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Market Update

14 October 2016

Thanksgiving is a time to be grateful for all the bounty in our lives and enjoy time with family and friends. Here in Canada we have rising wages, strong employment growth and very healthy real estate prices. So all is good.

In America, the same holds true. Wages are rising, employment numbers are up, economic growth is steady with real estate prices also pushing new highs. So what's the concern? The Federal election is the big unknown. Both presidential candidates come with significant baggage. Choosing the right leader will definitely shape economic growth in the short and near term. Never in the history of American politics has it been so critical to pick the right administration. The stress to voters has never been so high according to surveys as most voters report having sleepless nights and waking up at 3am to see poll results. In the case of an American election cycle, the entire world is on edge waiting in anticipation to see who will lead the world's superpower. The good news is the Federal Reserve is on course to handle whatever the next election cycle will throw at them. We see major head winds for Britain, EU and China continue to worsen thus keeping global growth weak. North America is on its own. How does the Federal Reserve plan to deal with pockets of high volatility in the months ahead and a potential Trump win? Why even consider, let alone factor the potential of a Trump win? Simple, polling and voter surveys have been highly inaccurate and deeply skewed lately. All you need to do is look at the Brexit polling data. Actually, most pollsters have failed to accurately predict election results in



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developed nations for a period of time. Massive change on how voters interface, the steady decline in the use of land lines and privacy rules has made it harder to survey and poll specific demographics crimping pollsters forecasting ability. So how will the Fed manage? The Federal Reserve will shift from proactive management of monetary policy to allowing the underlying lasting economic growth shape the timing of a rate hike. Expect the Federal Reserve to allow the economy to run a little hotter before taking action while interest rates unfold. The bellwether for the Fed's moving forward with interest rates is allowing inflation to stay well above 2% and unemployment to fall below 4.9%. Once wage inflations are consistent and broad based then the Federal Reserve will shift gears. Recent economic data shows that wholesale prices rose more than projected in September, aided by higher costs for energy and food indicating inflation may be picking up. Retail sales climbed in September the most in three months, showing American shoppers began to spend freely again after shying away from merchants earlier in the quarter. The Commerce Department reported a 0.6% advance in retail. Years of increased hiring and a slow acceleration in worker pay have laid a foundation for steady household spending and the combination of solid job growth. Additionally, the Labor Department reported the producer price index increased 0.3%, the first gain in three months, after being little changed in August. More stable commodity costs and a diminishing effect from last year's surge in the dollar are allowing for more price pressures in the production pipeline.

The next big shoe to drop in the European continent is Brexit discussion between the EU and Britain which are slated to start.

The ECB has braced itself by moving interest rates into negative territory and pushing to keep interest rates at negative rates longer. Such a move will push asset prices higher.

Earlier Thursday, customs data out of China showed that exports fell more than expected in September while imports also declined. The country's exports contracted 10% year over year to \$184.5 billion worse than the decline of 2.8% in August. Imports fell 1.9% to \$142.5 billion, also down from a 1.5% rise in August.

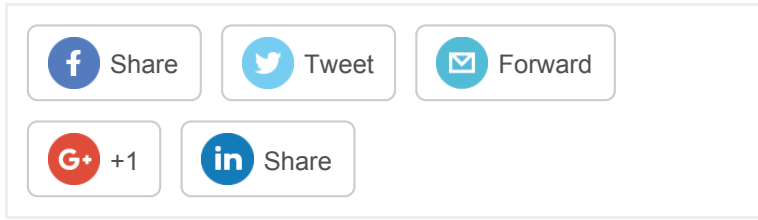
Assets in Europe and emerging economies are looking attractive at

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current prices but further economic slow down is ahead before a true bottom is reached.

Also, a surprisingly large build up in American oil inventories last week put some initial downward pressure on crude futures before they regained ground. The American Energy Information Agency reported oil supplies grew by 4.9 million barrels. A separate report from the private American Petroleum Institute issue stated crude inventories increased by 2.7 million barrels. Following the EIA report, the November contract for West Texas Intermediate traded lower, but subsequently recovered to close at \$50.44 US a barrel, up 26 cents from Wednesday. The new Kashagan oil field which just went on line will only add to the oil surplus. Above \$45.00 a barrel energy producers can return to profitability and ramp up production. To the dislike of OPEC nation non OPEC energy producers will continue to ramp up production at current price levels.

Here in Canada, The Federal government finally brought about sweeping change. Qualifying for a mortgage has become tougher and reporting of principal residence on your tax return will kill the tax loop hole on capital gains free profits made by speculators coupled with mandatory registration of foreign buyers holding Canadian real estate. Add into this that all home owners that bought with less than 20 % down will be subject to a financial stress test to determined if they can continue to afford living in their current home. With such a culmination of change taking place there is little doubt that the real estate prices will cool. However in the interim expect to see sales activity spike as many have rushed in anticipation of the announced changes. Home sales numbers in February through May point to how dramatic the change is. The key point to take away from all of this is that affordability has diminished and unless buyer's incomes can support such carrying cost the market will over heat and collapse. Back in 1990, the collapse in the ability for the homebuyer to carry home costs saw real estate prices collapse which took 13 years to recover. For those that own real estate that has seen lofty appreciation, you might want to consider looking at these high prices and selective sell real estate holdings.



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