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FINANCIAL SOLUTIONS

Slow and Low



By: Ahmet Jakupi | May 4th, 2018

It has been a while since my last market update... where do I start? The world has moved from secure and safe to euphoric, fear, volatility and now into pull back mode. All this titanic momentum was achieved through tweets.

Given all of this, what can we expect? Well, history is the best prognostication going forward. So lets look at the S&P 500 in the past as the Dow 30 is a very narrow sampling of economic performance. The S&P 500 is up 288% since March 2009. Such an advance is hardly alarming if

you take the long view. It's only the fourth-strongest advance on record. Three other bull markets moved higher, with one a quantum leap ahead of the rest: The 1987 to 2000 bull market saw the S&P 500 rise 580%. That bull market lasted nearly 13 years. So what is different now. Monetary policy has run its course. Since 2014, monetary supply has been tightening with interest rates also rising. So the days of easy money is over for now. Fiscal stimulus is being applied to the late stage of the economic business cycle. Corporate revenue earnings continue to remain strong. Our current economic recovery has similarities to the growth period of economic expansion from 1961-1969. An era of big government spending. The growth in the 60's was explosive unlike our current recovery since the great recession which has been slow. It has taken far longer than any other period of expansion with job gains being slow. Wages have not recovered fully with only recent wage inflation looking meaningful. We are in a low and slow growth pattern as many businesses and individuals are still paying off debts due to the great recession. The very fact that the economy has not roared back from the financial crisis speaks to the slow speed preventing a full blown market melt down. Since 2009, we have seen smaller market corrections and pull backs having a short lived cooling effect on markets. You have to remember, the great recession of 2009 left everyone shell shocked.

Inflation is nearing the Federal Reserves 2% target in March which has been driving 10 year Treasuries in America above 3%. Surging inflation late in an economic cycle will prompt the Federal Reserve to be more aggressive with interest rate hikes in the future. The Fed's wait and see approach has resulted in hold back further interest hikes this quarter.

Let's examine what is driving inflation and concerns. Tight labour markets, fiscal stimulus as a result of tax cuts and infrastructure spending coupled with rising commodity prices all suggest upward pressures on inflation are building. The employment cost index showed the fastest American wage growth since 2008 in the first 3 months of 2018. How about tariffs? Imposed tariffs on goods from the EU and China will be passed on to the consumer which will drive prices upward directly fuelling inflationary pressures. Acceleration in inflation will continue but it is important to note that the American economy, similar to other developed nations like Germany, has not been burning down the house of economic growth with no overheating apparent. Slow and low means an economy among developed nations to have more legs.

In this market update, I will refrain from commentary about President Trump and his administration as markets learn to manage the commentary and actions of a very specific leadership style and the potential Noble Peace Prize.

All of the European Union's 28 members are expected to grow in 2018. Having just come back from a trip to the EU, construction booms and infrastructure spending are everywhere. The EU is now under fiscal stimulus with an open ended monetary program. The larger question at hand in

the EU is economic growth deep rooted and able to withstand global shocks such as trade wars and the lack of mass job creation? It is clear the new world of technological advancements takes jobs away and creates little employment. The very fact that the ECB has not removed monetary stimulus from their economic tool chest points to expected headwinds of economic growth in the years to come. However for now, the EU, more specifically Germany, is growing GDP and confidence is also strong, both for business owners and individual consumers. Growth is slow and low just like in America and Canada.

Oil prices seem to confuse everyone, even some of the hardcore speculators in the hedge fund world which dream of oil prices hitting over \$100 a barrel. On Wednesday the EIA (Energy Information and Administration) reported the amount of crude stored rose by 6.2 million barrels in the week of April 27th, exceeding expectations by 700,000 barrels. Gasoline inventories rose by 1.2 million barrels last week. What has lifted oil prices is concerns over the 2015 Iran deal being voided by America and fresh new sanctions on Iran and their ability to export crude oil. America pushed hard to expand energy extraction as rig counts rose by 151 new operating rigs on April 20th, compared to April 2017. Rig counts rose by 8 new rigs last months compared to March. Canada's rig count dropped by 8 rigs in April compared to March of this year. International rigs also dropped by 7 in April compared to March. American energy extractors have grown rig counts at about 5 times the rate that Canada and other energy exertion nations have.

China has been preparing their economy from potential headwinds coming out of America, specifically as the Fed starts to hike interest rates again. The Chinese economic strategy is to de-link interest rate increases and insulate the Chinese economy as America raises rates. Politburo leaders in China understand that todays interconnect global markets impact China's interest rate policies. Chinese 3 month interest rates dropped sharply along with 10 year corporate interest rates hitting bottom on the 24th of April. Consider this move by the leadership as monetary stimulus.

Canada's economy just bounced back and grew by 0.4% during the month of February as January was the equivalent of a harsh winter pot hole. Second quarter economic growth is projected to come in at 2.5%. Manufacturing in the automotive sector was strong along with the energy sector. Real estate is a definite drag as activity among real estate agents and brokers fell by 7.9% in February and 12.9% in January. The new mortgage and lending rules are having a definite lasting effect on the real estate market.

Bank of Canada Governor Stephen Poloz sounded the alarm bell that household debt levels rose to a total national level of \$2 trillion, which is why the Bank of Canada has not been aggressive with interest rate increases. If they move too fast, the entire Canadian economy will go into a deep recession with the housing market falling off the cliff. Does everyone remember 1994 and when

short term mortgage interest rate dropped to the mid 3% level only to rise the following year to just below 8%. Such a rapid rise caused housing prices to melt and power of sale signs on Canadian front lawns to sprout up everywhere. Our big banks are expecting nearly half of all mortgages to renew this year and next. Rates are about a full 1% higher than last year. Additionally, expectations are that refinancing needs from home owners will be up by 30% in 2018.

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