Your weekly market update

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Market Update

18 March 2016

Let's start this week's update with the American Federal Reserve. Given we are in an election year in America, the Federal Reserve will do nothing for fear of disrupting the election process. In it's very nature, the Fed is a political animal, however at this point it will do everything in its power to remain and appear neutral. Credibility is key. The lack of interest rate hikes by the Federal Reserve has prompted the greenback to weaken and gold prices to continue to appreciate. Despite an announcement this week that America's core inflation is charging above 2%, chairwoman Janet Yellen forecasted a potential 0.5% hike in interest rates. It appears that the Fed is comfortable with allowing interest rates to climb up and then act once inflation has overshot the comfort limit. This represents a change in approach. Since the great recession, the Fed has always been proactive in shaping the American economic climate. Why the change in handling the economy? America is on strong footing. The only headwinds to America moving full steam forward are concerns around China's economy and a glut in oil prices. China is slowly becoming less of a going concern. The doom surrounding oil is clear. Oil prices have fallen not due to a sharp drop of global demand but due to aggressive pricing wars. As the American dollar weakens in the months ahead oil prices will continue to firm up.

Do not expect oil volatility to end anytime soon. Unlike the constant call to curb production, Saudia Arabia and the cartel partners have no desire just yet to curb product. In fact, both Russia and Saudia

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Arabia have hit their peak production capacity since 2014. North America energy extractor looked to exploit this very fact by getting into the energy game back in 2009. In fact oil prices could fall back to the $30.00 range once the empty nature of an OPEC-Russian production freeze is understood.

In late February, Saudi oil minister Ali Al Naim stated categorically, “There is no sense in wasting our time in seeking production cuts. That will not happen.”

Instead, Russia and Saudi Arabia have apparently agreed to a production freeze. This is meaningless theatre but it helped lift oil prices 37 percent from just more than $26 in mid-February to almost $36 per barrel last week. That is a lot of added revenue for Saudi Arabia and Russia but it will do nothing to balance the over-supplied world oil market.

The problem is that neither Saudi Arabia nor Russia has greatly increased production since the oil-price collapse began in 2014. A freeze by those countries, therefore, will only ensure that the supply surplus will not get worse because of them. It is, moreover, doubtful that Saudi Arabia or Russia has the spare capacity to increase production much beyond present levels making the proposal of a freeze cynical rather than helpful. Another interesting unknown is Iranian oil potential. New estimates are emerging that Iran has the capacity to move production up to 4 million barrels a day. This is quite a jump from the original 30,000 barrels a day estimate given last year. Remember, oil and energy prices are a direct drive of inflation. Low oil prices mean it will be much more difficult for central banks to jump start inflation. In turn it will prolong low interest rates.

Investment capital entering at this current stage of the economic recovery cycle is different that money that enters at the beginning of an economic recovery. Investment capital at this stage is not looking for recovery opportunity but rather proven yield and performance with little down side on capital erosion. With the latest down turn on equities, the window of opportunity looks right. The headwind to this all is energy and oil. Oil has had an impressive short recovery. The question will prices sustain beyond the OPEC theatrics. At this stage investment capital also tends to stay longer and is less jittery. Each and every recovery cycle has a second leg. North America is ripe for growth. Low interest rates, fiscal spending are two of the necessary foundations. If the Federal Reserve maintains their dovish stance on the American economy it will complete the circle needed for stock and asset appreciation.

I normally stay away from commenting on any individual running for office. However Donald Trump and Ted Cruz are sure indicators that the American right is disenfranchised with the traditional line up of politicians. Both the republican and democratic parties have been effective in neutralizing the Tea party movement. So the anti establishment movement is looking for a home and a voice. Bernie Sanders on the democratic side has tapped into this crowd of people and continues to be their voice. Hilary Clinton is the establishment and without such a sharp contrast like Donald Trump and Ted Cruz, she would have a great difficulty getting elected. As seen by Jeb Bush's ability to constantly discredit Hilary. As we all know now, Jeb Bush was crushed by the Donald. Mr. Trump is an excellent marketing machine able to plug into a specific psyche of the American people. My concern is that if a personality like Donald Trump actually makes it as the leader of the world's largest super power, he will not be a galvanizing voice of a politically united America. In fact, he will serve to further polarize the congress and senate. America has struggled to gain economic momentum under a political system which has currently little bipartisanship.

Europe's economic recovery looks to maintain a modest recovery. The Eurozone and not North America is the one feeling the biggest blow back from China. Europe as a whole was the biggest benefactor of China coming into the WTO. North America experienced the losing end of the deal by having millions of jobs move away. Where is the ECB heading with interest rates? Look no further than to Norway and Sweden for the possible answer. Sweden has applied negative interest rates since 2015. Since the transaction from -0.15 interest rates to -0.50% interest rates, Sweden's economy has boomed and is still growing. Under the same transition inflation hit a negative 0.18% in 2014. It has since rebounded to about 0.77% so far in 2016. A negative interest rate environment has forced dormant capital to get off the side line and enter equities and capital investments. Will the rest of the EU see the same thing? In theory, yes. In practice not as much as we would all like to see. The EU has too many internal issues which hold it back economically as a trading zone. Member states lack cohesion with Brussels. The ECB wants the country to continue down the road of stimulus which political leaders are still resisting any new forms of fiscal stimulus. At this stage of the economic recovery cycle both monetary policy and fiscal policy must be in sync or risk stagnation.

Chinese leadership is still very much an enigma to the western world. Just as past dynasties build the great wall to defend themselves. Today, the Politburo represents just that. The large internal working of the political machine is meant to keep marauders and unfavourable characters out of cherished realms of power and money. The communist leadership is going through this gigantic cleansing process. Each and every post and position will be reviewed with in the communist party at all levels of government. Each and every person with in the government party will be appointed to new posts. A process labeled in China as necessary. How can this not create mass uncertainty, upheaval and loss of confidence as China looks to avoid crash landing economically. Will the Chinese machine collapse? No! It is reinventing itself. Chinese leadership will spend their way out of economic crisis. This is an extreme form of fiscal stimulus. It does mean that China will come out of their great recession economically weaker and less able to spend their way through their next economic down turn. It will be spent beyond what is believed to be necessary

Here in Canada, we face a new kind of threat. Our Loonie keeps getting stronger by the day. Who thought we would see 0.77 cents. Oil prices are not the sole reason the Loonie is rising. Gold prices also help as Canada is a resource rich nation. Lastly and most importantly, the current slew of fiscal policy spending has not been perceived as wreck less but quite the opposite as timely and necessary. The Bank of Canada will need to step in and take some energy away from the Loonie. The sure method of doing this is by dropping interest rates. Just as in America, in Canada we are entering the second leg of an economic run up after a period of recovery. All indicators point to April being the spring of an economic summer to come.

Again don't rule out volatility. The second stage of the economic cycle will be limited to nations and corporations that have done all the necessary and unpleasant behind the scenes work of restructuring. These are the entities that will benefit and see growth.

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