

Your weekly market update

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Market Update

22 January 2016

The first part of January has seen the markets sell off due to two main issues which appear on the surface. One: the divergence of American Federal Reserve monetary policy from the rest of the world. While the rest of the world is still in monetary quantitative easing mode (QE) the American Federal Reserve is stepping forward to raise interest rates. Two: China in anticipation of a slowing economy and attempting to counter the American Federal Reserve actions has strategically devalued their current a total of 11% in less that 6 months leaving all other currencies around the world in flux and putting pressure on the American dollar to further increase in value. Third: not so readily apparent and massive contributor to current market declines in short selling. Traders have come together and will generate handsome profits by pushing markets lower Short selling trading has added increase volatility swings in equities and currencies as electronic trading managed by software. Short sellers hope fear kicks in and panic selling happens so their beat on low stock prices materializes. The move equities sell of the bigger the profit for the short selling traders.

The underlying fundamental are not there for a 2008 market. Yield curves (the difference between short term interest rates and longer term interest rates) remain healthy. When short term interest rates are equal to or greater than long term interest rates we are in a recession.

The drop in oil prices should act as an economic stimulator. Less money spent for energy means more for other types of consumption and leave bigger profit for corporations. However the issue at hand is Iran. This is having a wild card effect on oil and energy markets around the world. Iran has been out of the global energy markets since sanctions on Iran were introduced in 1979 by America and its allies . Ever since, oil prices have soared and Saudi Arabia became the biggest benefactor by meeting America's energy demands.

How low can oil go? It will be clear once Iran starts selling oil to the world. Most of the Iranian oil sales will be heading to Asia and parts of Europe. The issue with oil is not consumption The energy sector is in a price war. Saudi Arabia has been the largest producer of oil up and till the full exploitation of the Canadian oil sands and America's recent explosive boom in fracking and energy extraction. The big guy is trying to choke all other energy producers including the new contender Iran. Prior to economic sanctions Iran was the second largest producer of oil in the region at one million barrels a day. Iran wants to get back into the energy game at any cost and will sell oil at a loss just for market share. The once banished nation has secured energy export rights with 6 of the largest members of the G20.

Energy is in a pricing war not a consumption glut.

American consumers and industry will benefit. However the pricing war will force consolidation in the oil and gas sector. Europe as a whole will also prosper leaving oil rich countries feeling the pain.

The aggressive short selling of the Canadian dollar must have pushed the Bank of Canada Governor Stephan Poloz to not drop interest rates



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once again. As of yesterday's announcement what is clear is that our government is prepared to partially shift away from strict monetary policy easing and move to a much more liberal fiscal policy. The burden of aiding economic growth is transitioning from the Bank of Canada to the Federal government. The speech in Davos, Switzerland by Prime Minister Justin Trudeau made it clear Canada will be embarking on multi-year deficit spending programs as a means to stimulate economic growth. The Federal government has come to the aid of the Bank of Canada leaving an interest rate as a silver bullet approach in the future if the economic pain coming from western Canada worsens and temporarily killing the momentum against the Loonie. Currency traders were hoping to push our dollar to a low of 61 cents.

The recent acceleration in wage growth in China suggests that the day when it becomes too expensive to outsource to that country may be closer than anyone expected. Wages in China have grown much faster than in America resulting in a significant deterioration in competitiveness in China. Chinese labor costs have risen 7% annually for the past 15 years while American manufacturing has negative growth rates over the same period. Even with such magnificent wage inflation, consumer spending is not enough to offset a slowing manufacturing and sector.

Our outlook is that North America and the EU trading pack will see strong revival both in corporate sectors and consumers overall. Emerging economies have peaked and now must enter a phase of deep fiscal and monetary reform in order to survive.

Traders on both equities and currency markets are leveraging this moment of transition to generate profits by exacerbating fear. "Get everyone else to sell cheap so that the traders can buy low."

Expectation is volatility will remain high with first a flight to safety (already under way) for which after will follow a move to quality earnings.

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