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Market Update

24 February 2017

American consumer confidence peaked in February hitting an all time high of 96.3%. The consumer sentiment index remains high at 95.7% pointing to steady growth. Just a month earlier the sentiment index touched a 13 year high of 98.5%, reflecting a surge in confidence following the election. There was anticipation of tax breaks, jobs and infrastructure spending and such anticipation has pushed commodity prices to new heights.

Market valuations are near all time highs but does not provide a deeper understanding that markets can still push forward. One critical note to moving forward is that markets can only live on hype for so long and we need to see material change. Reforms must materialize. Given all the frothiness, the Fed Chairman will likely move forward with an interest rate hike in early April which will have a sobering effect on markets. Under all this hype is a very healthy economic engine which has just started to expand.

The full impact of Brexit will only be fully understood in the near future as critical trade agreements must be renegotiated on a one by one basis. Greece's exit (Grexit) will further harm the European Union and potentially tear the very fabric of the Union. Throw into the mix a potential Marine LePen victory and a pro national front in Germany would put the EU in grave jeopardy.

It is easy to be downcast about the state of global trade. It has faced stiff headwinds in recent years: in 2016, for the first time in



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15 years, it grew more slowly than the world economy. Regional and global trade deals are going nowhere, slowly. America's new President has promised to protect his country from trade-inflicted "carnage".

Amid all this gloom, optimism seems foolhardy. But in Asia's export dynamos, trade is picking up steam. In January, Chinese exports rose year-on-year for the first time in ten months; South Korean shipments have increased for three months in a row. Surveys reveal strong export pipelines in Japan, Singapore and Taiwan. Healthy order books for Asia's manufacturers normally bode well for global trade and indeed the global economy. It is too soon to declare a definitive upturn in global trade, but it looks like more than a blip.

The simplest explanation for the rebound is that global demand is itself on solid ground. Global growth is still slower than before the financial crisis of 2008, but is heading in the right direction. Both the IMF and the World Bank think it will speed up a bit this year. Investors have turned more bullish: the MSCI all-world index, which covers 46 different markets, hit a record high this week. The rebound in Asian exports is more reason for bullishness.

Structural changes may also be at play in Asia. A much-cited factor behind the slowdown in global trade in recent years has been China's tightening grip on complex supply chains. As more production takes place inside a single country, fewer cross-border transactions are needed to produce final goods. Yet this consolidation within China is starting to meet more friction. China is still aiming for a bigger share of high-tech industries, but less-developed countries in Asia are scooping up more of its low-end manufacturing, and wealthier markets are also fighting back. Over the last nine months of 2016, China's export performance trailed the rest of Asia.

Nevertheless, there are good reasons to restrain the optimism. The rebound in exports from Asia's commodity producers such as Indonesia and Malaysia is mainly the result of higher prices for oil

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and metals. Growth in their trade volumes has been much slower. For Asia's high-tech economies, the rebound's durability hinges on the fickle tastes of consumers. Both Samsung and Apple are expected to launch shiny new gadgets this year. Semiconductor makers around the region have gone into overdrive in anticipation. If demand falls short of expectations, exports of electronics will quickly dive again.

Looming large over all these trends is Donald Trump. Fears that he might declare China a currency manipulator in his first few days in office came to naught. But his threats during the election campaign to slap heavy tariffs on Chinese products still linger in the background. A trade war would be unwelcome at any time. If it came just when the world was breaking free from a long slump in global trade, the irony would be all the more cruel.

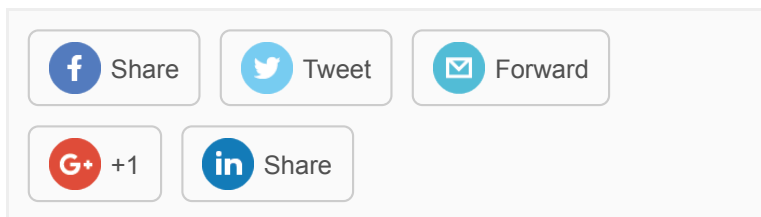
Crude oil inventories increased by 600,000 barrels. However, the changes in inventory levels this week happened in the context of net imports being almost 2 million barrels below normal levels. Oil imports would have to be dramatically curtailed going forward to prevent further accumulation of inventories.

Inventories will still need to be reduced going forward to prevent further accumulation during refinery maintenance season. Long term sentiment in crude oil remains at optimistic levels but the commodity has remained well over \$50 a barrel for the best part of 3 months now. Crude oil now seems to be 15 weeks into its present intermediate cycle and with sentiment remaining this high, an intermediate decline should be in the cards any week now. Tight oil fundamentals are going to keep a lid on crude oil prices going forward. In fact, the big majors such as Chevron Corporation and Exxon Mobil Corporation are now very much focusing on shale plays after decades of investment in other areas such as off shore, etc. More and more oil and gas shale discoveries are both taking place in America and internationally. Many drillers are now profitable with crude oil at present price. Furthermore fracking technology is only going to improve over time which is going to ultimately boost productivity by lowering the company's net cost per

barrel.

A new record has been set in the GTA with the average single family home now surpassing \$1 million, according to the Building Industry and Land Development Association. Figures from their official data source the Altus Group, show that the average price in January was \$1,028,395 with prices up 25% in just one year. A new detached house averaged \$1,316,325 with a townhouse averaging \$879,619. The GTA is facing a severe shortage of housing supply, particularly for single family homes which sell as soon as they come to market. When there aren't enough homes to satisfy demand, prices increase and that is exactly what has been happening in our region over the last decade. This is not healthy market appreciation due to rising salaries and greater economic prosperity.

The inventory of new single homes hit a record low last month, just 1,524 available for purchase compared to 18,000 ten years ago. There was also a decline in availability of new condo units with 11,529 available, a ten-year low. That pushed prices to a new record \$507,511 on average for an apartment, up 13% in a year. In the GTA there are less than half the overall number of new homes available to purchase than there were a decade ago. The lack of serviced developable land, excessive red tape and frequent delays in the development approval process have all been large contributors to our housing supply crisis.



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