Courier Capital Corporation

Market Review & Update

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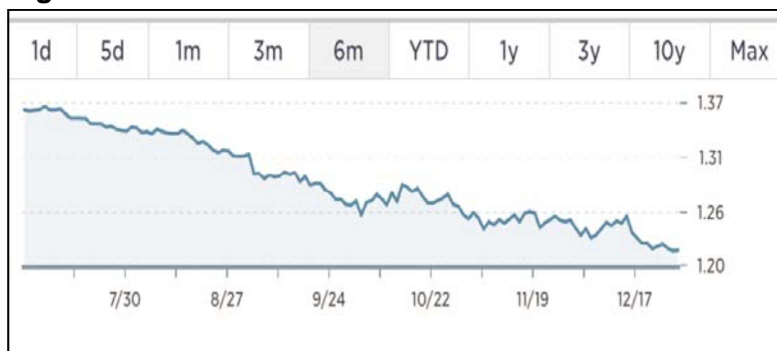
And that's a wrap!

The equity markets ended 2014 largely as we anticipated. Low interest rates and low inflation, coupled with fair valuations allowed for a continuation in earnings expansion and rising equity prices. After well over 50 new highs during the year, the Dow pushed through 18,000 for the first time in history. Continued earnings strength remained the primary driver. The most recent period of earnings releases manifested in over 80% of companies meeting or beating estimates for a year over year gain of 8.9%. Resilience was strong in the face of much global instability, as downturns quickly recovered.

While we predicted the Dow would surpass 18,000, there were several significant surprises. We saw increasing evidence that economic strength was building slowly in the US, this while China and more significantly Europe, continued to slow. The latter was responsible for the first big surprise, the lowest global interest rates in history. As growth rises, we normally would expect the 10 year Treasury to rise in yield, reflecting that strength. It never happened, largely due to the troughing in Euro zone 10 year yields, 1.6% and 1.7% in Spain and Italy, and a middling .5% in Germany. This put an effective glass ceiling on US rates, pushing the 10 year down to 2.2%. Those low rates kicked off a currency war, as the dollar strengthened both from higher relative rates and a more stable home for global funds. In the face of that we were pleasantly surprised to see the aforementioned strength in earnings, as a stronger dollar makes sales of our goods overseas more challenging. The most palpable example of this for people in WNY is the $1.16 exchange rate with our friends north of the border in Canada. Consumers here get a 16% discount on purchases in Canada, and conversely, Canadian dollars buy less here. But so far, our overseas sales have not been overly impacted. This is something we will want to keep a close eye on.

Figure 1: Euro vs. Dollar



The second big surprise was the collapse in oil prices worldwide. Losing half its value in fairly short order, it is assumed that OPEC, and more specifically the Saudis, wish to capture market share while simultaneously punishing the burgeoning oil shale and hydrofracturing industry in the US, whose extraction costs are now higher than the current price per barrel, while average Saudi extraction costs are close to 10 bucks per. The impacts of this oil war are many and many are not knowable. On the plus side, as we have discussed before, the price of gasoline is like a big tax cut for an average household, saving them about $1500 per year. Families and businesses have dollars they can now spend on other consumables and spend they will. On the minus side, many of the quality jobs created in the past few years have come from this domestic energy boom and about 30% of our capital expenditures have likewise come from the expansion. A good bit of that has hit the pause button. There is also a chance that the aforementioned potential for a slower export demand due to currency strength will be offset by the additional spending power manifesting in domestic consumers. This too bears watching. How low will oil go and for how long will it remain low? No one knows, but suffice it to say that like Newton's laws of physics, the forces of supply and demand are certain, so we can simply state

that the cure for the low price of oil is simply the low price of oil. We have already begun to see consumer demand behavior change as the price of gas declines.

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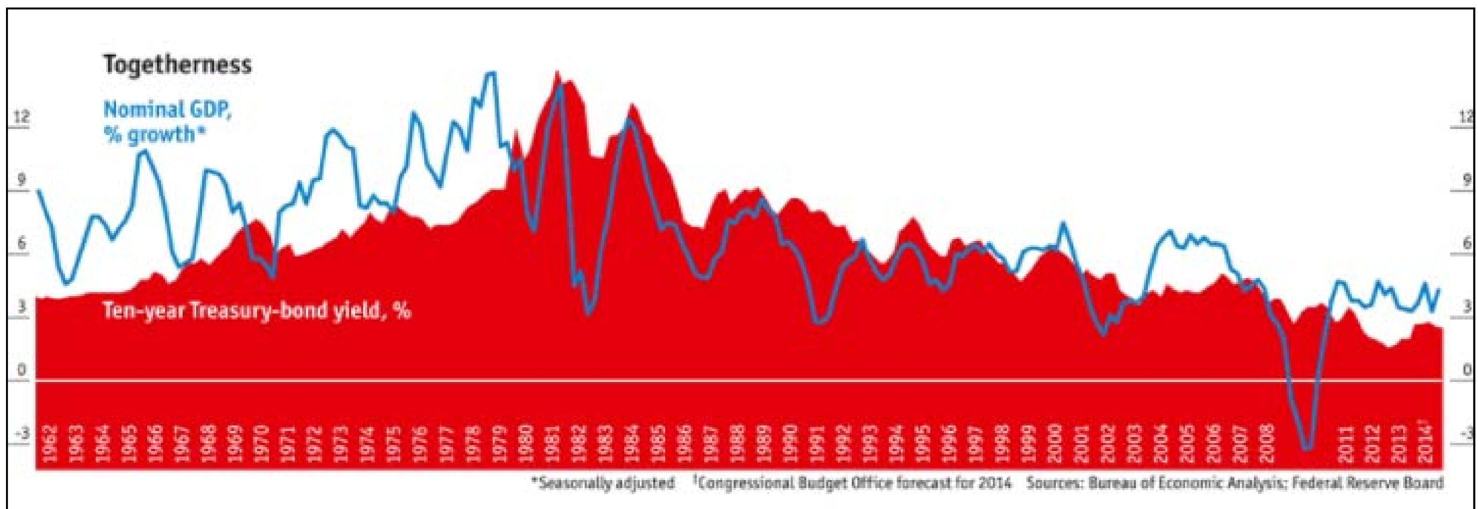
As we mentioned earlier, in addition to the strong quarter of recent earnings, domestic economic metrics were beginning to manifest signs of more strength. More jobs, yet still not enough to bring down the 40 year low participation rate, were created. And, there was an increase in some higher paying jobs, which was a first in this cycle. It may well take an increase in CAPEX by corporate America to increase the creation of higher paying jobs to bring more folks back into the labor force. Most analysis suggests that tax reform will be needed to act as the primary catalyst. There has been much talk in Washington of initiatives to address these anomalies, but as we have come to expect, a dearth of action. We'll see. GDP in the 3rd quarter may well have rebounded to 5%, while not expected to remain at that level, it made up for some of the weakness earlier in the year. GDP is expected to rise in 2015, a general consensus suggests something in the mid threes. We should at this juncture make it very clear that there is not a direct connection between GDP and the equity markets. As the chart shows, GDP can range quite independently of the major market indices. Recent years have clearly shown this lack of relationship. GDP has been mediocre at best since 2009, while earnings for the S&P have multiplied significantly. And perhaps China provides an even more illustrative example: its equity market floundered through years of double digit GDP growth, only to now rise rapidly as GDP simultaneously slows. This reminds us to simply focus on what's brought us to this point. Expanding global demand for goods and services that boost corporate earnings in a welcoming environment of low inflation and supportive interest rates have been the market's reliable partner. With valuations at historical norms, these ongoing momentums are likely to continue to provide a rewarding environment for most investors. Earnings are anticipated to rise 8-11% in 2015, and barring interruptions from the forces aforementioned, or unanticipated exogeny, markets should once again reward participants with a coincidental move higher.

Figure 2: Dow 1000 in the Early 80's



Our best wishes for a Happy New Year manifesting the anticipated reward.
We'll talk to you soon...

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