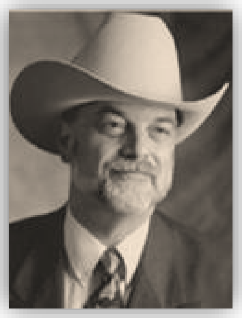

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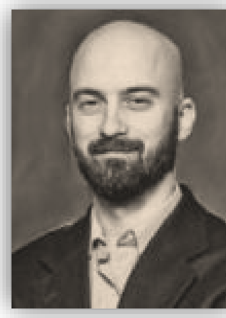

November 20, 2015

TPWC Market and Economic Update

The Markets

The stock market rebounded quite nicely this week after Federal Reserve Board notes from their last meeting revealed a consensus among its members that they really did need to raise rates in December, but then leave them alone for a while to watch what happens. The actual language in the minutes was that the increases should be "gradual and slow." The Dow Jones Industrial Average was up 3.4% for the week while the S&P 500 was up 3.3%, closing out the week at 2089. Just for the record, it was at 2135 in May, so we have a ways to go to get back to where we were at the beginning of the second quarter. The Index is still basically flat for the one year period, but the trend is positive, so, barring an unexpected event, we are expecting a positive number for 2015.

Meanwhile bonds continued to fall, with the 2-year US Treasury ending the week yielding 0.93%, and the ten-year note yielding 2.264%. (Bonds fall when interest rates rise.) To put that in perspective, the ten-year Treasury has struggled to rise above 2% for the past six years, and generally failed to do so. While it may not sound impressive, to those of us who watch such things, a yield above 2 1/4% is pretty significant.

Perhaps the most impressive thing about the equity markets in this week and last is what they didn't do. Following the terrorist attacks on Paris and other places, echoed by threats to carry out more such attacks, the markets did not fall. There appears to be a consensus that the economies of the developed world will not be affected by such things. It must be disappointing to the terrorists, but they are finally being revealed as the insignificant things that they really are on the global scale.

The Economy

One significant thing that happened this week is that the International Energy Agency released a report that oil may never again reach $100 per barrel. The fracking technological breakthrough has so increased the recoverable oil reserves of the planet that they are growing at a rate that is multiples of the increase in use. More, developed economies around the globe, as well as some of the larger developing economies are fully committed to reducing the use of fossil fuels, and it is working. In the developed world we are using less oil per capita each year, not more! As the developing economies become more developed, the trend is to become more fuel efficient, purely as a matter of self-interest. The Chinese, for example, have recognized that air pollution is one of the limiting factors in their economic growth and have determined that it must be controlled.

Oil closed out the week at around $41 per barrel. That is a full 60% below where it was a year ago, and is having a global impact. All the elements have not fallen into place, but the reduced price of oil appears to be here for the long-haul. A lot of wells were drilled and pipelines constructed, almost all with borrowed money. Those loans must be paid back, so the pumps keep pumping. Each time a report comes out on the oil reserves stored in tanks around the country the number is bigger.

Copper has dropped to a six year low, or back to where it was in 2009, while nickel fell to a 12 1/2 year low. Copper is down 27% this year alone. It is not so much that the world is not using copper as much as it is that a lot of copper mines were started when the price was at record highs. Those mines, like the oil wells, were built on borrowed money, and they must keep producing because the loan payments are due.

This is all a classic economic cycle wherein when prices for a commodity are high, many separate entities start the process of creating that commodity to sell. They generally all come on line at about the same time, producing a glut in the product, just as the unusually high demand levels off or even declines. This cycle is the longest studied area of economics and was originally written about as the "Corn-Hog Cycle." Things are never "different this time" and no matter what the trend, none of them "go on forever."

You may remember that gold was just below $2,000 per ounce a few years ago as the TV ads proclaimed that it would go to new heights. That shiny metal closed out the week at $1,076. To put that in perspective, 33 years ago it was $820 per ounce. Factor in inflation and transaction costs, and gold has lost about 50%, not just in the last few years, but also over the last third of a century. By our calculations, at its peak in this cycle, a gold investor in 1982 would finally have achieved a 0% return if he had sold at just the right time. That, by the way, is the really long-term story of gold. Since the 1500s gold has moved up and down, but overall it has trended downward—a lot!

The dollar has continued to climb. It now only takes about $1.06 to buy a single Euro. That amounts to about a one-third decline in the value of the Euro when measured against the dollar since 2009, and is a reflection of the relative strength changes between our economy and that of the Eurozone. We, meaning the Federal Reserve Board, are about to start raising interest rates lest our economy grow too strong and create inflation, while the European Central Bank (ECB) is making suggestions that they are going to increase bond buying to head off deflation and a looming recession. Several major banks have predicted that the Euro will drop (or the dollar will rise, depending on your perspective) to parity with the Euro within a year.

Some of our readers may remember when the Japanese were going to take over everything because of their strong economy. In those days, about 100 yen could buy a dollar. Today the yen closed at about 123 to the dollar. A shorter time in the past the Chinese economy was going to pass the US as the largest in the world. Now it appears that the Chinese economy, still in second place, is probably growing slower than ours as the Chinese government begins to take steps to stimulate it.

As the Economist Magazine predicted in 2002, this is likely to turn out to be the American century, and just possibly the American millennium.

As always calls and messages are welcome. We will be on the air from 10:00 to 12:00 Saturday on KTEM 1400 AM locally or you can listen in at ktemnews.com.

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