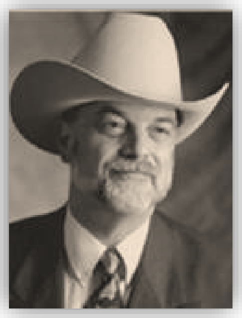

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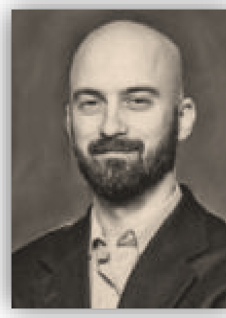

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TPWC Market and Economic Update

The Markets

Stocks

The S&P 500 Stock Index (SPX) ended the week down 0.3% after rising for the first three days and then falling Thursday and Friday. Notably, both European and Asian markets rose on Friday. This apparently odd behavior actually makes a great deal of sense if one considers that today, Friday, was what market participants call a "triple-witching" day in which a host of different options contracts expire, and in doing so distort regular market activity as the holders of those contracts have to buy and sell stocks to cover the contracts.

The activity early in the week, a market rise of about 4.5%, was credited to the increase in interest rates announced by the Federal Reserve Board. As we have written before, yes, the rise in rates that was so feared that it has nearly driven the stock market into a correction at least four times has finally happened, and when it did the market rose rather than fell. Then, on Thursday, the price of West Texas Intermediate oil (WTI) fell below $35. The fall in oil prices below yet another supposed "bottom" means that more oil companies will soon be missing payments on loans and payments on the use of pipelines. More than a few companies have invested (both directly and through loans) in the oil patch boom, and it appears that most of them will not get all their money back. That fear is causing a great deal of angst and caution.

Here is the bottom line this week: Like last week and most of this year, there is a lot of drama, but in the end not much happened. The real driving force is a profound indecision as to whether we are recovered from the so-called "great recession" or whether we are still at risk for falling back into a slump. There is little or no discussion about what historically is most likely to happen; that we will move from recovery to expansion in 2016.

From the perspective of traders, the Federal Reserve's comments that the economy is doing quite well suggested that we are ready to move from fear of recession to expectation of expansion, but then the oil glut, combined with the passage of the budget bill–which included a lifting of the U.S. oil export ban imposed in 1973--suggested that oil prices may fall further. Falling oil, copper, aluminum, and other commodity prices to levels not seen since 2009 suggested that somewhere things are slowing down, and thus triggered the fear reaction. A careful examination of the numbers reveals that what has happened is not a slowdown in demand but a massive increase in supply. More on that below.

Bonds

Bonds behaved very much like stocks, which is to say that the Barclay's Aggregate U.S. Bond Index was very little changed for the week and for the year. Like stocks, bonds were higher earlier in the year but are now down to about where they were when the year began, noting that that break-even value was dependent on all interest being reinvested.

For whatever it is worth here, the decline in stocks on Friday appeared to have nothing to do with the economy, or even stock valuations, but rather to be a result of options contract expiration in a market where not much else was happening. If that is true, barring some other news, markets tend to rebound on the following trading day. It will be interesting to watch to see what happens on Monday.

The Economy

The Congress passed a $1.1 trillion dollar budget which the President says he will sign. Believe it or not, that included a reduction in the deficit to a level that well may be below next year's inflation rate, meaning that in real terms our national debt may actually shrink over the next year. The budget included a rider that removes the prohibition against U.S. companies exporting oil. In effect, that means more oil will hit the international markets in the longer term. Given that both the U.S. and Iran are reentering the world oil-export market, the decline in oil prices should not be a great surprise.

Just as importantly, at least to us, is what was not in that bill. There was a serious attempt to include a rider in the House version of the bill which would have blocked the Department of Labor from imposing a fiduciary standard on any and all advice given by financial firms on IRAs and other retirement plans, like 401(k)s. The Senate made it clear that the bill would not pass with that amendment and it was removed. It thus appears that beginning sometime in 2017 it is very likely that "financial advisers" selling and advising on Department of Labor regulated retirement plans will have to act in their clients' best interests, whether they want to or not. The amount of lobbying that went into trying to kill that proposal was amazing. Frankly, we see it as a huge step forward.

We continue to see the actual, net, long-term result of all that happened this week as positives. Low oil prices will indeed probably create some pain as those who loaned to and invested in the oil drilling and transportation boom start seeing the losses pile up, but in the longer term lower oil prices reduce the cost of transportation, electricity, and just about everything else. The reduction in energy cost will more than offset rises in interest rates. In fact, the reduction in oil prices has the potential to be a greater stimulus to the economy than just about anything the Federal Reserve has done at any point.

Christmas continues to look like it will be excellent for retailers, but far more so for those selling online than for the bricks and mortar stores. Again, with the American consumer constituting about 70% of our economy that is good news.

We plan to be on the radio tomorrow as usual, so feel free to give us a call.

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