Your weekly market update

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Market Update

15 January 2016

What we are seeing in global market is a result of monetary policy divergence between America's Federal Reserve Bank and central banks around the world. America wants to end loose monetary policy and endless printing of paper while the EU, Japan, UK and other nations are just getting started. Janet Yellen, chairwomen of the federal reserve feels America is strong enough economically to handle a small increment interest rate increase. Both Japan and the EU entered the quantitative easing game in hopes of suppressing their currency prices to facilitate higher manufacturing out specifically for export. A cheap currency gives manufactures a competitive edge in selling product abroad. According to an IMF study, 10% currency boosts exports by 1.5% of GDP over the long term with the biggest gains had in year one and two. Looking back at both the EU and Japanese economy before quantitative easing and currency devaluation, we saw these specific nations uncompetitive in the global market place. Since the introduction of quantitative easing (loose monetary policy) both the EU and Japan have seen their export driven manufacturing sector and industrial services soar.

In August of last year, China decided to step into the game of quantitative easing and loose monetary policy after years of so called tightening, which sent ripples around the world as the Yuan was effectively devalued by 4% in just one day. Raising interest rates is meant as a monetary policy tool to slow down an economy from over heating. This is the current view point of Federal Reserve in America. In the rest of the global economies, we have nation that are doing whatever is possible to avoid their economies from slowing down which includes Canada. I expect to see the Bank of Canada drop interest rates next week putting further pressure on our Loonie to fall which the currency markets are clearly telegraphing right now as the Loonie falls below 70 cents.

So what we have is a divergence in strategy not just amongst developed nations but with American monetary policy and the rest of the globe. America lead the pack in restructuring monetary and fiscal policy and making liquid banks while the rest of the world economies resisted and played the waiting game. As the rest of the global economies are playing catch up, America wants to shift gears to increase productivity rates and spur inflation. However, no other nation is quite ready for such a shift. All other nations have deeply undervalued their currency in order to keep manufacturing and export moving. For instance, the Russian Rouble is undervalued by 69% which means all things coming from Russia are on sale by 69%. In the EU zone, the EU dollar is undervalued by 19%. Recent drop in the Canadian dollar means all things made in Canada are 16% off. The whole world except America has agreed to hold a grand Boxing Day style sale while America is offering no sale on their goods. Why?

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America has the largest and wealthiest per capita of consumer base. American citizens are the number one consuming society in the world and have been for ages. Why put thing on sale when you can't keep up with consumer demand. You will notice record car sales in America continue to climb and hit new highs in 2016. GM is forecasting its best year in 2016. Automotive demand is so high across the border, that the inventory of used car in Canada has all but dried up. Auto dealers here at home can't find cars fast enough to sell across the border. Our cheap Loonie will only increase demand for Canadian made and sourced cars. I believe the automotive sector is an early indicator. The next area to heat up is real estate sales in Canada. Canadian real estate is now on sale by 30% to foreign buyers as compared to a few years ago. Foreign money and foreign investors looking to directly hold Canadian assets will be the next move forward.

For China and other emerging nations it will take more than just currency manipulation to keep their economies going. A strong reliable partner in consumption is needed. We Canadians are fortunate in that as our next door neighbour to the South happens to be the largest consumer of all goods and services. It is unfortunate, that our Loonie was allowed to appreciate for so long and go beyond par. The manufacturing sector (the engine of growth in Canada) was deeply damaged.

Let's look at the reality of oil. The OPEC monopoly on oil prices have come to an end. These once very cosy dictators ruling the Middle East now are at war with each other. Each nation for themselves. Since the oil crisis of 1973, (the first oil shock) OPEC has dictated the price of oil. The oil shock of 1973 saw oil prices quadruple. In 1978, the second oil shock saw prices double. OPEC nations had agreed to cut oil production as a concerted effort. Now we have a reversal, due to massive investments in energy exploration in Canada and America. No one is expecting America to become the number one energy exporter to the world, however according to the International Energy Agency, America is the number one producer of oil and energy at 12,332 million barrels of oil a year with Saudi Arabia at 11,600,000 yearly. This translates to a massive loss in market share for the Middle East. America does not need to sell oil to foreign market. All the oil will be consumed by Americans.

Technology has become so pervasive that efficiencies can be had in most all sectors and not limited to demographics, topography or political boundaries. We are shifting to consumption based markets. At seven billion people, the planet earth will consume per minute or each day more than ever recorded.

Total world annual GDP is over 75.59 trillion USD. Average life span is above 70.78 years of age and increasing. Corporations and multinational that best serve global consumption through intricate supply chain management will be the winners who are not confined by boarders, cheap labour or state control capital.

In closing, if you believe that interest rates are going up think again. We are just beginning to see the effects from ongoing massive QE (Quantitative Easing). The Japanese Central Bank is now by far the largest buyer of Japanese government bonds and they are running out of institutions willing to buy Japanese government bonds. Each and every day the BOJ (Bank of Japan) creates a new $1.8 Billion and uses the majority of that to buy bonds. At this pace the supply of bonds will run out which means the BOJ will shift their purchases to other areas which they already are buying ETFs. The other alternative is to run bigger budget deficits to issue more bonds and continue buying in other asset areas. We are in a monetary twilight zone now.

How does this effect Canada? Well, Canadian 10 Year bond yields also hit a new low this week but a full percentage point higher than Japanese government bonds at 1.19%. However, the Bank of Canada is on the same page and it is only a matter of time before Canadian interest rates are also zero.

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Expect our government to run bigger and bigger budget deficits going forward. The Federal government in Canada is willing to borrow more and more. Why? Interest rates are only 1.19% interest. In this new QE driven monetary policy world there is no longer any standard (aka the gold standard) to stop fiscal proliferance.