

Your weekly market update

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Market Update

8 January 2016

The direct financial impact of lower share prices in China is moderate. There is not enough foreign investment in the Chinese market for it to be a major problem with foreigners owning just 2% of shares. The issue is more about whether the financial turbulence shines a light on wider issues about the economic slowdown in China: is the economy heading for what's called a "hard landing", too sharp a slowdown? China is now such a big force in the global economy that it would inevitably affect the rest of the world. It is the second largest economy and the second largest importer of both goods and commercial services.

A weakening of the currency is often seen by investors as an indication that the economy is not doing well and needs to be propped up by boosting exports. A lower Yuan makes the cost of exporting goods for Chinese companies cheaper, giving the slowing factory sector a boost.

For the second time in less than six months, market turmoil in China is rattling the rest of the world. As in last August, the trigger is a sudden slide in the value of the renminbi, which in turn has dragged down domestic stocks. Chinese attempts to prop up world their economy through both quantitative easing and qualitative devaluation of their currency mean Politburo leaders are concerned China's economy is in for a hard landing. The Chinese currency is down 1.5 percent against the American dollar in fewer than four full days which is only slightly less than the supposedly one-time depreciation that surprised global investors last summer. The latest slide prompted a sell-off in Chinese stocks, twice activating circuit breakers, which suspend trading when the benchmark CSI 300 index moves more than 7 percent. On Thursday morning, the market closed within half an hour of the opening bell.

Broadly, there are two theories for what is going on. The first is that the Chinese leadership have concluded a hefty devaluation is the least destructive solution to the country's economic predicament. Renewed fears of a currency war have prompted investors to flee major trading partners like Australia and South Korea, while also putting pressure on commodity prices. A barrel of Brent crude oil now sells for little more than \$33.

Chinese authorities counter that the renminbi is weak only when compared with the dollar. Measured against a broader basket of currencies, the renminbi was more or less flat last year. Besides,



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China is still running a healthy trade surplus, which lessens its incentive to seek a competitive advantage by devaluation.

Yet if China really has no grand plan, that gives weight to the second theory: that the Politburo is losing their grip on the world's second-largest economy. Last year's bungled stock market intervention and mini-devaluation punctured the myth of Chinese bureaucratic infallibility. The latest ructions reinforce the belief that officials are struggling to reconcile contradictory demands: promoting market forces while preserving stability and rebalancing the economy while continuing to meet increasingly unrealistic growth targets. The clash between Politburo demands and market forces are materializing. A centralized approach to managing GDP and investment capital most always results in capital leaving the controlling autocratic machine.

Whether China's latest market upheaval is by design or default, it's little surprise that investors are assuming the worst for China.

What can we expect next?

Just like last August, capital inflows will shift from emerging economies such as China into developed nations such as America and the EU.

Since the great recession of 2008, we have seen developed nations starting with America, then Japan and recently the EU under go massive financial restructuring of financial institutions and government spending. Emerging economies and specifically China have enjoyed a free pass. We have entered the final phase of quantitative easing, fiscal and monetary reform. It is not just China but all EM nations must embark on aggressive reforms in order to survive. China being the largest EM economy in the world and the second largest economic engine - all eyes are on China.

How does this effect us?

For the last few years, our weekly updates have been signalling a hard landing for China. The first crash landing in China was the property market. The up and coming hard landing will be in the stock market. With only 2% of direct foreign ownership in Chinese stocks, the impact will be contained. Our modelled portfolios have been concentrated with approximately 83% of the total assets in North America along with exposure to the EU and no EU countries ranging between 10% and 14%. By sector, client modelled portfolios are concentrated between financials, fixed income and with cash over 20% .

Following our three investment disciplines of capital preservations, monthly yield and growth have allowed clients to benefit in monthly distributions while preserving capital. Even with 2015 being a very challenging a special year end distribution was paid to client accounts as either a cash deposit into their chequing accounts or reinvestment back into your portfolio. Year end distributions ranged from 1.54% for the income modelled portfolio to 4.19% for the dividend modelled portfolio. Please refer to your online personal website for specifics to your investment portfolio and respective holdings.

The Dow Jones industrial average has fallen over 6.01% in the last 12 month while the TSX has fallen 12.77%. Our modelled client portfolios have provided shelter current this current period of upheaval. A similar experience occurred in 2011 which saw markets swing wildly.

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