



## Counterintuitive Markets

The possibility of a global economic meltdown if Donald Trump becomes elected was not an uncommon opinion among investors before the US Elections. The hawkishness of the candidate's policies and the unpredictability of his ideas instilled huge uncertainties in the markets prior to the US Elections in November. Gold ( Ticker: XAU), a safe haven asset, jumped to US\$1307 per ounce one week before the elections. The VIX index ( Ticker: VIX), often referred to as the investor fear gauge, spiked to 22.99 to quantify the expected increase in volatility of the market.

While the general consensus tilted towards a Clinton win following a tight race, the outcome of the event obviously challenged the market's view in the same way as the Brexit referendum did. Yet, if the electoral results were not surprising enough, the abnormal reactions in the markets in the days following the election day definitely was.

First of all, during "normal" periods of uncertainties, gold spot usually spikes and stays sticky for the short term due to investors reassessing

their portfolios. Yet on the evening of November 6 and the morning of November 7, gold spot ( Ticker: XAU) surged 4.87% only to plunge back to where it started on the same day, with the following month trending downward a stunning 9% to US\$ 1169 per ounce. Secondly, US 10-Years bonds yield surged an impressive 40 basis points within a week of the elections to yielding 2.22% to maturity, bringing it back to June 2015 levels. This benchmark rate has heavy implications to the markets and economy in general which will be discussed here down.

To understand the rationality behind these huge and somewhat counterintuitive movements, one needs to understand the politics by which Donald Trump stands. In his pre-election speeches, the president-elect emphasizes that he will accelerate the American economy by lowering business taxes and increasing import tariffs to keep enterprises from moving jobs abroad, thus creating more jobs for Americans. This strategy seems to increase US domestic production of goods and thus boosting the economy, but due to the fact that the US is the number one economy of the world and

imposing tariffs will decrease global welfare since it impacts economies that are heavy exporters such as China. Nevertheless, the US economy will gain a boost in the short term, therefore sparking inflation, which has been sluggish in the US during recent years. In a sense, Donald Trump did something that Janet Yellen, chair of the Federal Reserve, has been trying to do for years, which is boosting inflation. As expected inflation increases, the nominal yield of US bonds will increase as dictated by the Fisher Effect. As the yield on US bonds increase, investors shift their assets from gold to other relatively risk free assets that are yielding returns, thus the gold price plunge.

The bottom line is to emphasize that the current market values of these assets are based on speculations of policies under a Trump presidency. Until they are passed as regulations market volatility may keep its current levels.

# Dryships

Dryships is a dry bulk shipping company which owns 41 carriers, 6 drilling units, 5 tankers and 11 oil rigs through a **subsidiary**, Ocean Rig. It mainly ships cargo such as coal, iron and grain. On December 29th, 2015, it traded at its year-high price of \$435.68 before sliding downwards to a price of \$142.73 on June 7th, 2016. On this date, it was publicized that Dryships had **defaulted** on three loan payments that had amounted to around \$213.7 million as they only had around \$146.3 million in current capital and that there was serious risk in the company declaring bankruptcy. Furthermore, Dryships had disastrous liquidity ratios such as a debt-to-equity of around 62.67 which means for \$1 of equity, the company had \$62.67 in debt. The fear of Dryships declaring bankruptcy caused it to slide to a temporary 52-week low of \$3.84 on November 2, 2016.

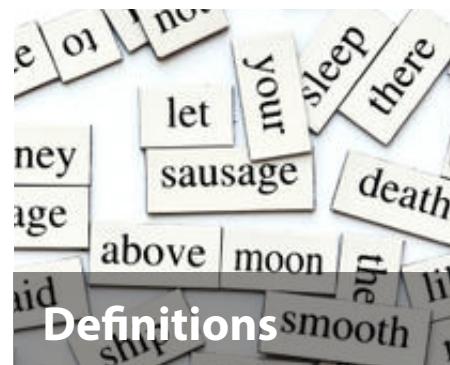
Dryships is traded on the Nasdaq and by

the listing requirements of the Nasdaq, stocks must meet certain criteria in order to be allowed to remain on the NASDAQ. One of these requirements is that the stock must be trading above \$4. As Dryships stock began to crash from its high in December, there was danger that Dryships could be unlisted as it would drop below \$4. In order to combat this, Dryships went through a 1-25 **reverse stock split** in March, a 1-4 reverse stock split in August and a 1-5 reverse stock split on November 1st, 2016 in order to keep its stock price above \$4. If Dryships did not go through these reverse stock splits, Dryships stock would be trading at around \$0.01 if the price of the stock went the way it did. However, the problem with these stock splits is it brought Dryships publicly traded shares from around 569 Million to 1,137,712 currently which greatly affected liquidity and comes into play later in the article.



Following the election on November 8th, 2016, the Dryships stock began to soar upwards and hit a high of \$102 on November 15th before closing at \$73. A fundamental reason that could have contributed to this surge is that Trump had pledged a \$1 trillion spending increase in infrastructure during his campaign which caused the **Baltic Dry Index** which surged around 38% following the election from 911 to a high of 1257. This is significant since the Baltic Dry Index is an economic indicator provided by the London-based Baltic exchange and provides one of the best assessments on the price of moving major raw materials such as coal and iron across the sea which is exactly what Dryships does. However just the surge in the price of the Baltic Dry Index was

not enough of a reason for Dryships to surge 16 times in the span of a week from November 8th to November 15th. This caused the NASDAQ to halt trading through its **T12** trading code which means that NASDAQ is requesting additional information from Dryships to explain the sudden surge upwards. Dryships did not respond on November 16th and trading was halted entirely on that day but Dryships responded the next morning. Dryships explained that the only reason that it could come up with for the surge in price is that it had sold 20000 **preferred shares**, 80000 preferred warrants and **warrants** to buy 372874 common shares to a company based in the British Virgin Islands called Kalani Investments Limited. This brought in around \$20 million in much needed capital for Dryships.



## Definitions

- 1 SUBSIDIARY**  
A company (Ocean Rig) controlled by a holding company (Dryships).
- 2 DEFAULT**  
Failure to meet legal obligations of a loan. It is different from insolvency which means that a debtor is unable to pay their loan.
- 3 REVERSE STOCK SPLIT**  
Common stock are merged to form a smaller number of proportionally more valuable shares.
- 4 BALTIC DRY INDEX**  
An economic indicator issued by the London-based Baltic exchange which provides an assessment of the price of moving raw major materials such as coal and iron across the sea.
- 5 T12**  
A code on the NASDAQ which halts trading when the NASDAQ or another body requests information.
- 6 PREFERRED SHARES**  
Offers a fixed dividend as opposed to common stock and often gives the holder the right to convert the preferred share into common shares. Preferred shareholders are also ahead of common shareholders in the event of insolvency.
- 7 WARRANTS**  
Similar to an option, it gives the holder the right to buy the underlying stock of the issuing company at a predetermined exercise price before the expiry date. It is however issued by the company itself as opposed to an option.
- 8 S&P GLOBAL MARKET INTELLIGENCE**  
A code on the NASDAQ which halts trading when the NASDAQ or another body requests information.
- 9 SHORT INTEREST PERCENTAGE**  
Percentage of outstanding shares being sold short.
- 10 DAYS-TO-COVER**  
Number of days it will take to cover all outstanding short positions if the average volume stays the same.
- 11 BUY-STOP**  
An order to buy a stock that is triggered once the market price goes above a certain price.



However, on closer inspection, this explanation is shady and can bring bad news for current shareholders of Dryships. This is because the **S&P Global Market Intelligence** does not know of this company called Kalani Investments Limited. Furthermore, the preferred shares and warrants give Kalani the right to convert them to common shares at \$30 a share or if the price of the common stock is below \$30, Kalani has the right to convert them into common shares at 77.5% of Dryship's lowest daily average price to a floor of \$1.50. If the former option was executed, it would bring in additional dilution of around 69% to Dryships current outstanding shares but

if the latter option were to occur when the price was \$1.50 then around 72 million shares would be brought in which would deeply dilute the market. Following this explanation, Dryships stock continued trading on November 17th and immediately dropped 85% and continued to sink and is currently trading at \$5.25 as of December 1st.

From a technical analysis standpoint, the price movements in the Dryships stock greatly resembles a short squeeze and is most likely one. Going into the election and the beginning of Dryships surge upwards, Dryships had a **short interest percentage** of around

30.63% which is very high and a **days-to-cover** ratio of 3.6. As soon as Dryships stock began to surge, short-sellers had their **buy-stop** orders triggered and other short-sellers began to scramble to cover their outstanding shorts. When this happens, it adds more upwards pressure on the price of the stock and causes more short-sellers to have to close their positions which can rapidly and artificially inflate the price of a stock. This can also explain why the volume of Dryships increased sharply from under 100,000 shares per day to around 5 million per day to the current 10-day average of 20 million.

## Is OPEC's New Deal the Real Deal?



OPEC has caused many shockwaves in the oil markets and the energy sector in the past few months with their motion to decrease oil output to raise the price of the volatile commodity. Earlier this year, OPEC's member nations agreed to lower output without putting a concrete figure or number as to how many barrels per day of output each member would reduce. This caused a spike in oil prices for the weeks following this announcement. For more information on OPEC's original agreement in September, check out FARMSA's October Edition. Much has changed since the original agreement. On November 30, 2016, OPEC's member nations

met in Vienna to discuss oil output cuts. OPEC's members agreed to cut their production by over 1.2 million barrels a day which are about 4.5% of its current production of about 33.64 million barrels per day. Saudi Arabia took the biggest hit from this agreement as they are reducing their output by 486,000 barrels per day to 10.06 million barrels per day. Iraq took a significant hit from this agreement as well. The Iraqis who previously resisted to production cuts are forced to cut production by 200,000 barrels per day and are producing about 4.351 million barrels per day instead. The oil-guzzling giant Russia also agreed to cut output by 300,000

barrels per day in the hopes of driving the price of oil higher.

However, not all of the OPEC nations were affected to the extent of the Saudis or the Iraqis. Countries like Kuwait, Venezuela, and Algeria only agreed to be compliant with the agreement while Iran was allowed to have a slight production boost before freezing their production level since they are still recovering from Western sanctions.

After the agreement was struck, oil and all oil-related financial instruments rebounded and experienced immense amounts of growth. Gasoline futures were up by 4.87

Agreed crude oil production adjustments and levels\* (tb/d)

Member Country	Reference Production level	Adjustment	Production level effective January 2017
Algeria	1,089	-50	1,039
Angola	1,753	-80	1,673
Ecuador	548	-26	522
Gabon	202	-9	193
Indonesia**			
IR Iran	3,975	90	3,797
Iraq	4,561	-210	4,351
Kuwait	2,838	-131	2,707
Libya			
Nigeria			
Qatar	648	-30	618
Saudi Arabia	10,544	-486	10,058
UAE	3,013	-139	2,874
Venezuela	2,067	-95	1,972

prior to the agreement as well. On November 25, the US crude fell by 4% while the Brent Crude futures and the US crude futures dropped down \$1.76 (3.59%) and \$1.90 (3.96%) respectively and the prices continued to decline. With new OPEC agreement finally in place, many questions arise. Why cut production now? Is this agreement even legitimate? What does this mean for the future of oil and the energy sector?

OPEC's decision to cut oil supply for the first time in eight years is attributed to the fact that Saudi Arabia, OPEC's leading oil producer is struggling to fund and maintain its own kingdom. As a result, Saudi Arabia will be facing unprecedented amounts of civil unrest if the government does not act now. After the crash of the oil market in 2014, where oil dropped from trading at around \$100 a barrel to under \$50 a barrel (as indicated through the WTI and Brent Crude) due to a massive market oversupply of oil, OPEC's members collectively decided to allow the price of oil to fall to force the high-production-cost fracking companies and the high-tech oil extraction companies to shut down, thus eliminating their competition. However, with social, economic, and political unrest bearing down on almost every OPEC nation including their leader Saudi Arabia, the oil-dependent members of the cartel are forced to take action and lower production in hopes of raising the price of oil by lessening its supply.

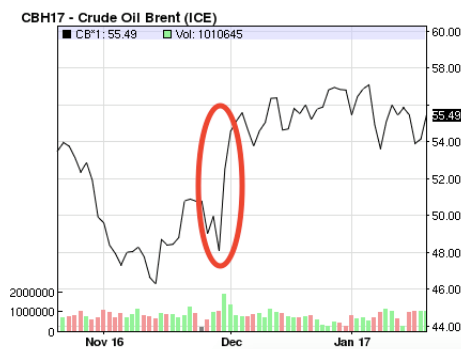
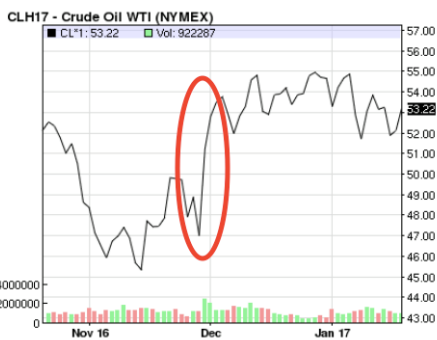
Despite the agreement, there is no guarantee that every member involved with this deal will cut their production in compliance with the agreement. It is hard to legitimize such an agreement knowing that many of these countries are in a tough economic position. By taking advantage of the heightened prices, each OPEC nation, and every non-OPEC, oil-producing nation has an incentive to increase their production of oil which could be sold at a higher price to increase their profit instead of complying with the agreement to cut oil supply.

OPEC's agreement will become effective in mid-January and at this time, we can only speculate as to what would happen in the future with rising oil prices. There is one fact that is certain and that is the fact that rising oil prices will encourage companies to enter the market. One of the biggest threats that OPEC's initiative is the return of the high-tech drilling, fracking, and oil sands companies that have the capability of producing large amounts of oil and stealing a significant market share from OPEC. With rising prices, investors and entrepreneurs of these new oil companies now have an incentive to start drilling again which may defeat OPEC's purpose of creating this agreement in the first place.

The future of oil at this point in time is still very uncertain, and only time will tell whether or not OPEC's decision will become effective or not. This agreement is essentially a game of supply and demand with a spot the cheater twist to it. Stay tuned to the oil markets for further developments of the commodity.

cents, diesel futures were up 4.68 cents while both the US and international crude futures are all trading well above \$50 a barrel a day after the deal was struck. The West Texas Immediate, the US benchmark for oil was up \$1.27 while Brent Crude, the global benchmark was up \$1.41 to \$53.25 a barrel. The current prediction for oil is that it will remain around the range of \$50 to \$60 a barrel for the next few years.

Despite the success of the agreement, the days and weeks leading up to the Vienna conference were very tumultuous. There was a lot of uncertainty as to whether or not the OPEC members can even reach a deal in Vienna. There were also many arguments and threats made within OPEC that raised a huge question mark over the legitimacy of OPEC's earlier agreement. In fact, the Saudis even threatened to raise production and back away from this whole agreement if Iran did not agree to cut output prior to the conference. The oil markets were in reverse for the weeks



# About the Authors

## Danny Jiang

Danny is a first year Financial Analysis and Risk Management student at the University of Waterloo. With a passion for learning, and a love for exploration, he has been able to partake in many leadership experiences in and out of the University of Waterloo. During his high school career, he captained the track and field team, the math team, and coached the soccer team. As a former athlete, coach and captain, he is also the first year associate working with the finance department of the University of Waterloo's Sports Business Association and has a love for sport and athletics.

In addition to his wide range of skills, Danny was also a Senior Contributor at [giveme-sport.com](http://giveme-sport.com), one of England's most popular online sports websites and has extensive knowledge in journalism and writing. With about ten thousand total online views, Danny hopes to further develop his interest for writing while learning and sharing information about the world of finance by taking on the Editor role with FARMSEA.



## Steven Lin

Steven is a first-year student studying Financial Analysis and Risk Management at the University of Waterloo. He is preparing to specialize in Financial Analysis in his third year and pursue a CFA. He has taken previous leadership positions in high school such as an executive position at his school's DECA and sport teams such as table tennis.

Steven is very interested in the financial markets and the field of trading. He follows the NYSE and NASDAQ along with the underlying options of stocks in those markets closely each day and commodities such as oil and gold. To help him grow in this field, he has read many books such as *Technical Analysis of the Futures Markets*. Steven has also completed his Canadian Securities Course. Steven hopes to further enhance his knowledge about the financial markets through the role of editor on FARMSEA.



## Jing Pu Sun

Jing is a fourth year student majoring in Financial Analysis and Risk Management and minoring in Computer Science. He has completed all four exams of the Professional Risk Manager's certification and is preparing for the CFA level 1 exam. He has been president at FARM student association for two terms and has worked closely with professors on various initiatives to help students build knowledge base as preparation for a career in the financial industry.

While specializing in CFA, Jing is very interested in various portfolio management strategies including value investing, absolute return, global macro, etc. By authoring these articles, he wishes to help university students gain exposure to real life financial markets and global economics.