Financial Wanderings

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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2014 Market Numbers:

S&P 500: -3.1% to 1,995

NASDAQ: -2.1% to 4,635

DJIA: -3.7% to 17,165

10-Year Treasury Yield: -22.5% to 1.68

Gold: +8% to $1,279/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.

Why'd It Do What It Did?

The glorious year of 2015 started off in grand style as the Dow Jones had its worst start to a year since 2008. But I don't see what the big deal is, was 2008 a bad year or something?

The rest of the month didn't get much better. But don't worry; I'm almost mostly sure we aren't headed for another year like 2008.

GDP & the economy:

After the strongest six-month period since 2004, during which the economy grew at a 5% clip, our GDP only managed a measly 2.6% in the 4th quarter of 2014.

Despite the panic button, I'm not all that worried. This economy is strong, but it certainly isn't booming. So, after such strong growth during the middle of 2014, the roller-coaster was bound to head downhill a little bit. If that doesn't calm your nerves, just remember this: The 1st quarter GDP report from last year changed almost 3% between the first and final reports. In other words: The first GDP report is often total garbage.

The other major economic news was the continued strong growth in jobs. However, like most of the recent economic data, the news was more lukewarm than hot. The economy added 252,000 jobs in December, and the unemployment rate dropped to 5.6%. There will be no quibbling from me about adding 252,000 jobs, that's a legitimately strong number. But the unemployment rate dropped to 5.6% because even more people quit the workforce completely. Even worse, wages actually dropped in December. Those aren't signs of a roaring job market. On the other hand, there are currently nearly 5 million job openings, so the sky isn't falling.

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Europe

Some big things happened in Europe in January. But before I get to that, I want to remind you that the European economy has been painfully weak for years. However, the economic news in January told a slightly different story: The European economy is STILL weak.

To make it worse, Greece is starting to cause problems again. During the Greek crisis back in 2012, I boldly predicted they'd leave the Euro. So far that's been a terrible prediction; so my plan was to never, ever bring it up again. But I may not be wrong after all, which would be great news. Of course, Greece leaving the Euro could cause a major crisis which would spread damage and heartache across the world. In my mind, that's a fair trade.

Here's what happened: The Greeks just voted in a new government that ran on the idea of not following the strict rules the rest of Europe put in place in exchange for the billions of dollars in loans Greece received during the crisis. Of course, the Greek economy is still in shambles, and they aren't very excited about non-Greeks telling them how to conduct their business. But not playing along with the rules probably means leaving the Euro, which would likely make things worse on Greece. The new Greek government does seems to understand this though, and their early actions have been surprisingly reasonable. So everything will probably be okay. What a bummer.

Switzerland took a turn shocking the markets too, as the Swiss National Bank "cut its currency cap with the euro." Yes, I totally know what that means and why it's important. If you really sit back and think about it, I think you'll understand too.

Thankfully, in the face of all this bad European news, the European Central Bank (ECB) finally officially announced their version of Quantitative Easing. Phew… Everything is going to be okay now. Yes, that was sarcasm. In the ECB's defense, Europe is still in a crisis. My biggest beef with the Fed wasn't the first round of QE, but the two that came after it when our economy was clearly not in a crisis anymore. But… the American economy looks pretty good compared to Europe. Maybe I've been wrong about QE this whole time?

So what should you make of all this?

I think our economy will be fine. Things are slowing down a little bit from the frenetic pace we saw through the middle of 2014, but that doesn't mean we're falling back to the painfully slow growth we were stuck in for years. However, I'm a little less optimistic about the stock market. I continue to think the coming months will be a tricky time for investors. It's also possible that the last few years have made me overly sensitive. We're probably just getting back to the way the markets usually are.

What's The Deal With Oil?

It has been a crazy ride for oil. Back in June, after hovering near $90 per barrel for almost two years, the price of oil started falling. In six short months, it fell more than 50%. Nearly everyone was surprised by this. However, here's what I wrote back in June, before all this happened:

> *"I predict that over the next six months, oil will fall more than 50%."*

Yes, that's a lie. I did not see this coming.

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 new 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. We might see

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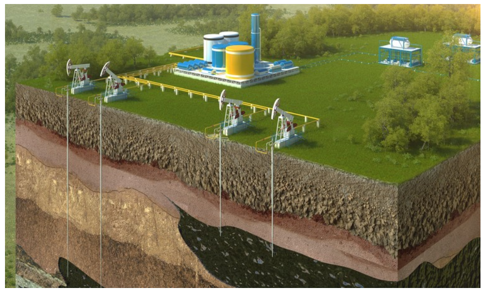
Russia, or some other oil-dependent country, spiral into a crisis, or default on loans made to the rest of the world. You also might see entire industries put out of business, like shale oil production which has been a huge positive for the American economy in recent years. At the very least, our gigantic oil companies are going to dramatically cut their spending, which will hurt. But the benefits of cheap oil probably outweigh the scary stuff. So I'm going to cross my fingers and be happy about it.

The part I find interesting is what caused the drop in the first place. It comes down to three things: The dollar is rising, there's a lack of demand for oil, and a glut of supply. Let's start with the rising dollar, which is the most boring part of this. As the value of our American dollar increases, it can buy more stuff. The effect of that is we can buy more oil for the same dollar. Most of the analysts I've read attribute about 20% of oil's drop to the rising dollar. Let's move on to the more interesting stuff.

Everyone knows the law of supply and demand. But oil is an odd beast, because for so long, OPEC (which is a cartel of oil producers from across the globe) would use supply and demand to artificially manipulate the price of oil in a way that would get you thrown in jail in America. But OPEC doesn't cast quite the same shadow over the oil markets anymore. A big reason for that is the huge jump in oil production from non-traditional oil producing countries.



America, Canada, and countries all over the world are using new technologies (like fracking) to suck out oil from places we used to think were completely inaccessible. That has led to a big increase in the supply of oil across the globe. But this trend has been going on for years, so why are we just now seeing prices fall? There's got to be more to it.

Remember the weak global economy? When the economy is humming, there's more manufacturing, shipping, shopping, and consumption. All of those things increase demand for oil. But the opposite is true too – a weak global economy means much less demand for energy of all types. And that brings us to the two-pronged answer: There's a big supply of oil out there, and not as many people who want to buy it.

In normal times, OPEC would cut their supply, which would help prices stay higher. After all, if you have something to sell, you'd rather have a high price, right? But these aren't normal times. Remember all that modern, high-tech fracking stuff we're doing here in America? Here's the problem with it: It's expensive. Fracking can cost anywhere from $60 to $80 per barrel just to produce. So if oil is only selling for $50, fracking companies have a very big problem. And this is where this whole thing starts to get interesting: Are the world's oil producers purposely keeping prices low as a way to take out their new competition?

Saudi Arabia is still the major player in oil, and they have essentially admitted as much. They aren't cutting the supply of oil because they WANT prices to be low. Imagine you're a fracking company in America trying to convince investors or bankers to throw money at you. That's going to be a pretty hard sell if you're likely to lose money on every drop of oil you produce. So Saudi Arabia has opportunistically used the current lack of demand for oil to knock its competitors out of business. But Saudi Arabia may have even more to gain from low oil prices. The Russian economy relies very heavily on exporting oil, and this drop in prices has sent their economy into a legitimate crisis. As it turns out, Saudi Arabia would like Russian support in Syria and against Iran. As Russia gets more desperate, perhaps they'll be more willing to help Saudi Arabia in Syria and Iran, if Saudi Arabia is willing to allow oil prices to rise back up.

So Saudi Arabia is using low oil prices to push the world away from new oil technologies, and encourage Russia to play nicer… It's shrewd, it's bold, and I'm not convinced it will work. Lower oil prices hurt all oil producers, including Saudi Arabia. So who can hold out the longest? Regardless of who ultimately wins, this "war" will hurt both sides. In the meantime, let's just sit back and appreciate these low gas prices.

Probably a Mountain or a lake

Here are two more photos from one of my favorite days in the mountains. These were taken up the Icicle in the Ladies Pass area.

This is the view from amazing viewpoint at the end of the Chatter Creek Trail. You can see Ladies Peak, Cape Horn and Snowgrass Mountain.

This is Lake Edna. In the background to the left is Big Jim Mountain, which is very recognizable from nearly anywhere in the Wenatchee Valley. What an amazing place we live in.

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