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Market Update

21 October 2016

This has to be one of worst election cycles in American history were anything goes. Well, my use of the word “worst” is excessive but it is definitely tumultuous which is tearing at the cohesive fabric of American society. Nixon’s loss against Kennedy rocked America. Nixon won more states while Kennedy had more individual votes. This was a very narrow win for President Robert Kennedy. How about the highly contested presidential election of Al Gore and George W. Bush? Only after 36 grueling days and a Supreme Court ruling did Al Gore concede the presidency over to George W. Bush. However, both of the past two mentioned election cycles went ugly after the vote and ultimately cooler head prevailed in order to unify the American people and to restore order. Right now, the exact opposite is happening. With less than one month to go, the nation is polarised. What happens if the vote is close or questionable? The Trump camp has made it clear how it will respond. How about if the Clinton’s camp gets a surprise upset and loses. Will she quietly concede to Trump and allow the American people to heal and unify? At current tension levels, rioting will be an option for the disgruntled. By letting out their frustration and forced attempts to bring about change will be fruitless. For any democratic society to function properly there has to be an understanding that the election process is functioning and not corrupt otherwise what is the point of a democracy. Voter fraud or voting suppression are elements that must be corrected



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otherwise wide spread disillusion will fuel the fires of civil discontent. Unlike another political process democracy allows for an orderly transfer of power from one administration to another. If the transition of power can't be orderly and transparent, then capital investment will not wait around. Fundamentally the economic environment since 2009 in America has been one of progressive steady gains. Political stability and bipartisan cooperation are dearly lacking in America resulting in adequate and stalling fiscal reforms. The lack of political direction and decisive action plans are not just plaguing America but also many other developed nations. Political grid lock seems to be the norm. Central Banks have had to step in and do the heavy lifting and overcome the ineptness of the political machine. Central Bankers are reaching their limits and the effectiveness of monetary tools at their disposal to bring about lasting change. America is about to embark on the largest deficit spending program in their nation's history. On a greater scale than WWII. The trillion dollar question after the election is: Are market makers confident that regardless of who leads this nation, will their administration have the political buy in by both sides to bring about necessary fiscal policy? No!

No one is forecasting a roaring recovery. Progressive economic steadiness is the expectation with heavy intervention from American Federal Reserve. It is a sad statement to make as American corporations are healthy and profitable. American Banks are set to be the biggest benefactor of Brexit not the EU. London is out and New York is in. Early data of institutional investment capital flows point to a growing out flow of funds from London into New York. America has all the underpinnings for not just a growing economy but for roaring growth. The muting factor is the political environment brings about uncertainty in the next leaderships ability to bring about lasting and meaningful economic reforms. Capital markets do not want another 8 years of Obama style economics.

Hard or soft Brexit (sounds like a discussion about cheese and eggs) is the topic of discussion in both the United Kingdom and the EU. Hard exit is simple. All trade agreements end on a

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predetermined date and then Britain must start from scratch and renegotiate all agreements with its surrounding neighbours and trade partners. Until such agreements are reached the EU would apply unilateral tariffs. Soft agreements work a little different. The United Kingdom would be grandfathered the free movement of goods, services and capital. Once article 50 process is completed and Britain has officially left the EU , the UK would open negotiations for comprehensive free trade deals. A trade deal favoured by both the EU and the UK would be similar in structure with the proposed CETA free trade agreement between Canada and the EU. So, in short the United Kingdom would like to have the same free trade agreement as Canada is about to sign with the EU.

CETA has not been warmly received by all regions of the EU and risks not being signed by the October 27th. Prime Minister Justin Trudeau is expected to visit Brussels on the day of signing.

The CETA (Comprehensive Economic Trade deal Agreement) between Canada and the EU is currently being blocked in by the region of Wallonia in Belgium. Wallonia represents about half of Belgium geographically and one third of the population. This region was at the center of the industrial revolution for continental Europe. Wallonia's vast wealth has declined over time however the political influence the region exercises over Belgium and the EU has only grown since Brussels was established as the administration centre for the EU.

China officially reported on Wednesday that the economy grew by 6.7% in the third quarter compared to a year ago. Ironically, that matched government economists' forecasts. Not surprising to say the least. Regardless of the rhetoric, China has come to the end when it comes to export and investment lead growth. Both foreign investment and export are rapidly shrinking. The following economic outcomes are possible for the dragon nation:

Financial Meltdown: China escaped the 2008 financial crisis by embarking on a state directed campaign to create mountains of new debt. This may have cushioned the blow of the global crisis

only to delay the financial day of reckoning. China risks unleashing its own version of the 2008 crisis which shocked Wall Street and plunged the America into a great recession. The EU and other parts of the world are still reeling from the shock. The Bank for International Settlement published new data estimating the gap between China's outstanding credit and its long term growth rate has widened to record levels well above historic levels that indicate financial crisis is likely. Just like the shadow banking that broke Wall Street, the IMF reported that shadow loans average 300% more than the capital buffers in Chinese banks.

Japan Syndrome: Like China now, back in the 1990's Japan faced enormous bank debt, over capacity of industrial output and bursting of a stock market bubble brought about a 30 plus year recession for which the economic repercussions are still present today. If China fails to restructure the current debt it too will experience decades long low growth and anemic activity. The biggest take away from the data released by both the IMF and the BIS is multiples beyond what we saw in Japan.

The Bank of Canada announced that interest rate changes are on hold. What's next for the Bank of Canada. Economic expectations are muted as expressed by Stephen Poloz, the governor of the Bank of Canada. This time the Federal Finance Minister did some heavy lifting and took pressure of the Bank of Canada to act on a change in direction of interest rate policy. Had the Federal government not done its part the Bank of Canada would need to act as Australia did by raising interest rates to cool the real estate market and then to lower interest rates in order to weaken an over heated dollar. The Canadian economy could not handle such rapid gyrations let alone individuals with too much debt to service.

Our Federal government has had one full year in power. They have done what was promised. New elected leaders have listened and then listened some more to the Canadian people. Now sound fiscal policy is needed to be put into action. The Bank of Canada's failure to act pushed the Federal Finance Minister into action. Now

let's hope Mr. Morneau is a man of action and executes much need fiscal policy.

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