The TSX Index Is Down 100 Points to Start the Week: 3 Warning Signals That Are Flashing Red

Description

Three important warning signals are flashing red in this week's trading following the September long weekend, indicating investors may want to approach the current market environment with a heightened level of caution.

Ongoing NAFTA negotiations between Canada and the United States

The United States and Mexico have reached a preliminary trade agreement; however, thus far Canada has found itself on the outside looking in.

Following last week's news of a tentative trade deal between two of the three parties to NAFTA, the Mexican peso gained while the Canadian dollar, or "loonie," lost value, signaling that at least for now there remains at least some degree of uncertainty as to the extent of what Canada's involvement will be as part of any forthcoming North American trade pact, or what any deal, if signed, might look like.

Tensions have been rising amid negotiators, as the two countries work to renegotiate a deal under the leadership of the new Trump administration.

So far in 2018, Canada's benchmark index, the TSX Index (S&P/TSX Composite index), is virtually unchanged; meanwhile, its U.S. counterpart, the S&P 500, has gained more than 7.9%.

Meanwhile, the Canadian dollar has lost just shy of 4% against the U.S. dollar, or "greenback."

Those measures would seem to indicate that the outcome of any forthcoming trade deals would stand to be more impactful for Canadians than their American neighbours and could stand to being additionally volatility to the markets.

The "loonie" is falling…

The decline in the Canadian currency also stands to make the TSX Index less desirable to foreign investors.

The Canadian market is home to the listings of hundreds of international companies — mostly mining and a few oil and gas companies — and thus takes in a significant amount of foreign capital.

The fact that those foreign investors are losing money on the value of their Canadian holdings — in addition to a market that is lagging behind the U.S. — could foreshadow a stampede toward the exits should trade talks stall, or worse.

Canadian private markets are particularly vulnerable

Last week, investment bank **Goldman Sachs** released a report indicating that the finances of Canadian households are among the most vulnerable of any in the developed world.

While the economy continues to grow in nominal terms, unemployment is at respectable levels, and the TSX Index continues to churn higher; the most troubling sign looming is the rising level of spending relative to incomes.

Simply put, spending more than you earn means that you're relying on one of two things: asset values appreciating or a dangerous reliance on credit markets.

The problem is, neither of those "solutions" should be relied on times of crisis.

Bottom line: it's not good for the banking sector or the Canadian economy at large

If talks were to break down between Canada and the U.S., it could be bad news for millions of Canadians and perhaps could spell dire trouble for several of Canada's key lenders.

One of the possible scenarios facing lenders like **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), **Bank of Montreal** (TSX:BMO)(NYSE:BMO), **Laurentian Bank of Canada** (TSX:LB), and others is potentially three-fold.

In a "bear market," not only would the Canadian banks be forced to deal with a customer base flooded with overly indebted households — something that has arguably been going on for several years now — but if asset values (think housing prices) were to fall in line with a depreciating domestic currency, something would inevitably have to give.

That could end up meaning a rising wave of defaults and bad debts in the short term.

Longer term, Canadians could very well be on the verge of a "great deleveraging" and "lower rates for longer," similar to the environment experienced in the U.S. just 10 years ago and the one facing the United Kingdom over the decade since.

And that would not be good for anyone — banks nor Canadian investors.

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