

Your weekly market update

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Market Update

07 Nov 2017

In today's market update, I will side step all the indictments and the path to impeachment for which President Trump should be very concerned. Economic data is at the heart of what we do and takes away the smoke and mirrors. America's October jobs report is out and was a slight miss. The American economy added 261,000 jobs in October while the unemployment rate fell again to 4.1% as reported the latest figures from the Bureau of Labor Statistics. This is the lowest unemployment rate since December 2000. Wall Street was looking for a big bounce back for the labor market in October after the hurricanes America saw back in September. Employment data from September were also revised upwards by 18,000 after having been estimated to decline by 33,000. Job gains in August were also revised higher, to 208,000 from 169,000, and average job gains are now at 162,000 over the last three months. With all the good news on jobs comes disappointing data on wage gains in October, which was flat over the prior month and 2.4% over the prior year. Wage gains have picked up in recent years but still running below expectations given the ultra low level of unemployment.

Average hourly earnings were expected to rise 0.2% over the prior month in October with earnings forecasted to rise 2.7% over the prior year. Wages rose 0.5% monthly and 2.9% annually in September, though last month's annual wage gains were revised down slightly to 2.8% in Friday's report. The report on underemployment rate, which captures those out of work as well as folks working part time but who would like full-time work, is just as an important economic indicator, rate fell to 7.9% in October to



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the lowest since December 2006. President Donald Trump's chief economic advisor Gary Cohn said the administration is focused on getting this number down.

Economists have also been tracking the labor force participation rate, which has been in decline for over a decade and stabilized somewhat in recent years. This rate fell in October to 62.7% after hitting a three year high of 63.1% in September. Big employment gains were expected for the sectors most directly impacted by Hurricanes Harvey and Irma, which include leisure & hospitality, construction, and mining. Leisure & hospitality saw a notable rebound in October, gaining 106,000 jobs after losing 102,000 in September. Construction and mining, meanwhile, saw job trends in line with September.

Non manufacturing economic activity climbed higher in October, defying expectations of a contraction following a banner month of growth in September. The Institute of Supply Management's survey of non-manufacturing firms from 17 industries, such as real estate, construction and mining, rose to 60.1 in October, 0.3 percentage points above the prior reading. October's survey result represents the highest reading since the index's debut in 2008. The measure was forecast to fall to 58.5 in October, according to a survey of economists from Thomson Reuters, after jumping 4.5% points to 59.8 in September. October's reading represents the 99th consecutive month of growth in the overall economy, and the 94th month of growth for the non-manufacturing sector itself. A reading above 50 for the index indicates expansion in the service sector, and a reading below 50 signals contraction. A reading above 48.9 over time is considered an indicator of overall economic expansion.

What does this mean to you and I? America is finally on a stable economic recovery after nearly 8 plus years of monetary life support. A magnificent reduction in the Federal tax rate from 35% to 20% will only be a direct catalyst in driving corporate net profits and dividends. Will it create more jobs is the big question. Such a drop in the Federal tax rate will drive corporations to relocate back to America. The reason we are not seeing wage inflation even at these ultra low unemployment rates now and into the future is the application for further automation in all aspects of both corporate

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and our personal lives. Artificial Intelligence (AI) will do more to take away jobs than both industrialization and robotization of the corporate world. AI goes after skilled jobs and professions. In other words, higher paying jobs. If we fast forward AI application, it is not hard to see professions such as lawyers and physicians being dramatically reshaped also. As the next economic boom takes shape less people will need to be employed in turn removing wage inflation from the equations. The demand for more work and more bodies will be done by AI. Wage inflation is an important part of any economic cycle as it allows people to save more and move into bigger homes as their discretionary income increases.

A few years ago, the news about the European economy was uniformly not good and many times bad. These days, it is the humdrum diet of benign data that prompts a yawn. Figures this week show that GDP rose by 0.6% in the three months to the end of September, annualized at 2.4%. The European Commission's economic sentiment index rose to its highest level in almost 17 years. Yet when the European Central Bank's governing council gathered on October 26th, it decided to keep interest rates unchanged, at close to zero, and to extend its bond-buying programme (known as quantitative easing, or QE) for a further nine months. Why? Well, the very same reason which applies to all developed world economies, inflation cannot move beyond the magic 2% level. China still is a big factor as it finds ways to push product below market price and second is wage inflation in developing nations is just not taking off as automation replaces human functions at a quick clip.

In the oil world, money is no longer being thrown at every imaginable oil play, and only the ultra cost effective oil producers remain. As a result, oil companies that survive low oil prices for longer get the investment dollars to expand. The current cycle, sparked by a flood of production as American shale extractors and drillers learned to extract oil and gas from shale rock formations, sent prices tumbling to \$26 a barrel in February 2016 from more than \$100 a barrel in the summer of 2014. Bear markets in commodities are a consequence of human behaviour in the preceding bull market. Higher crude oil prices invited investment in new technology such as shale oil extraction. The bear market has

already gone through the first step of the healing process: weeding out the weakest players. Roughly 22% of exploration and production companies went bust during this phase, compared with about 26% in the 1986 oil price crash.

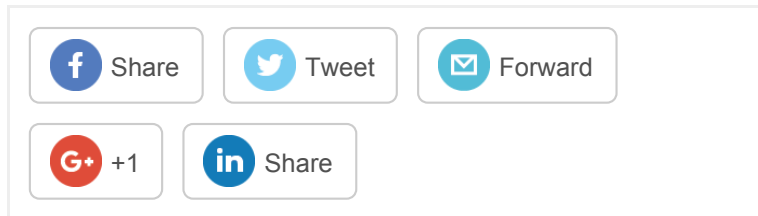
We are just entering the next step of cycle as investors in energy lose patience in the oil recovery and move their capital elsewhere. As investment dwindles down and the demand for oil overtakes supply prices will start to rise. Oil inventories are declining as demand from North America and China ramps up. The question is for how long will demand from China grow as the dragon nation looks to lock in their own stock piles in Africa.

Let's move onto China, The China General Services Purchasing Managers Index (PMI) which is a private non-governmental measure of economic activity, slipped to 50.6 in September from 52.7 in August, according to the survey conducted by financial information service provider Markit and sponsored by Caixin Media Co Ltd. A reading above 50 indicates expansion, below 50 shows contraction. The reading was the lowest recorded by the survey since June. As a result, the Caixin China Composite Output Index, which covers manufacturing and services companies, fell to 51.4 last month from 52.4 in August, also a three-month low. The rise in costs in the service sector accelerated for the second month in a row, but far milder than in the manufacturing sector, where costs increased at the fastest rate in nine months in September due to higher raw material prices. Rise in costs in labour and materials are catching up in China affecting both multinationals and regional corporations. No longer can China make all things the cheapest and must contend with driving costs down while improving quality and volume. All are extremely tall orders to fill without feeling any economic pain for the dragon nation.

The Canadian economy continued to churn out more jobs in October even amid forecasts that economic growth is slowing in the second half of the year. Statistics Canada reported the economy added 35,300 jobs in October as the number of full-time positions swelled by 88,700, while part-time employment dropped by 53,400 jobs.

So expect the Bank of Canada to look at an interest rate hike in

December if economic momentum continues. As the residential real estate boom in BC and Ontario has come to an end with further tightening of lending, its harder to qualify and move up the market. However a new trend is emerging. Foreign buyers are now focused on commercial real estate which is not subject to the same rules and foreign buyer tax as residential. So we could see a surge in commercial real estate prices as foreign money looks to exploit loose property ownership rules in Canada.



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