

Your weekly market update

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Market Update

12 January 2018

The goldilocks phenomenon is upon us as the January effect is taking hold across the globe and with its strongest effect in North America. Unemployment in America holds steady at 4.1% with job gains of 148,000 occurring in health care, construction and manufacturing. The biggest drop in unemployment was for teenagers declining by 13.6%. GDP remains strong at 3.2% annualized as personal consumption drives.

The Trump administration is pushing forward on bringing about a deal with the Democrats regarding “Dreamers”. Such collaboration on a highly contentious topic would act as a door opener for raising the federal debt ceiling and rolling out a multi trillion dollar infrastructure program. Walmart and other retailers start to raise minimum wage to \$11.00 as they search to hire and retain quality workers as it becomes hard to motivate and retain employees.

There appears to be a growing change in the Federal Reserve of how best to manage inflation and interest rates from aggressive interest to wait till “you see the whites” of inflations eyes. Wage inflation and rising oil prices should push the world off ultra low and even negative interest rates creating a constant cycle deflation / disinflation , holding back developed nations. Emerging nations such as China and India have been punished from a strong American dollar and internal higher than average wage inflations and rising costs. Bond markets look to have bottomed. The great bond boom of nearly 30 years is finally at an end. The challenge for the American Reserve and other central banks around the world is to raise interest rates at a pace where by short term rates



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do not track higher than long term rates, which would point to a recession in the near term (less than 24 months). A healthy yield curve should be rising from left to right with short term bond yields being low and gradual as the term of the bonds increases. Over the last 2 years we have seen the yield curve flatten and even look to trend to inversion, all of which point to potential recessionary events. The silver lining in all this is inflation is moving faster than the Fed is expecting. Let's see how the Fed will handle this.

Unemployment in the Eurozone hit its lowest rate for almost nine years last November, the latest sign of the revival of the single currency area's economy. Eurostat, the EU's official statistics agency said that the jobless rate fell to 8.7%, hitting analyst predictions and down from 8.8 % in October. The figures are the lowest since January 2009, when the Eurozone was reeling from a deep recession following the global financial crisis. Nigel Farage, former leader of the Eurosceptic party looks to be changing his mind regarding Brexit by stating that a second referendum is needed to EU membership. Does this signal an about face? Regardless, the EU will continue to make it extremely painful for Britain to exit and a multi billion dollar divorce bill. Amongst all of this Britain is seeing higher than expected inflation and a continued exodus of young talent moving to France and Ireland as these countries prepare to grab London's share of the financial services market.

Oil is on its way up mainly due to supply disruption in the North Sea pipeline, Nigeria and a potential civil unrest and sanctions for Iran. Since America has lifted sanctions under the Obama administration Iran has quickly filled a much needed void in middle east oil. All the hype and the new Russian-Saudi alliance to reduce the supply of oil has been over played. Let's be realistic, the current draw down in oil according to the American Energy Information Administration reported inventory supplies fell by almost 5 million barrels. Production slowed by 300,000 barrels which analysts attributed to colder than usual weather across continental America. OPEC and Russia will continue to push planned production cuts through out 2018. I do expect energy producers in America to fill the void by OPEC and Russian producers as operating rig counts continue to rise with a total of

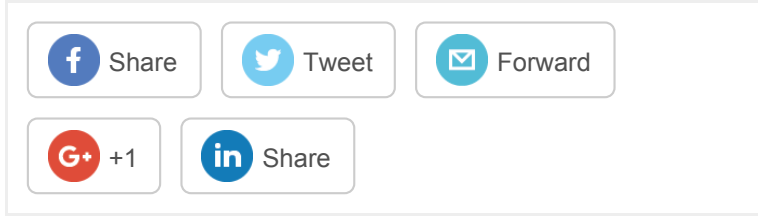
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259 new rigs over 2017. Let's look at how oil prices have ebbed and flowed over the last 160 years which do not represent a happy medium. Investors either jump all in or flee. At \$40 oil prices are too low as cashflow dries up and investors jump ship. Oil rigs get shut down and production starts to slow down. On the consumptions side, people start to guzzle oil/gasoline like free coffee refills. Prices over \$80 is too high. Yes, energy producers are flush with cash and investors are glad to fund more oil rigs. Production just goes through the roof. Consumers tighten their wallets and look to alternative energy sources which lead to a drop in consumption. A mid range of \$60 Brent leave inventory and consumption at an equilibrium. Prices are low enough to generate ample cash for investors including energy producers. At current price levels consumers are willing to burn more hydrocarbons and not feel financial pain.

China has put the peddle to the metal as exports jumped in November to 12.3% year on year, the fastest pace in the last 8 months driven by electronics and high tech goods. Imports also grew by 17.7% year on year. All the good news did not stop the IMF from announcing that China's four largest banks will be the only Chinese banks to pass stress test standards. Late October of 2017, the IMF stated China's dependency on debt continues to grow at a dangerous pace. Of the 33 stress tested banks 27 financial institutions will need a significant increase in capital reserves.

What a stellar year of economic performance for the Canadian economy in 2017 growing at 3.7%. The big question is: "Is this paid pace of growth sustainable into 2018?" The uncertainty of NAFTA talks are weighing heavy and already muting Canada's economic outlook. Mortgage lending rule changes are estimated to eliminate 50,000 buyers putting home ownership out of reach. We are seeing the definition of home ownership in Canada radically reformed. Owning a single detached home has always been within reach of all families. Tighter lending rules have reduced the ability each persons ability to borrow by 18.1%. Canada's economy has relied on consumers continually upgrade their homes over their working life. Will the new lending rules have deeper implications to the overall real estate market. Spring will point to how big the

impacts are.



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