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Market Review & Update

SUMMER 2015

"Bring out your dead!"

A classic sequence from a Monty Python movie, during a plague, a resident tosses a relative on the cart in an advanced state of morbidity, clearly not quite dead. And so goes the sequence…

And so goes the role of the Fed, central bankers and their surrogates worldwide. Strategic efforts continue to resuscitate flagging economies. In the US, as we have discussed in March, our big concerns, truly global in scope, were:

- Massive port strikes on the west coast
- A sudden 50% decrease in the price of oil
- Euro QE bringing global interest rates to their lowest level in history, resulting in a strong dollar advance
- Last but not least, the frigid, snowy weather in the bulk of the Nation

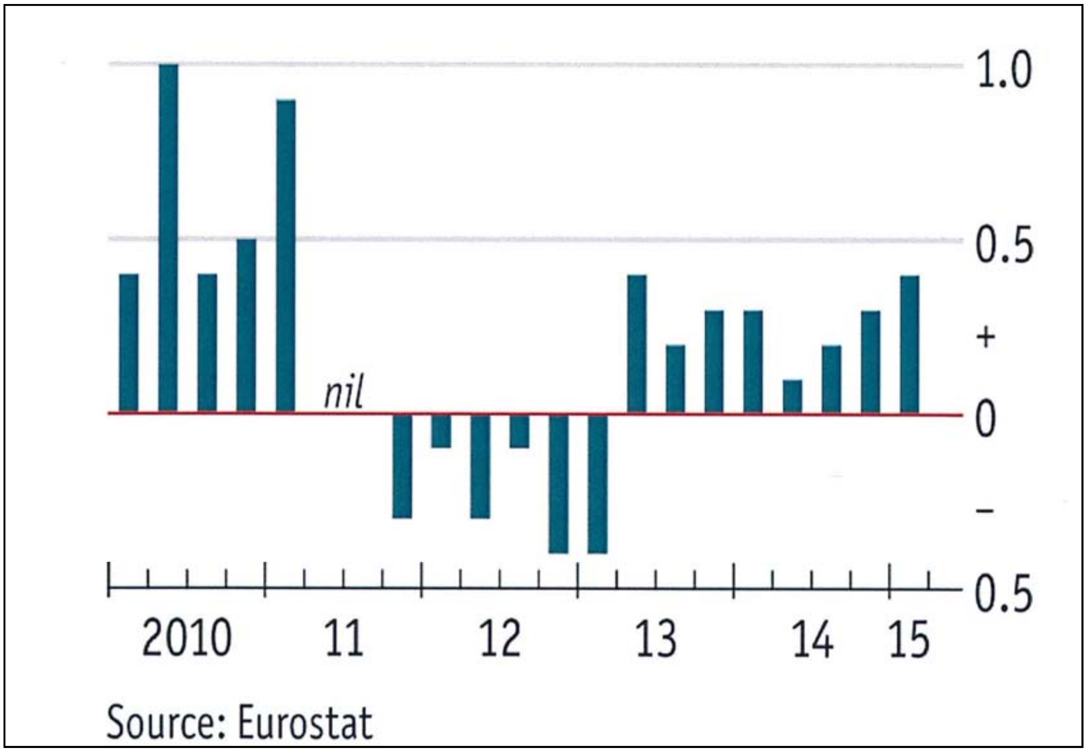
We had suggested in our last writing that the combined impact of these forces would most certainly have a harsh impact on Q1 GDP, perhaps resulting in a negative retracement. GDP is released and then periodically revised as more refined data comes into view. The debut of Q1 GDP came out at .2%. The most recent revision, highlighting how being right can often bring mixed feelings, came in at -.7%. This negative number is quite understandable when you look at those major forces aforementioned.

The port strike was perhaps the most clandestine. So many massive container ships bobbing in the ocean for months, not unloading goods from perishable foods, to the latest fashions, to high tech and industrial equipment, turning "vintage" at sea. The strength of the dollar began to constrain the volume and profitability of US exports. The sudden drop in energy prices put a halt to the major source of lucrative job creation and capital expenditures in the energy sector. And last but not least, if you were brave enough to venture out in the snow on an 8 below zero eve, you suddenly noticed one thing…you were the only one out! No one at car dealers, shopping malls, or restaurants. One bad quarter was an inevitability, welcome to the inevitable.

What we see beginning now is clearly critical. Rebound will be largely anticipated, and very needed. Normally, pent up demand, unrequited in slow periods begins to provide traction as these periods subside. Domestically, we have seen some, but clearly not enough yet. The jobless rate declined, but so did the participation rate, partially negating the advance. And research now shows 1 in 10 to officially be underemployed, which will be weighed upon further by the lack of quality incomes growing in the oil patch. Quizzically, the "oil price dividend" effectively a tax break to every oil consumer, has yet to show up in spending in a big way. We might guess at this juncture, that confidence might well be the culprit. It can, historically, sometimes take consumers as long as six months to change spending patterns after a decent sized energy decline. And this decline bottomed at the end of January, so one would expect some changes to begin soon. We began to see some evidence in May that consumer spending for vehicles has been robust. Other retail sales often dovetail to vehicle patterns. Up to now a key element that has been absent and would be most impactful would be an acceleration in housing activity. There have been many forecasts of millenials beginning to move out of their parents' basements, if that begins to show up in the metrics it would be quite positive, albeit an increased likelihood of Fed hiking rates would almost certainly follow.

Overseas, our neighbors have been quite busy. As we noted before, the Euro QE program devours about 80 billion in bonds per month, the driver of the historic level of interest rates. Fortunately, it seems to be having some effect (see chart). GDP is beginning to rise across Europe. And perhaps of even greater significance, our most impactful neighbor, China, has reduced rates numerous times in the last 6 months to hopefully spark domestic consumption and keep their GDP growing north of 7%. Doubt their significance? Peek at the price of copper & steel now and then look at those commodities during China's double digit growth rates. The reason for the 30-40% declines becomes clear.

Lift off: the Euro zone's economy



"**But I'm not quite dead yet!"**

While all that can begin to sound a bit morbid, let's look at how the markets are interpreting and manifesting their opinions. During the Q1 economic deep freeze the equity markets began a March that took all major indices to new all time highs. Even the NASDAQ managed to break through its year 2000 bubble peak, but clearly at a much more "rational" valuation. The Dow broke through 18,300, the S&P through the 2100 level, and the aforementioned NASDAQ broke solidly through 5100.

This activity and a reasonable outlook for the remainder of the year has one common supporter, the Fed and central bankers everywhere. If the economic data were unequivocally strong, central bankers would have strong incentive and responsibility to raise rates. Which ultimately would not be bad. But it would be change, and change always needs to be digested. However, the current state of the data here and abroad gives central banks little reason to consider a hike. Hence, the regurgitation of the 90's saying "Goldilocks environment" as we get closer to 80 months on an interest-free diet. Let's instead call it, the Holy Grail…

We will want to keep an eye on how readily this rebound unfolds to be sure it arrives as anticipated. That Q1 slowdown took what was expected to be a 3% GDP 2015 to what is more likely to be 2-2.5%, or more of what we saw in '14. But then again, quite different. Stronger dollar means that non-exporting (including many small and mid caps) companies will have an advantage. If the consumer begins to spend that cash hoard not spent on gas, that will begin to do it.

So, an oddly similar finish to a slightly different story, A bit of volatility, but still on a trajectory of advance. Enjoy a beautiful Summer.

We'll talk to you soon…