“CETA is an extremely important trade agreement that removes around 99% of all customs, tariffs, taxes, and other restrictions on various markets and contracts.”

Projected Effects of CETA:
1. Increase bilateral trade by ~20% annually
2. Boost Canada’s overall income by ~$12 billion CAD annually

“The most comprehensive, ambitious and progressive trade agreement ever negotiated by either Canada or the European Union”

“... more accessibility to the two markets cuts like a double edged sword... ”

“... many Canadian businesses and industries will suffer because they will be outcompeted by European products that will flood the Canadian markets.”

MARKET COMMENTARY

CETA

After almost a decade of discussions, negotiations, and delays, Canada and the European Union finally signed the Comprehensive Economic and Trade Agreement (CETA) at the EU-Canada Summit on October 30, 2016. This is the first major trade agreement made between the EU and another major world economy and this agreement will have a drastic impact on both the Canadian and the European economy once it is fully applied.

So what exactly is CETA? CETA is an extremely important trade agreement that removes around 99% of all customs, tariffs, taxes, and other restrictions on various markets and contracts. They also help with copyright laws in Europe, and allows for a better environment for innovators, investors and job creation. CETA also creates and enforces better standards in regards to worker, safety, and health regulations for both the EU and Canada. Essentially, CETA aims to create more jobs, develop better trade relations between Canada and the EU, and encourage trade and investments between the two major world economies.

Statistically speaking, CETA sounds like a very progressive trade agreement that would benefit both the Canadian and European economies. Projections state that CETA could increase bilateral trade by about 20% annually and would boost Canada’s overall income by about $12 billion CAD annually. To support CETA, Canada will cut tariffs on EU manufacturers by about 300 million Euros or approximately $549 million CAD while taking down over most of our tariffs for European goods. Both the Canadian and European leaders called CETA “the most comprehensive, ambitious and progressive trade agreement ever negotiated by either Canada or the European Union,” and have high hopes for this pact to succeed for both parties.

What does CETA mean for Canadians? CETA aims to create more economic growth and jobs between the two countries by eliminating most trade barriers allowing for easier access to their markets. This means that many imported products and services from Europe will become significantly cheaper due to the removal of these price-inflating duties and tariffs. As a result of the removal of tariffs and regulations, this allows for more competition between Canadian and European businesses, providing both Canadians and Europeans better services and products and more options.

However, the idea of having more accessibility to the two markets cuts like a double edged sword. Since Canadians have more accessibility to European markets, and Europeans have more accessibility to Canadian markets, foreign investment and trade will grow and this is generally beneficial to the Canadian economy and the average Canadian. With more investment options in every sector and fewer restrictions, both Canadians and Europeans are able to invest more openly, mutually benefitting both parties.

On the other hand, with fewer restrictions and tariffs, many Canadian businesses and industries will suffer because they will be outcompeted by European products that will flood the Canadian markets.

Brexit Update

On June 23, 2016, Britain shook the financial world after the result of their referendum to leave the EU. The vote resulted in a motion to leave the EU (52% to 48% in favor of Brexit) which led to a gargantuan chain of events for both the world economy and the British economy.

Immediately after the referendum, over £2.08 trillion dollars of global shares were lost and the Prime Minister at the time, David Cameron, resigned a few weeks after. The British pound suffered drastically and London-based indices like the FTSE 250 and the FTSE 100 fell off the cliff the next day.

It has been over four months since the referendum occurred and the British economy is much more stabilized than the days and weeks following the referendum. In the past 3 months or so, the UK economy grew by 0.5% and the currency is trading at about 1.12 € now, which is down from 1.3 € per pound prior to the referendum. The unemployment rates are up from 4.9% to 5.4% but the Bank of England managed to lower the interest rates from 0.5% to 0.25% to encourage consumer spending.

In fact, the consumer confidence levels seem to be improving as of late due to higher wages, low inflation, and the new record low interest rates that have been set to prevent a major financial downturn in the UK. This allows for consumers to continue spending versus just saving it which is what most people do prior to an expected economic downturn.

Despite the plummeting of the currency, the indices, and the interest rates, there have been two domestic parties that have benefited from the effects of Brexit. The UK tourism industry has seen over 7.1% more
Netflix (NFLX) posted EPS of $0.12 beating analyst expectations of $0.06, had an increase in sales due to a gain in membership and surged 19.03%.

Fitbit (FIT) posted EPS of $0.13 beating analyst expectations of $0.11 but had its stock plunge 33.57% due to falling year-over-year earnings, falling sales and poor guidance due to market saturation.

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Apple (AAPL) posted EPS of $8.67 beating analyst expectations of $8.66, but suffered a 2.25% decline in its stock price due to a decline in annual revenue for the first time since 2001.

Alphabet (GOOG) posted EPS of $9.06 beating analyst expectations of $8.64 along with increasing revenues but declined slightly (0.0%) after a sell-off at market open.

Amazon (AMZN) posted EPS of $0.52 and missed analyst expectations of $0.85 and the stock dropped -5.14%.

Facebook (FB) posted EPS of $0.88 beating analyst expectations of $0.76 but dropped 5.64% due to poor guidance.

Microsoft (MFST) posted EPS of $0.76 beating analyst expectations of $0.68 and its stock increased 4.21% and broke its all-time high.

2 Interesting Earnings Reports

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Furthermore, both the FTSE 250 and the FTSE 100 appears to have recovered from Brexit. The FTSE 250 and FTSE 100 indices are both indicators of the overall UK economy as they comprise of mid-capitalized companies which represent 15% of the UK market capitalization and the 100 most highly capitalized blue-chip companies listed on the London Stock Exchange respectively. In fact, both the FTSE 100 and FTSE 250 were seen flirting with its historical highs all throughout September and October. Based off of the recent market results, the International Monetary Fund credited the UK as the world’s fastest growing economy this year.

The Brexit story took a new turn in early November when the British High Court ruled that there must be a Parliamentary vote to invoke Article 50, which vaguely outlines an exit process for a member state to leave the EU. Theresa May, the current Prime Minister wanted to invoke Article 50 on her own by the end of March of 2017 but with the new court ruling, there might be a delay and an even longer process before the deliberations and negotiations for the Brexit proceedings can formally take place.

Brexit is a long and complicated process, and now with a potential general election call looming due to May’s failed Brexit plans, the situation in Britain is even more uncertain than ever. The story of Brexit is like a divorce, and it is in the middle of a complicated settlement at this time. Stay tuned for more developments.
The effects of Brexit on these currencies are being felt inside the Great Britain today. Due to the numbers above, it is obvious that Brexit has had a large negative effect on the GBP and has had a minor positive effect on the DXY and a minor negative effect on the EUR. The main reason for the large drop in the price of the GBP is because the exit out of the European Union can hurt trade and investment due to the loss of some European trade deals and other contracts which will damage the British economy. Brexit also caused a sell-off in the GBP-USD currency pair and due to the high leverage of FOREX, it has caused even more investors to close their positions which prompted a huge decline in price. The Euro also suffered a small decline since losing the United Kingdom can threaten the political and economic stability of the union. The clear winner in this situation is the USD dollar as it can be seen as a safe haven in this situation and investors in the GBP and EUR can flock over to the US dollar.

As the dust began to settle and the lingering effects of Brexit continued to cast a shadow on the market, the GBP continued to crash and hit 73.90 on November 1st, 2016. However, the GBP has made a small recovery and is now at 84.60.

Brexit and FOREX + Currencies

The FOREX (foreign exchange) market is the market where market participants can buy, sell and speculate on currencies. This is done by taking a long, short and different combination of options positions on currencies. A trade on FOREX is done by simultaneously buying 1 unit of 1 currency and selling 1 unit of another currency (the two are called a currency pair). It is the largest and most liquid market in the world with around $5.3 trillion changing hands every day per the Bank for International Settlements. To put this into perspective, only $28 billion is traded on the NYSE and $437.7 billion is traded on the futures exchanges per day. FOREX is so large because it offers many advantages. For example, FOREX is very liquid (especially when the USD is involved) due to the sheer amount of volume which goes through FOREX each day. Furthermore, FOREX is great since it operates 24 hours each day as opposed to a market like the NYSE as FOREX allows traders to make trades at times convenient to them which may not be possible in the NYSE due to circumstances such as school or work. FOREX is also unique due to the high leverage that it offers. FOREX offers 100:1 leverage which means a trader with $1000 can trade up to $100000 in currency.

Brexit had a large effect on many different markets. One of the markets in which it had the largest effect is the FOREX market especially any currency pair involving the Great Britain Pound (GBP) due to the lasting effects that Brexit will have on the Great Britain. Brexit also had significant effects on the currency pairs that involved the Euro (EUR), Japanese Yen (JPY) and the US Dollar (USD). The road to Brexit officially began on September 1, 2015, when the referendum question was set. When the question was first posed, polls had 51.1% of voters remain, 37.6% agreeing to Brexit and 11.3% undecided and the Great Britain Pound Index (GBP) was at 93.30. On February 23rd, David Cameron, the Prime Minister of Great Britain at the time announced the date the referendum would take place which was set to be June 24th, 2016. At this point in time, the remain votes had dropped to 44.6% while Brexit had increased to 40.3% along with 15.6% of viewers being undecided. Before the date of the referendum was announced, GBP was already beginning to trend downwards and hit a low of 86.50 on the last trading day before the referendum date was announced. After the date was announced GBP plunged even lower and continued to do so until it reached a low of 84.70 on February 24th. As Brexit inched closer and closer, GBP seemed to settle in a range between 84.50 to 87.80. The night before the referendum, the polls showed that 46.2% of voters were in favour to remain, 44.3% wanted Brexit and 9.5% were undecided which caused the market prices to slightly be in favour of the United Kingdom staying. The closing prices of the currency indices that night was: GBP - 87.80, DXY (US dollar) - 93.21, EUR(Euro) - 88.97.

As the votes began to pour in for the Brexit referendum, the currency indices and other commodities such as gold changed in price by the minute to reflect the new information available. GBP opened the next day down 4.20 points and continued to slide another 1.80 points closed at 81.80 for a total drop of 6.83%. EUR did not fluctuate much during the day and closed down 1.6% because of Brexit while DXY would open at 93.45 and rally to 96.70 before eventually closing at 95.54. The most interesting change during the day was the change in the price of gold where gold would open at $1250 and surge all the way to a high of $1358 before eventually closing at $1314.

As the dust began to settle and the lingering effects of Brexit continued to cast a shadow on the market, the GBP continued to crash and hit 73.90 on November 1st, 2016. However, the GBP has made a small comeback since November 3rd, 2016 because High Court has ruled that Article 50 needs a parliamentary vote for Brexit to be enacted. Other currencies such as DXY, EUR and JPY (Japanese Yen) have all been quite stable since the night of Brexit and their small price fluctuations are not because of Brexit.

From the numbers above, it is obvious that Brexit has had a large negative effect on the GBP and has had a minor positive effect on the DXY and a minor negative effect on the EUR. The main reason for the large drop in the price of the GBP is because the exit out of the European Union can hurt trade and investment due to the loss of some European trade deals and other contracts which will damage the British economy. Brexit also caused a sell-off in the GBP-USD currency pair and due to the high leverage of FOREX, it has caused even more investors to close their positions which prompted a huge decline in price. The Euro also suffered a small decline since losing the United Kingdom can threaten the political and economic stability of the union. The clear winner in this situation is the US dollar as it can be seen as a safe haven in this situation and investors in the GBP and EUR can flock over to the US dollar.

The effects of Brexit on these currencies are being felt inside the Great Britain today. Due to the decrease in value of the GBP, many imports to the Great Britain are now being priced higher than before and since incomes have not changed in the Great Britain, purchasing power has gone down. The price of the iPhone 7 has increased by 100 GBP while the price of raw materials bought by manufacturers has increased by 4.3% since a year ago. It is also affecting sports such as soccer and puts English soccer teams at a bit of a
Mortgage-backed securities (MBS): securitized investment vehicles that provides the investor with the cash flow generated by mortgages, in this context residential mortgages. During the pre-crisis period from early 2000s to 2007, Deutsche Bank and many other major global investment banks including Goldman Sachs, JP Morgan and Bank of America purposely misled investors by manipulating credit ratings of low quality asset pools, including MBS’s, to boost their commissions and earnings.

"The event (election result) sent ripples throughout global markets as investors consider the consequences of the candidate’s policies…"

"US pharmaceutical companies and financial services companies saw gains of 6.45% and 4.10% respectively…"

"…relieved on concerns of regulations that a Clinton presidency may bring…"

Deutsche Bank

Deutsche Bank (the bank) is facing potential liquidity issues as the Department of Justice of USA (DOJ) proposes a fine of $14 billion for the malpractice of the bank in the underwriting and selling activities of residential mortgage-backed securities (RMBS) from 2005 to 2007. Although Deutsche Bank refused to pay the said amount and declared its continuous negotiations with the DOJ, the news sent the share price of the largest bank of Germany plunging a stunning 9.45% to $12.00 a share, the largest daily drop in almost 5 years besides from the aftermath of the Brexit referendum.

The second wave of bad news knocked out Deutsche Bank’s stock price to less than €10.00 a share, for the first time in the bank’s history, on September 26th when the chancellor of Germany, Angela Merkel, insinuated that the European country will not be assisting the lender in this time of crisis. Concerns about Deutsche Bank becoming the second Lehman Brothers are spreading in the industry, deepening the stock’s plummet.

So what does $14 billion mean for Deutsche Bank? A glance at the financial institution’s annual and quarterly reports concludes that the bank’s average net income over the last 10 years is $1.6 billion per year, after suffering a loss of $6.8 billion in the fiscal year 2015 (that includes a spending of $5.2 billion on litigation expenses), largest yearly loss since the bank’s listing on the NYSE in 2001. Even with an existing provision of $6 billion for litigations set aside, simple math indicates that the bank needs to operate for 5.3 years to pay off the fine, which in combination with the fact that it has to be paid in a one-time sum of cash, has obvious reasons to have investors question the liquidity of the bank.

The turning point of the story struck on September 30th, when reports by Deutsche Bank say that it is nearing a settlement with the DOJ at $5.4 billion, sending share prices up by 12.17%.

Nevertheless, the bank is revisiting its current business strategy and is making adjustments to boost its profitability and de-risk its balance sheet. For instance, on September 28th, Deutsche Bank announced the sale of Abbey Life business line to Phoenix Life Holdings for £935 Million and on October 26th the sale of its banking and securities subsidiaries in Mexico to InvestaBank S.A., both indicating that the bank is cashing on assets as it repositions its business model. Furthermore, John Cryan, CEO of Deutsche Bank, announced on October 6th that the bank is on route to its 9000 positions cut around the globe before 2020 in order to reduce administrative expenses and thus making the bank more competitive.

The bottom line of the article is to emphasize on the fact that even the biggest financial institutions can face difficult times and it is through vigilance and strategic development that businesses can consistently generate positive returns.

US Elections

Donald Trump won the presidential elections on November 9th with 279 electoral votes against Clinton’s 228, becoming the 45th president of the United States of America. The event sent ripples throughout global markets as investors consider the consequences of the policies by which the candidate stood on the economic outlook of the United States and globally.

The S&P 500 index (ticker: SPX) ended the first day of trading after elections with gains of 1.11%. US pharmaceutical companies (ticker: IHE) and financial services companies (ticker: IYG) saw gains of 6.45% and 4.10% respectively as markets close on November 9th, relieved on concerns of regulations that a Clinton presidency may bring to the two industries.

US Dollar to Mexican Peso spot exchange rate (ticker: MXN) peaked at 20.77 from about 18.6 to stabilize at around 19.9 due to protectionism for US local businesses that a Trump presidency may instate.

On the Far East side, the Nikkei 225 index (ticker: N225) tumbled 6.34% during the trading session while US Dollar to Japanese Yen spot exchange rate (Ticker: JPY) dropped to 100.07 due to flight to a safe haven before rebounding higher to about 105.7.

Gold Spot (ticker: XAU) peaked to US$1337.4 per ounce around 12:30 November 9th to stabilize at around US$1273 per ounce before tumbling down to $1227 at on November 11th.

Western Texas Intermediate crude oil futures (Thomson Reuters ticker: CLc1) dropped to a lowest US$43.07 due to flight from risky assets before climbing higher to about US$45.4.
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 givemesport.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 FARMSA.

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 FARMSA.

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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.