Financial Wanderings

December 2015

A masterful examination of the previous month's financial events, written by Brad Blackburn, CFP ®
(and made even awesomer by Andrea Dickerson)

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Market Numbers for the year 2015:

S&P 500: -0.70% to 2,044

NASDAQ: +5.03% to 5,007

DJIA: -2.2% to 17,425

10-Year Treasury Yield:

+4.6% to 2.27%

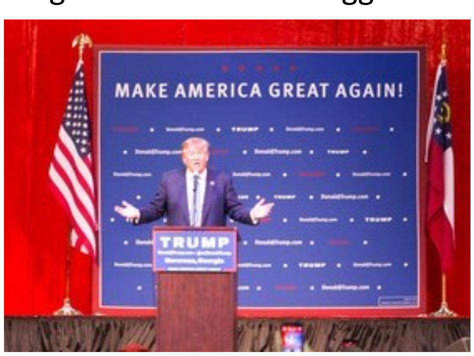
Gold: -10.5% to $1,060/oz

Although the commentary in this newsletter has been thoroughly researched, well-reasoned and contains many impressive multi-syllabled words, please enjoy it responsibly. There are many economic minds that are far smarter than mine—and even they can't agree on even the simplest economic questions. In other words, please enjoy this newsletter with the full understanding that it may be entirely wrong.

The Year in Review

Blackburn Financial was recently audited by the State of Washington. One of the issues uncovered during the audit was the use of "puffery" in my newsletter, which means I referred to my own expertise in overly glowing terms. Although the auditor noted that I made the "puffery" comments in jest, he said people could get the wrong idea. Therefore, it's simply not acceptable for me to refer to myself as one of the greatest financial minds in the history of humanity.

This is particularly bad timing. That's because the S&P 500 was almost perfectly flat during 2015 (it lost 0.70%), which is remarkably close to what I predicted. Typically at a time like this, I'd strut around and fill this space with outrageous bombastic braggadocio.



Unfortunately, "The Man" is holding me back from truly expressing myself. Instead, I have to resort to lame Trump jokes, and that's just sad.

The Markets

After years of great returns, the stock market finally hit a plateau. Over the last year-and-a half, the S&P 500 has gained less than 5%.

Unfortunately, the picture gets worse when you look at the performance of a diversified portfolio of stocks and bonds. The Morningstar Moderate Risk Index, which is a good measurement of what a typical investor should be invested in, has lost nearly 3% over the last 18 months. That's because bonds and international stocks, which are hallmarks of a diversified portfolio, haven't done as well as the S&P 500,

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which only represents large American stocks.

What will it take for the markets to take off again? Is there anything out there to inspire hope? What could possibly be big and awesome enough to break the markets out of their malaise?

(I want the record to show that I resisted doing a Trump joke here)

Our best bet for a stock market catalyst is for the global economy to pick up again. For more on that, keep reading.

Global Growth:

The weak global economy was one of the major themes of 2015. Whether it was a flare-up of the Greek drama, China's stock market implosion, or the mess in the Middle East, the global economy was a huge drag on our economy and stock market here in America.

But what if that changed? What if the global economy actually started to hum again? What would that mean for the stock market? What would it mean for our economy? How would it change our lives?

For now, that's just a dream, but the global economy has been down for a long time. At some point, it will start growing again. In the same way that we're probably due for a recession here in America, the world is due for some growth.

China is the key player, and as worried as I am, there's one thing that gives me heart: China is about the only place in the world with economic "ammunition" left. Interest rates across the globe are essentially at zero, but China's primary interest rate is still above 4%. Further, China has shown a willingness to be aggressive and creative in addressing their slowing economy. Unfortunately, they've also shown the ability to be dumb about it. So, I'm not predicting China will start to grow at amazing rates anytime soon, but I think they'll do enough to avoid falling into a full-fledged crisis in the near-future.

The U.S. Economy:

While we continue to add jobs at an impressive pace (more than 240,000 per month in 2015 according to Marketwatch), that's the only part of the economy that is really humming. Nearly everything else has slowed since last year. Here's what I wrote in March regarding the slowing economy.

This economic weak spot is being caused by a combination of things... But let's not overthink this. Maybe this is just part of the normal ups and downs. Economies don't move in a straight line.

The American economy isn't strong enough to power through all the headwinds it's facing. I think the economy will continue to be solid, but unsteady. I do worry that we're due for a "normal" recession sometime soon (not every recession is a crisis), but so far, the economic signs aren't pointing in that direction.

The Fed:

It finally happened. The Fed raised rates for the first time since 2006. The best part was how little the markets seemed to care. The Fed is playing the markets perfectly.

On the other hand, if the Fed is so smart, why did their own estimates assume they would raise rates 1% in 2015, when they only ended up raising rates 0.25%? Maybe they aren't so smart after all.

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Or maybe these are just really difficult questions. In case you're wondering, the Fed's estimate for 2016 is, once again, that they'll raise rates 1%. But I just can't imagine that happening. My own estimate is that the Fed will continue to wuss out on raising rates.

However, what if inflation picks up, and they are forced to raise rates more quickly than they want to? That's one of the spookier scenarios we could see in 2016. To calm your nerves, I thought it would be good to go back and look at how the stock market performed the last time the Fed raised rates, which was from June 2004 through June 2006. During that time, the Fed raised rates from 1% to more than 5%. Through that steep rise in rates, the S&P 500 gained more than 15%. I'll take that.

For years, my argument has been that ultra-low rates have actually hurt the economy. That's because it didn't match what was happening in the real world. We haven't been in a crisis since 2009, but the Fed has been at panic level the whole time. So I'm pleased the Fed has changed course and is finally projecting a little optimism. This is a vote of confidence for the markets.

Oil:

After the price of oil fell steeply over the last six months of 2014, oil was on everyone's radar at the start of 2015. Here's what I wrote at the time:

On one hand, the falling price of oil is a good thing. I think everyone understands that if gas costs less, people have more money for TV's, eating out, vacations, and paying off debt. Those are all good things. However, when the lifeblood of the world economy falls more than 50% in value, you're going to have some shockwaves too.

Since I wrote that, oil has fallen nearly 40% more. And yes, there have been shockwaves. So what's causing oil to go down so much? It's a supply-demand thing: The global economy is weak (which creates less demand for oil), and there's a lot more oil production across the globe (which increases supply). America is a perfect example of that increased production, as we are now the world's leading oil producer.

Typically, with oil prices so low, OPEC (the cartel of many of the world's major oil producers) would cut their production in order to raise prices. But this is where it gets interesting; OPEC isn't cutting their production because they actually want low prices (more on that below).

So what's going to happen with oil in 2016, and beyond? There's only one thing I'm fairly certain of: It's not sustainable for the price of oil to be less than the amount it costs to get it out of the ground. According to CNN, it costs approximately $36 in America to produce a barrel of oil (roughly where the price of oil currently is), and it's more expensive than that nearly everywhere else in the world. The exception of course, is the Middle East, where the cost of production is closer to $10 a barrel. However, according to the IMF, those Middle Eastern countries need oil to be at $50 a barrel in order to not run out of money. That means it's not sustainable for anyone if oil remains so cheap.

Even though it hurts them over the short-term, OPEC wants low oil prices because their devious plan is to undercut all the new oil production across the globe, especially here in America.

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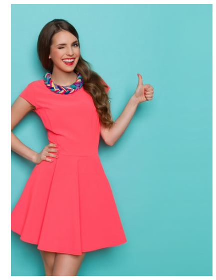
Their plan is starting to work. According to Bloomberg, US oil production is set to drop in 2016 for the first time in 8 years. It makes sense - who wants to invest in oil production when it's not profitable?

This is a game of attrition. Who can survive the longest? Either OPEC will run out of money and be forced to cut their production to raise prices, or oil production across the globe and in America will slow. Either way, the supply of oil can't remain this high forever, which means oil prices will eventually recover. It's hard for me to imagine oil prices at less than $50 over the long-term.

So what will 2016 bring?

After such a lucky prediction last year, I considered retiring from making bold predictions. It's pretty much guaranteed to be all downhill from here. On the other hand, it's been fun. Since nailing that prediction, I've understandably received much more attention from the ladies.

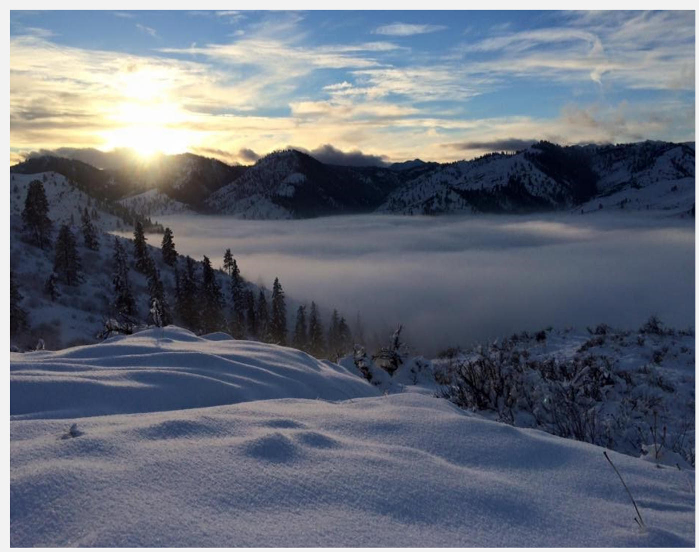


So, I'm going to put myself out there once again with a bold, courageous prediction. And here it is: My official prediction for 2016 is exactly the same as my prediction for 2015 – a flat stock market. Also, I predict the markets will crash in the first week of 2016 because of China.

Probably a Mountain or a Lake

Now that's a winter!

What a treat it's been to get a bunch of snow. This picture was taken from Butler Ridge in Cashmere, looking towards Blewett Pass.



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