MARKET COMMENTARY

Commodity	Aug 31	Sept 30	$ CHG	% CHG
Crude Oil (WTI)	$44.83	$48.04	$3.21	7.16%

"OPEC's new deal carries the intention to increase the overall profit of oil by artificially putting a cap on the supply"

Shale Oil - Oil contained within a rock called oil shale which is similar to a rock sponge. In order to get the oil from oil shale, it must be heated to 1200 degrees F where it releases many volatile components that can be condensed into shale oil in a process which is called retorting. Shale oil needs more refining in order to be turned into gasoline or diesel than crude oil.

Crude Oil - Oil that is pumped straight out of the ground and requires the least refining to be turned into a useable form such as gasoline.

Point (index) - $1 Price change in an index.

"Since 1992, the S&P 500 has gained an average 0.85 percent on the day after the first major debate between the two key presidential candidates"

Treasury Bond - A fixed-interest US government debt security that matures in over 10 years which makes fixed (non-changing) interest payments every 6 months and is taxed only at a federal level.

NAFTA - North American Free Trade Agreement (NAFTA) allows free trade between Canada, USA and Mexico which means there is not a tariff on imports and exports.

OPEC

OPEC's decision to curb oil production in September has taken the market and many investors by surprise. OPEC, also known as the Organization of Petroleum Exporting Countries, made a deal to cut the production of oil to lower the supply of oil by lowering the production ceiling. The exact figures of OPEC's desired ceiling for outputs are not specified, but they lie within 32.5 to 33.2 million barrels per day, meaning that the production of about half a million to a million barrels will be cut. OPEC's new deal carries the intention to increase the overall profit of oil by artificially putting a cap on the supply. The oil-rich OPEC nations such as Venezuela, Iran, and the UAE have all suffered economically, socially, and politically due to the crash of oil prices in 2014 where the price of a barrel of oil dropped from over $110 USD to about $26 USD. The crash was the result of a drastic increase of supply from the development of new technologies and **shale oil** in the US. Due to the plummeting prices of oil, many investments have been driven away giving many OPEC nations a reason to drive up the price of oil.

So, what does this deal mean for the market? The initial market reaction to OPEC's deal was very predictable, but it is the long-term effect that concerns investors. The TSX gained 173 points the day after the deal was announced while the Dow Jones Index and the S&P Index shed 195.79 and 20.24 **points**, respectively. The price of oil gained 78 cents and closed at $47.83. However, this is not a precise indicator as to how the market will behave in a few weeks, months, or years following this deal. **Crude oil** has been notoriously unpredictable and unstable and the nature of the new OPEC deal is just as unpredictable. Crude oil's demand is hard to forecast due to the changing markets, trends, and technological advances. Meanwhile, the supply is just as difficult to forecast because of the new technological improvements for oil processing and extraction and political and social crises can randomly happen and drastically tilt the price of this commodity. In addition to crude oil's volatility, the outcome of the OPEC deal is even harder to forecast and predict.

Despite the deal being announced, OPEC has not implemented any cuts to the oil supply. Furthermore, the deal is against the interest of many OPEC nations such as Venezuela and Nigeria who need the capital from oil to recover from internal conflicts and develop their own economies. Also, a cut in oil and a jump in the price of oil may give an incentive for other oil-producing, non-OPEC nations to continue to develop their own technology to increase their oil-producing capabilities. This could potentially drive the price of oil down even more, causing OPEC to lose both profit and their market share in oil from this deal. The outcome of this new deal is just as uncertain as a penny stock. At this time, one can only speculate as to how the deal will play out and whether it will succeed in OPEC's favour. There is one thing that is certain though: OPEC's deal depends heavily on the supply and demand of oil in the coming months and years following the deal if it materializes.

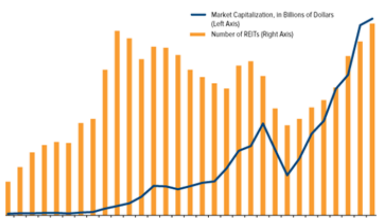
Election's Effect on the Market

Every four years, investors all over the world hold their breath and begin speculating as to what the US presidential election will bring to the global market. This year, the political affair between two of the most unpopular presidential candidates, Republican Donald Trump and Democrat Hillary Clinton has become the centre of attention in the world of business. History has proven time after time that presidential debates and elections can have a tremendous effect on markets. After all, "since 1992, the S&P 500 has gained an average 0.85 percent on the day after the first major debate between the two key presidential candidates, according to Strategas" (CNBC). This year's first presidential debate is no different.

Generally, markets prefer stability and less volatility and risk. A change in popular indices, currencies, and even bonds can signify the success or failure of every candidate during their electoral campaign. Prior to the first presidential campaign, Trump's success led to a monumental 30% fall of the Mexican peso since his campaign begun. During the day of the debate, both the S&P 500 and Nasdaq dropped by 0.8% while the Dow Jones industrial average lost 166 points which is equivalent to 0.91%. The US stock market also lost 1% while many big banks were also in the red (the Guardian). However, after the debate, the markets reacted favorably towards Clinton. The Mexican peso climbed over 2% the day after the debate while the S&P 500 was up a few points. The two year and ten-year **treasury bonds** also rose after the debate. Trump is seen as the unpredictable and volatile candidate, and the market often sees red when Trump sees success. Since markets like certainty, the financial markets suggest that Trump suffered a marginal defeat during the debate as the indices and the Mexican and Canadian dollar improved.

The Mexican peso in particular is a key indicator for both Trump and Clinton's campaigns. For example, Trump would personally tear up **NAFTA**, build a wall between Mexico and the USA while discouraging offshoring operations in Mexico while Clinton only seeks to re-evaluate NAFTA. If Trump is elected president, the Mexican economy will suffer greatly due to the disintegration of NAFTA and increased taxes on exported manufactured goods. On the other hand, Clinton holds greater respect and favourable policies towards the Mexicans and only seeks to reform NAFTA to benefit a greater number of people. If Trump is leading the race, the Mexican peso will drop drastically due to the imminent damage the Mexican economy will face. However, if Clinton is leading the race, the peso will rise due to the fact that Clinton is not Trump and Clinton holds the Mexicans to a higher level than Trump does. A 2% increase in the Mexican peso after the first debate indicates that Clinton marginally won the first debate. Despite the indicators of Hillary's success during the first debate, the presidential race is still hot and Trump still has a decent chance of winning. A modest climb in the indices, bonds, and the peso suggest that the presidential position is still anyone's to win and the race is still on.

REIT Investment has soared in the Last 30 Years



The 11th Sector of the S&P 500

When the market closed on September 16th, 2016, the S&P 500 added its first new sector since 1999. Once a subsector of the financial sector, Real Estate is now its own separate sector and mainly consists of Real Estate Income Trusts (REITs). The financial sector which used to make up around 15.7% of the S&P 500 is now down to 12.7% with the remaining 3% becoming the Real Estate sector.

What are REITs? REITs are a type of exchange-listed managed products which means they are publicly traded on an exchange such as the NYSE and are managed by a professional portfolio manager for a small management fee. REITs consolidate the capital of a group of investors and invest in a diversified real estate portfolio. They typically pay a high percentage of their income to unit-holders. The benefits of REITs as opposed to actual real estate include but are not limited to: much higher **liquidity**, **full disclosure** rules and professional management.

The addition, this sector is certainly not a surprise and ever since the housing crisis, REITs have seen significant cash inflows and have a market capitalization of $1.065 trillion as of August 2016 (see diagram to the side for past 30 years). This astronomical market capitalization and the great increase in cash flow can be attributed to many factors. First of all based on the performance numbers, REITs have outperformed the S&P500 by yielding an average of 3.6% compared to the 2.1% of the S&P500.

Furthermore, REITs have paid out over $46.5 billion dollars in dividends in 2015. Therefore, REITs have provided better fixed income and capital gains over the past few years for investors. Another reason for the substantial growth in investments into REITs is because of the low mortgage rates. 30-year mortgage rates are currently at around 3.5% which is very close to a historically low rate sparking a boom in demand for houses.

Liquidity - A financial instrument is said to have high liquidity if it can be rapidly sold and the act of selling has little impact on the price of the financial instrument.

Full Disclosure - All material facts which are relevant to decision making must be released.

Commodity	Aug 31	Sept 30	$ CHG	%CHG	YTD
Real Estate SPDR Fund (XLRE)	$33.38	$32.77	-$0.61	-1.82%	$1.42

September FOMC Meeting

The previous **FOMC** meeting on July 26-27 kept interest rates at 0.5% and left off with the FED confident about raising rates in the fall, possibly in September. At the beginning of September, analysts were optimistic about a **rate hike** occurring in September. However, on September 2nd, the Bureau of Labor Statistics released a weaker than expected report on its Employment Situation. Wage growth had slowed down; 151,000 jobs were created opposed to expectations of 180,000 and the unemployment rate stayed steady at 4.9% which also surpassed the expectation of a decrease. The US dollar index (DXY) slumped 0.5% at the start of the day but went on to close higher. Despite the positive close on the US dollar index, the damage has been done, as expectations of a rate hike began to edge lower. On September 6th, the DXY closed 0.95% lower and offered a much-needed boost to precious metals.

On September 9th, fears of a rate hike began to take shape again and were reflected within the financial markets. The major market indices would suffer their biggest **sell-offs** since Brexit. The Dow Jones Industrial Average (DJIA) would close down 394 points (2.13%), the NASDAQ slumped 133 points (2.57%) and the S&P500 would gap down 53 points (2.45%). This marked the first time in over 40 days that the S&P500 had closed outside of a change of 1%. This **gap down** for the S&P500 was also significant as it broke a key indicator in the 50 day **SMA** and signalled the end of its uptrend. However, the very next trading day on September 12, the markets would recover with the S&P 500 closing 31 points.

When the FOMC meeting finally came around, the Fed decided not to raise rates and keep them at 0.5%. However, three of the seven members of the Fed voted to raise rates but others voted against it by citing that the **core inflation rate** was below the target rate of 2%. The effect of this decision caused the DXY to dip and offered a strong increase to the market indices and precious metals. The next Fed meeting will take place on November 1-2, 2016.

FOMC - The Federal Open Market Committee (FOMC) is the branch of the FED that determines direction of monetary policy.

Rate Hike - Increase in the rate of interest rates.

Sell-Off - Sale of securities at low price due to huge downwards selling pressure

Gap Down - Gap downs occur when the price of a stock moves sharply down with little to no trading in between.

SMA - Simple Moving Averages are calculated by taking the total sum of closing prices over a number of days and dividing it by the number of days.

Core Inflation Rate - The long run trend in a particular price level and is a good measure of inflation. It is often calculated with the Consumer Price Index (CPI).

	Aug 31	Sept 30	$ CHG	%CHG
S&P 500	$2170.95	$2168.27	-$2.68	-0.12%
DXY	$95.99	$95.42	-$0.57	-0.59%
DJIA	$18400.9	$18308.2	-$92.7	-0.50%
NASDAQ	$5213.2	$5312.0	$188.8	3.62%

Gold

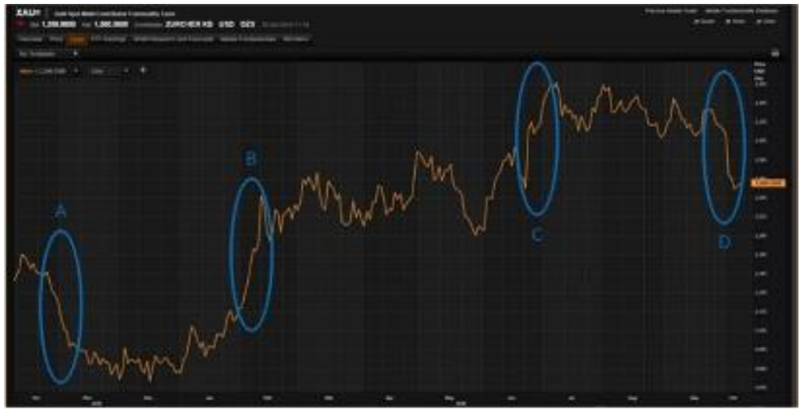
Ever since ancient Egypt, gold has been a symbol of wealth and prosperity, and this view is shared by almost every society across the globe and across history. This aspect of gold makes it a very commonly traded commodity in the barter system and gives it one of the properties of the presently known money. In the current financial world, gold is still one of the most traded commodity, although its value denominated by currency rather than the inverse.
What brings the attention of this issue on gold is that on October 4th gold **spot price** opened at US$ 1311.70 and closed at US$ 1267.81, touching a lowest **bid** of US$ 1266.33 and marking the biggest intraday drop since September 2013.

Spot Price- The current market price at which a financial instrument is being bought or sold.

Bid- The highest price that a prospective buyer is willing to pay for a financial instrument.

Market Correction- A reverse movement of usually at least 10% within a stock, commodity or index in order to adjust for an overvaluation.

Fluctuations in the gold price in relation with the overall financial market performance sources from its very own nature of a commodity. During times of market instability where investors' confidence is low, the price of gold tends to soar due to the nature of physical commodity and, generally speaking, preserves value over time. On the other hand, when economic environments are favourable, the effects translate into potential federal rate hikes as is the situation right now, investors prefer to move into asset classes with more predictable returns and higher interest incomes such as equities and debts.



Daily 1-Year Gold Spot Price in USD

A: Gold price plunges on concerns over the Federal Reserve's raising rates, which they did in December 16th 2015
B: Gold price skyrockets as fear of a **market correction** due to global growth concerns increases
C: Gold price soars after the surprising turnout of the Brexit referendum on June 23rd 2016
D: Gold price tanks on concerns of a second Federal Reserve's interest rate hike since 2006

Factors that may influence gold price in USD and their effects

Federal Reserve's rate hike	↘
Strengthening US Dollar	↘
Global growth/market correction concerns	↗
US Inflation	↗

A forward-looking statement about the gold price for the short to medium term would be, excluding extraordinary events, a relatively flat if not slightly negative trend. The reasoning behind this opinion relies on the facts that the current market price already takes into account a December (most likely time for a) rate hike, after which the fairly conservative FOMC is not likely to raise the Fed rate again for another four to six months, thus reducing the downward pressure on short term gold price. While we exclude the probabilities of another wave of concerns on global growth and market correction as it was the case around February this year, a stronger USD due to an increased US interest rates will be the main downward driver that will act against the positive effects of inflation on gold price.

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.

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.