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Market Update: January 2016

Stocks started off the New Year by stumbling out of the blocks, as investors turned their attention to slowing global growth and declining oil prices.

> **It's like you woke up on January 2nd and all of a sudden everyone decided the world is falling apart. We reject that.**
>
> **Kelly King, CEO of BB&T Corp – WSJ (1/23/16)**

With concerns mounting that a slowdown in China would spill over to the United States, global stocks saw declines of about 6% in January. Although declining oil prices should have a net positive economic impact, investors are worried that oil prices are falling because global growth is slowing.

> **It seems ironic that in the run-up to the global financial crisis, we were worried about oil prices being too high in 2007 and 2008. Now we're worried about them being too low. In the long run, lower oil prices should be positive or at worst neutral for the world economy because all they're really doing is transferring income from oil producers to oil consumers.**
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> **Julian Jessop, Capital Economics Ltd. – AP (1/21/16)**

U.S. oil inventories are at their highest level in 80 years, and the lifting of international sanctions against Iran could further increase stockpiles. The International Energy Agency expects global oil supply in the first half of 2016 to exceed demand by 1.5 million barrels per day.

Bankruptcies in the oil and gas industry are on the rise, and some investors are worried that the economic consequences could rival the subprime mortgage crisis that propelled the *great recession*. **To quote Chris Rock - "Sloooow down".** The energy sector should not be compared to the housing market. The oil and gas industry has about $500 billion in outstanding debt, while residential mortgage debt is in excess of $11 trillion.

The real culprit here is China. As the world's second largest economy, China has generally provided about one-third of overall global growth. Further, China accounts

for one-third of all the combined emerging market output (GDP) and half of all emerging market outstanding debt. With China's economic growth rate slowing to 6.9% (the weakest pace in a quarter century), fears of financial contagion are on the rise.

> **I never give stock market advice, and this is no exception. But the market is probably overreacting to news from China by a wide margin. In the case of oil prices, it seems to have the direction wrong. China is not as big a deal to us as they think; and falling oil prices should help, not hurt, U.S. growth. Don't misinterpret any of this as investment advice, however. The markets can stay irrational longer than you can stay solvent.**
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> **Alan S. Binder, Princeton University – WSJ (1/20/16)**

Other News from the Economic Front:

- U.S. GDP expanded at 0.7% during the fourth quarter of 2015. (This was not a surprise, since economists expected 0.8% growth.)
- Despite weak first and fourth quarter growth, the U.S. economy expanded 2.4% for calendar 2015 - slightly better than the 2.1% average growth since 2010.
- The U.S. economy has been resilient thanks to steady job gains, an improving housing market, and strong auto sales.
- Consumer spending in the U.S. grew at the fastest pace in 10 years.
- The yield on the 10-year U.S. Treasury note fell 0.345% to 1.928% in January … the lowest rate since April of 2015. So much for rising rates!
- Oil prices fell over 9% to $33.62 per barrel in January, but were up 27% from the $26.55 low reached on January 20.
- Many of the world's biggest stocks are now in bear market territory – meaning that they are off 20% or more from their recent highs.
- The International Monetary Fund has cut its global growth forecasts nine time in the past year.
- Profits for S&P 500 companies are expected to decline by nearly 5% in the fourth quarter. This would mark the third consecutive quarter of declining corporate profits.

Just when you think central bankers are out of ammunition, Japan shocks the markets by dropping its key short-term interest rate below zero. (Many consider negative rates to be a desperation move to drive banks into taking greater risks.) The move came on the last trading day of the month, causing stocks to soar, and the yen to decline.

> **This is another "whatever it takes" moment. Central banks never run out of ammunition. They can print (money) as much as they want. They can make rates as negative as they like. The only question is: at what point does the collateral damage become so great that they decide to stop?**
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> **John Stepek, Money Week – (1/29/16)**

Only 3 of the last 13 bear markets have taken place in the absence of a recession … and the U.S. economy is not in recession. The declining markets are as much a statement on the limitations of central-bank stimulus, as they are a broader reassessment of global growth expectations. **Simply put, monetary policy has probably run its course.**

In retrospect, the Fed probably waited too long to raise rates. **Usually, rate hikes happen when profits are growing … now they are shrinking.** The Fed has put itself in a difficult position. Raising rates now causes some pain. Doing nothing risks longer-term disaster.

What should investors do?

The two most important variables investors use to value stocks are profits and interest rates. Right now both are going in the wrong direction. Diversified investors should simply stay put while the markets reprice against a changing economic backdrop.

> **Just stay the course. Don't do something, just stand there. This is speculation that we're seeing out there, and you can't respond to it.**
>
> **John Bogle, Vanguard Group founder – CNBC (1/21/16)**

I recently recommended to a client that he "hang in there". His response, **"I am hanging … but my fingers are slipping."** I know it's difficult, but panic is not a strategy. The only successful time tested strategies are patience, discipline, and diversification.

Daniel G. Corrigan, CPA/PFS, CFP®