to GDP growth.

So don't get too excited about the Q2 reading of potentially 3% GDP growth. The real health of the Canadian economy, due in part to these constraints, is more in line with a below potential 1 1/2% reading.

Which brings us back to the BoC. The reality that faces the Bank is that the only way to ease the pain is via a weaker C\$. But the expected divergence in monetary policy has already resulted in a 3% appreciation in the currency - exactly the opposite of what we need. How much more dollar appreciation should we expect? Between March and October of 2010, the BoC tightened rates by 75 bps while the Fed was on hold, but most of the rise in the currency occurred in the months leading up to the first hike. That was not the case during the 2002-2003 divergence, when most of the dollar appreciation took place after the first move. That suggests another potential round of dollar appreciation this time around. In the environment of only temporary convergence, and limited underlying inflationary pressures, we believe that the Bank will try to ease the pain by cutting during the course of 2020.



# Week Ahead Calendar And Forecast

CANADA		UNITED STATES	
	CIBC	Consensus	Prior
Monday July 22	(May) (M) 0.8%		1.7%
	8:30 AM WHOLESALE TRADE M/M		
Tuesday July 23	AUCTION: 3-M BILLS \$3.525B, 6-M BILLS \$1.425B, 1-YR BILLS \$1.425B CASH MANAGEMENT BUYBACK (Aug'19 - Nov'20) - \$0.5B		
	10:00 AM RICHMOND FED MANUF. INDEX EXISTING HOME SALES SAAR EXISTING HOME SALES M/M	(Jul) (M) 5.0 (Jun) (M) 5.34M (Jun) (M) -0.1%	3.0 5.34M 2.5%
Wednesday July 24	AUCTION: 10-YR CANADAS \$3B		
	AUCTION: 2-YR FRN \$20B AUCTION: 5-YR TREASURIES \$41B		
	7:00 AM MBA-APPLICATIONS	(Jul 19) (L)	-1.1%
	9:45 AM MARKIT US SERVICES PMI MARKIT US COMPOSITE PMI MARKIT US MANUFACTURING PMI	(Jul P) (L) 51.8 (Jul P) (L) 51.5 (Jul P) (L) 51.2	51.5 51.5 50.6
	10:00 AM NEW HOME SALES SAAR NEW HOME SALES M/M	(Jun) (M) 676K (Jun) (M) 8.0%	626K -7.8%
Thursday July 25	8:30 AM PAYROLL EMPLOYMENT, EARNINGS & HRS		
	AUCTION: 7-YR TREASURIES \$32B		
	8:30 AM INITIAL CLAIMS CONTINUING CLAIMS ADVANCE GOODS TRADE BALANCE WHOLESALE INVENTORIES M/M DURABLE GOODS ORDERS M/M DURABLE GOODS ORDERS EX-TRANS M/M RETAIL INVENTORIES M/M	(Jul 20) (M) 220K (Jul 13) (L) 1686K (Jun) (M) -\$72.4B (Jun P) (L) 0.9% (Jun P) (H) 1.3% (Jun P) (H) 0.2% (Jun) (L) 0.4%	216K 1686K -\$75.0B 0.4% -1.3% 0.4% 0.4%
Friday July 26	8:30 AM GDP (annualized) GDP DEFLATOR (annualized) PCE DEFLATOR Y/Y PCE DEFLATOR Y/Y (core)	(Q2 A) (H) 1.8% (Q2 A) (H) 1.8% (Q2 A) (H) 1.5% (Q2 A) (H) 1.6%	3.1% 0.9% 1.5% 1.6%

## Week Ahead's Market Call

by Andrew Grantham

**In the US,** Fed officials enter the blackout period before the July 31<sup>st</sup> decision, which may be a good thing considering some of the confusion caused by comments this past week. The advance GDP release should confirm a deceleration in growth, albeit with the composition actually a little better than in the first quarter. The trend in business investment has been cited by Chairman Powell as a source of concern, but a third straight increase in core capital goods orders could help allay some of those fears, given that it is a forward-looking indicator for second half business investment.

**In Canada,** it's a quieter week data wise, with wholesale trade completing the industry reports ahead of May GDP the following week, and expected to print somewhere in between the exuberance of manufacturing and the disappointment of retailing.

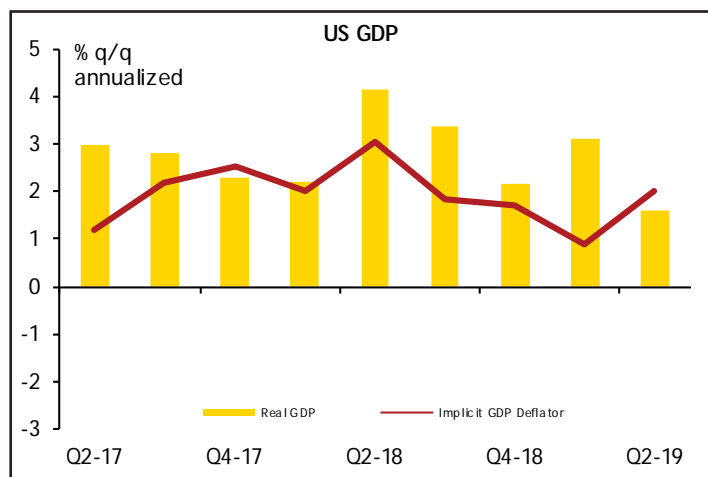
**There are no key Canadian numbers this week.**

**Week Ahead's Key US Number:****Real GDP—Q2 (Advance)**

(Friday, 8:30 a.m.)

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	CIBC	Mkt	Prior
GDP q/q annualized	1.6%	1.7%	3.1%
GDP Deflator	2.0%	1.8%	0.9%



The second quarter GDP release could be a mirror image of Q1's – a soft headline with some better details. That's because much of the deceleration in headline growth will likely come from inventories, which saw a large build-up in the prior quarter, and net trade, which was a surprisingly big contributor in the first quarter.

Indeed, growth in domestic demand is likely to actually have accelerated in the second quarter, largely thanks to consumer spending, with core retail sales seeing a sharp acceleration after a trying start to the year. Residential construction also may not be quite as negative as it has been recently, although business investment appears to have been sluggish.

**Forecast Implications** — Consumer spending isn't likely to keep up Q2's torrid pace in the second half of the year, despite solid income growth and a relatively high savings rate. However, with the largest drag from slower inventory building likely behind us, headline GDP growth shouldn't slow much further.

**Market Impact** — We are close to the consensus and as such would expect limited market reaction.

**Other U.S. Releases:****Durable Goods Orders—June**

(Thursday, 8:30 am)

Core durable goods orders provided a glimmer of life in May, and we're hopeful that will continue in June forecasting a 0.5% gain ex-transportation. Aircraft orders could see more volatility thanks to cancellations in July, but for June, they appear to be marginally higher than in the prior month. That will lift headline orders to a 1.3% increase.

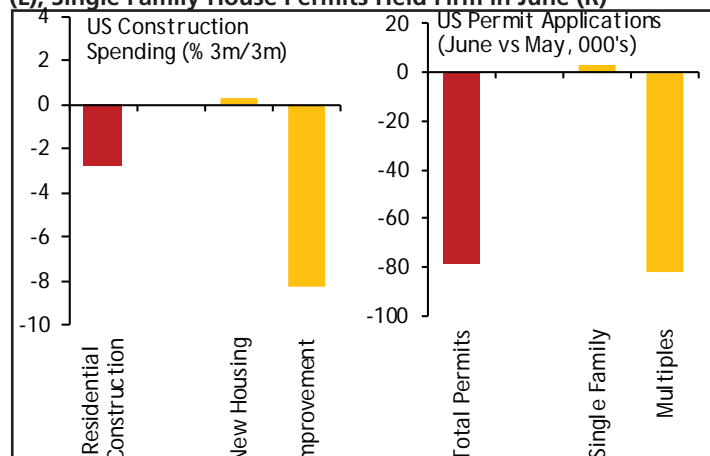
## Equity Insights

Andrew Grantham

### US Housing: Cracks, But Nothing More

Earlier in the week we identified that residential construction spending was one of three areas of the US economy currently seeing a decline on a three-month basis. However, potentially more interesting is what's driving that decline. Rather than being new home construction, the headline decline is actually due to the smaller and more volatile home improvement category. And while the latest housing permit figures disappointed relative to expectations, the decline was due to the again more volatile and less lumber-intensive multiples area. Demand for US single family housing, and by extension lumber, remains solid, just not quite as strong as it was at the recent peak in early 2018.

Residential Construction Decline Driven by "Improvements" (L), Single Family House Permits Held Firm in June (R)

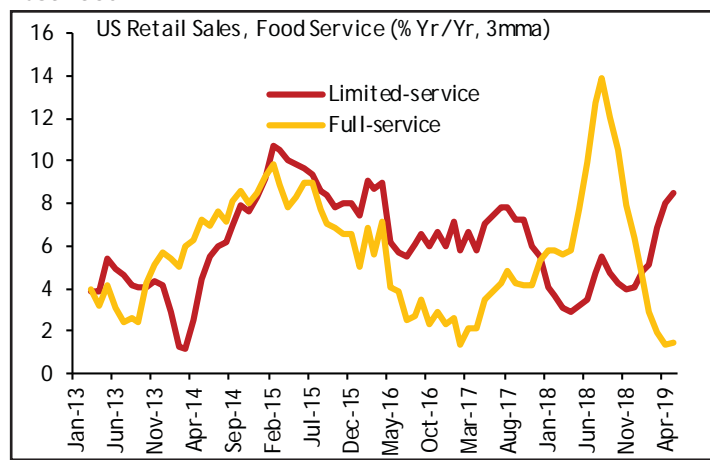


Source: BEA, CIBC

### Cheaper Tastes Suggest Reduced US Spending Appetite

Core retail sales in the US posted a strong bounce-back in Q2 after a weak first quarter, and consumer spending will be the primary contributor to GDP growth due for release next week. However, changing tastes in eating out suggest consumer sentiment isn't as high as it was in 2018. Last year, after the change in personal income taxes, there was a surge not just in eating out but eating out at higher-cost "full-service" restaurants. While growth in restaurant sales is still fairly solid, this year it's much more tilted toward "limited-service" fast food establishments. That could suggest US consumers aren't quite as hungry to spend, as recent headline retail sales figures imply.

Unlike 2018, Food Service Sales Recently Focused on Cheaper Fast-Food

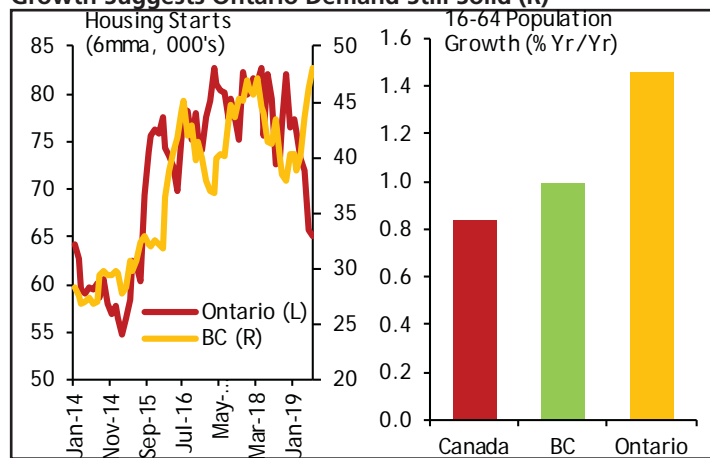


Source: Census, CIBC

### Location, Location, Location For Canadian Housing

While house prices are still struggling in Vancouver and firming in Toronto, starts have seen the opposite trend. Weaker pre-sales last year in Ontario, impacted by new mortgage regulations, appear to have negatively impacted housing starts in the province so far in 2019. In contrast to trends elsewhere in Canada, and in particular BC, homebuilding in Ontario has decelerated this year. However, we're seeing some signs of activity picking up again, and certainly judging by the strength of population growth in the province, demand remains solid.

Diverging Trends in Homebuilding This Year (L), But Population Growth Suggests Ontario Demand Still Solid (R)



Source: CMHC, Statistics Canada, CIBC

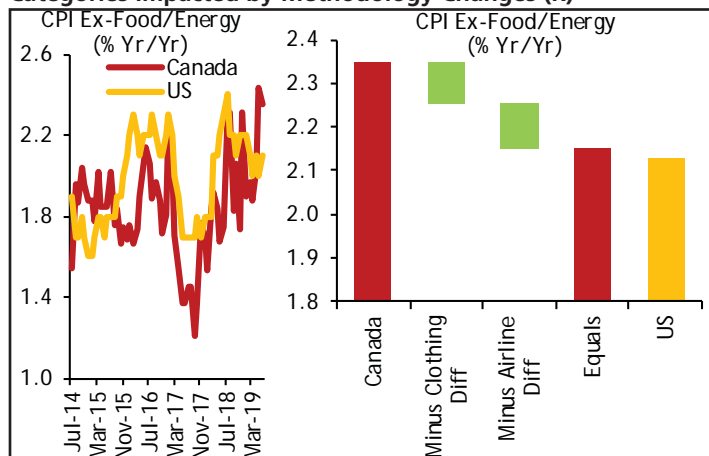
## Currency Currents

Andrew Grantham

### CAD Shouldn't Be So Inflated

Policymakers may focus on differing measures of inflation, but focusing on the old favourite ex-food/energy CPI it's interesting to note that price pressures have been sustainably higher in Canada than the US for the first time since 2015. However, that has more to do with statistical changes than differences in economic slack, and hence shouldn't be seen as a sign that BoC policy can diverge from the Fed's for too long. Adjusting for clothing price differences (that appear to have been depressed by a data collection change in the US) and air fares (inflated it seems by a methodology change in Canada) and the inflation rates are very similar. Once the BoC partly follows the Fed and cuts 25bp in the first half of next year, the C\$ will start a weakening trend again.

Ex-Food/Energy CPI Now Higher in Canada (L), Mainly Due to Categories Impacted by Methodology Changes (R)

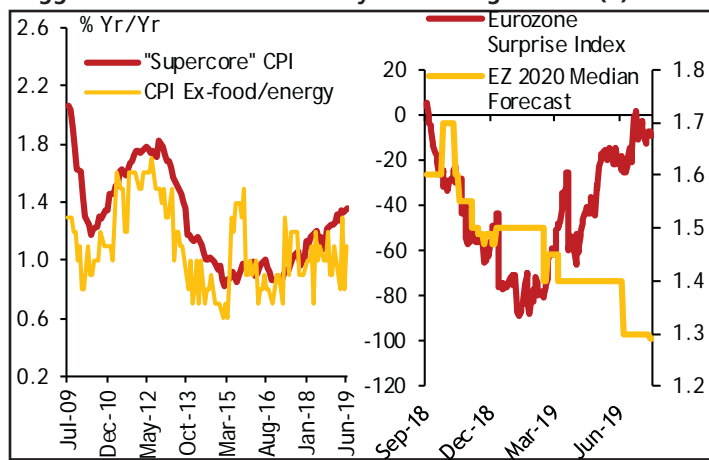


Source: Statistics Canada, BLS, CIBC

### Green Shoots to Support Euro

Low growth and low inflation have resulted in a dovish ECB and a downtrodden euro. However, growth and inflation may not be quite as low as people now think. The "supercore" measure of inflation (which omits other volatile prices such as air fares, not just food and energy) has been grinding higher. Meanwhile, a run higher in the surprise index suggests that the downgrades in growth expectations could soon be coming to an end. If these trends continue, the ECB may not have to be as forceful in any further stimulus measures, which would support the currency.

Underlying Inflation May be Creeping Higher (L), Surprise Index Suggests Growth Forecasts May be Nearing Bottom (R)

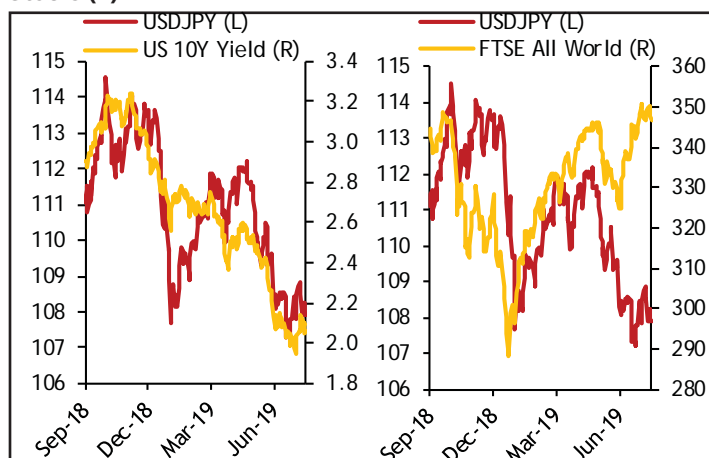


Source: Bloomberg, Citi, CIBC

### JPY: Following Bonds or Stocks ?

Bond markets are pricing in about 100bps worth of cuts from the Fed, suggesting possibly a mild recession scenario. Equity markets clearly aren't anticipating anything that bad. Where does the risk-off yen fit in? Given where USDJPY is compared to the end of last year, it appears to be pricing in a scenario more like the bond market. As such, if the 50bps worth of cuts from the Fed (plus other policy easing globally) is enough to shore up growth that could have the yen underperforming other currencies such as the euro and sterling against the US\$ next year.

USDJPY Appears to Have Followed Bonds (L) rather Than Stocks (R)



Source: Bloomberg, CIBC

# CANADIAN RELEASE AND EVENT DATES July/August 2019



MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
15	16	17	18	19
	<b>INT'L TRANSACTIONS IN SECURITIES C\$BN, NET</b> 8:30 AM BONDS MONEY STOCKS TOT MARKET MAR 4.7 -5.4 -0.8 -1.6 APR -0.3 -3.8 -8.6 -12.8 MAY 12.9 1.9 -4.6 10.2	<b>SURVEY OF MANUFACTURING</b> 8:30 AM SHIPMENTS M Y MAR 2.8 2.4 APR -0.4 3.5 MAY 1.6 3.0 <b>CPI</b> 8:30 AM M Y APR 0.4 2.0 MAY 0.4 2.4 JUN -0.2 2.0	<b>ADP EMPLOYMENT SURVEY</b> 8:30 AM	<b>RETAIL TRADE</b> 8:30 AM (Current\$) M Y MAR 1.3 2.9 APR 0.1 3.7 MAY -1.0 1.0
22	23	24	25	26
<b>WHOLESALE TRADE</b> 8:30 AM			<b>PAYROLL EMPLOYMENT, EARNINGS &amp; HOURS</b> 8:30 AM	
29	30	31	1	2
		<b>GDP BY INDUSTRY</b> 8:30 AM (2002\$) GDP IND.PROD. M M MAR 0.5 1.1 APR 0.3 0.6 MAY <b>INDUSTRIAL PRICES</b> 8:30 AM M (NSA) Y APR 0.8 1.7 MAY 0.1 0.6 JUN		<b>MERCHANDISE TRADE</b> 8:30 AM \$MN 12 MO. BALANCE APR -1083 -22,767 MAY 762 -19,156 JUN
5	6	7	8	9
<b>CIVIC HOLIDAY</b> (Markets Closed)		<b>IVEY PURCHASING MANAGERS' INDEX</b> 10:00 AM	<b>NEW HOUSING PRICE INDEX</b> 8:30 AM	<b>EMPLOY. SITUATION</b> 8:30 AM NON- CIV AVG FARM UNEMP HRLY PAYROLL RATE EARN MAY 72 3.6 3.4 JUN 224 3.7 3.4 JUL <b>HOUSING STARTS</b> 8:15 AM 000's (AR) TOTAL SINGLES MAY 202 45 JUN 246 48 JUL <b>BUILDING PERMITS (\$)</b> 8:30 AM M M (RES) (NON-RES) APR 26.7 2.0 MAY -17.2 -5.7 JUN
12	13	14	15	16
			<b>ADP EMPLOYMENT SURVEY</b> 8:30 AM	<b>INT'L TRANSACTIONS IN SECURITIES C\$BN, NET</b> 8:30 AM BONDS MONEY STOCKS TOT MARKET APR -0.3 -3.8 -8.6 -12.8 MAY 12.9 1.9 -4.6 10.2 JUN

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 July/August 2019



MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
15	16	17	18	19
	<b>RETAIL SALES</b> 8:30 AM M Y APR 0.3 3.7 MAY 0.4 2.9 JUN 0.4 3.4 <b>CAPACITY UTIL/IND. PROD.</b> 9:15 AM LEV M Y APR 77.9 -0.4 0.9 MAY 78.1 0.4 2.0 JUN 77.9 0.0 1.3 <b>BUSINESS INVENTORIES</b> 10:00 AM <b>NET CAPITAL INFLOWS TICS</b> 4:00 PM <i>BOT (9:00) REDBOOK (8:55)</i>	<b>HOUSING STARTS</b> 8:30 AM Mn. M/M APR 1.270 5.9 MAY 1.265 -0.4 JUN 1.253 -0.9  <b>Beige Book</b>	<b>PHILADELPHIA FED INDEX</b> 8:30 AM  <b>LEADING INDICATOR</b> 10:00 AM  <i>2, 5, 7-Yr NOTE ANNOUNCEMENT</i> <i>INITIAL JOBLESS CLAIMS (8:30)</i>	<b>MICHIGAN SENTIMENT (P)</b> 10:00 AM
22	23	24	25	26
	<b>EXISTING HOME SALES</b> 10:00 AM  <i>2-Yr NOTE AUCTION</i> <i>BOT (9:00) REDBOOK (8:55)</i>	<b>NEW HOME SALES</b> 10:00 AM  <i>5-Yr NOTE AUCTION</i>	<b>DURABLE GOODS ORDERS</b> 8:30 AM M Y APR -2.8 -0.7 MAY -1.3 -2.8  <b>ADV. TRADE IN INTERNATIONAL GOODS</b> 8:30 AM  <i>7-Yr NOTE AUCTION</i> <i>INITIAL JOBLESS CLAIMS (8:30)</i>	<b>GDP</b> 8:30 AM (AR) REAL IMPLICIT GDP DEFLATOR 19:Q1 (2 <sup>nd</sup> Est) 3.1 0.8 19:Q1 (3 <sup>rd</sup> Est) 3.1 0.9 19:Q2 (1 <sup>st</sup> Est)
29	30	31	1	2
	<b>PERS. INC &amp; OUT.</b> 8:30 AM SAVING INCOME CONS RATE M M AR APR 0.5 0.6 6.1 MAY 0.5 0.4 6.1 JUN  <b>S&amp;P/CASE-SHILLER HOUSE PRICE INDEX</b> 9:00 AM  <b>CONSUMER CONFIDENCE</b> 10:00 AM  <i>BOT (9:00) REDBOOK (8:55)</i>	<b>ADP SURVEY</b> 8:15 AM  <b>ECI</b> 8:30 AM WAGES & BEN. TOTAL SALARY 18:Q4 0.7 0.7 0.7 19:Q1 0.7 0.7 0.7 19:Q2  <b>CHICAGO PMI</b> 9:45 AM  <b>FOMC Rate Decision</b> <b>Fed Chair Powell speaks @ 2:30 PM ET</b>  <i>2, 5, 7-Yr NOTE SETTLEMENT</i> <i>3, 10-Yr NOTE ANNOUNCEMENT</i> <i>30-Yr BOND ANNOUNCEMENT</i>	<b>ISM MFG SURVEY</b> 10:00 AM COMP. PRICES INDEX INDEX MAY 52.1 53.2 JUN 51.7 47.9 JUL  <b>LIGHT VEHICLES</b> SALES MIL (AR) Y MAY 17.397 1.2 JUN 17.291 0.4 JUL  <i>INITIAL JOBLESS CLAIMS (8:30)</i>	<b>EMPLOY. SITUATION</b> 8:30 AM NON- CIV AVG FARM UNEMP HRLY PAYROLL RATE EARN MAY 72 3.6 3.4 JUN 224 3.7 3.4  <b>GOODS &amp; SERV. BALANCE (BOP) \$B</b> 8:30 AM GDS SERV TOT APR -71.7 20.5 -51.2 MAY -76.1 20.6 -55.5 JUN <b>FACTORY ORDERS</b> 10:00 AM M(SA) Y(NSA) APR -1.2 0.6 MAY -0.7 -1.2 JUN <b>MICHIGAN SENTIMENT (F)</b> 10:00 AM
5	6	7	8	9
<b>ISM NON-MFG SURVEY</b> 10:00 AM	<i>BOT (9:00) REDBOOK (8:55)</i>	<b>CONSUMER CREDIT</b> 3:00PM	<b>WHOLESALE TRADE</b> 10:00 AM  <i>INITIAL JOBLESS CLAIMS (8:30)</i>	<b>PPI</b> 8:30 AM M (SA) Y (NSA) MAY 0.1 1.9 JUN 0.2 1.7 JUL
12	13	14	15	16
<b>TREASURY BUDGET</b> 2:00 PM	<b>CPI</b> 8:30 AM M(SA) Y (NSA) MAY 0.1 1.8 JUN 0.1 1.6 JUL  <i>BOT (9:00) REDBOOK (8:55)</i>		<b>NON-FARM PRODUCTIVITY</b> 8:30 AM Q/Q (AR) Y/Y 18:Q4 (A) 1.3 1.7 19:Q1 (A) 3.4 2.4 19:Q2 (F) <b>RETAIL SALES</b> 8:30 AM M Y MAY 0.4 2.9 JUN 0.4 3.4 JUL <b>CAPACITY UTIL/IND. PROD.</b> 9:15 AM LEV M Y MAY 78.1 0.4 2.0 JUN 77.9 0.0 1.3 JUL <b>PHILADELPHIA FED INDEX</b> 8:30 AM <b>BUSINESS INVENTORIES</b> 10:00 AM <b>NET CAPITAL INFLOWS TICS</b> 4:00 PM <i>INITIAL JOBLESS CLAIMS (8:30)</i> <i>3, 10-Yr NOTE SETTLEMENT</i> <i>30-Yr BOND SETTLEMENT</i>	<b>HOUSING STARTS</b> 8:30 AM Mn. M/M MAY 1.265 -0.4 JUN 1.253 -0.9 JUL  <b>MICHIGAN SENTIMENT (P)</b> 10:00 AM

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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