Financial Wanderings

March 2015

A masterful examination of the previous month's financial events, written by Brad Blackburn, CFP ®

(and made even awesomer by Andrea Dickerson)

Brad Blackburn, CFP ®

Financial Advisor
Blackburn Financial
121 Cottage Ave.
Cashmere, WA 98815

509-782-2600

brad@blackburnfinancial.net

2015 Market Numbers:

S&P 500: -1.76% to 2,068

NASDAQ: -1.29% to 4,901

DJIA: -1.96% to 17,776

10-Year Treasury Yield: -3% to 1.94

Gold: -2.47% to $1,183/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?

At the start of this year, I wrote the following words:

Given that stocks are up more than 40% over the last two years, and the global economy is a mess, my official 2015 prediction for the markets is this: Zero. I expect a year of pushing, pulling, and grinding our way to the same place we are now.

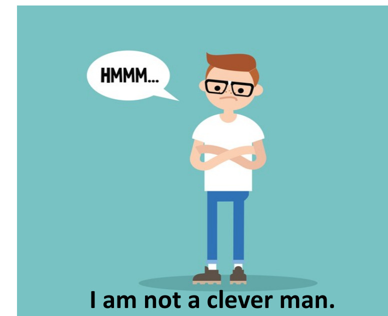
The technical term for what the stock market has done since that prediction is "up*down*up*down*up*down*." For those of you who aren't familiar with sophisticated financial jargon, that means my prediction has been exactly right. But it's only been three months. It's not that big of a big deal.

The economy

A couple years ago, while much of the economy was warming up, jobs and real estate were still painfully weak.

Today, it's the opposite story. Jobs and real estate are still strong, but nearly everything else has been weak: Consumer spending, manufacturing, factory orders, durable goods, car sales, corporate earnings, retail sales, construction and more. The economy is definitely slowing down a little.

Just like last year, lots of smart people are blaming bad weather as the primary culprit – and just like last year, I'm not completely buying it. I hope I'm just as completely wrong as I was last year.



My guess is this weak spot is being caused by a combination of things: The weather, the rising dollar, the Fed, the weak global economy, etc. 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.

(Cont'd on Page 2)

The Fed isn't "patient"

If there's a silver lining in the weak economic news, it's that it puts less pressure on the Fed to raise rates. As I've discussed over and over again, the markets are deeply in love with low interest rates. I think that's short-term thinking. I'd like to see the Fed raise rates right now, even if it does slow the economy down a little bit. The longer we are at rock-bottom interest rates, the more risk there is over the long-term. I also want the Fed to have some ammunition should another crisis occur. You can't lower rates any lower than they are now.

However, Fed Chairman Janet Yellen doesn't read my newsletter; she just looks at the pictures. So the Fed is clearly on a course to raise rates very slowly, and calm the markets at every step. Here's how careful the Fed needs to be: For months, the big question about the Fed was when they'd take the word "patient" out of their official policy (i.e., they'd be "patient" about raising rates). In March it happened – the Fed finally took out the word panic. However, to soothe the markets, the Fed added that they'll need "further" economic improvement before they'll raise rates. That made the markets purr like a little kitty cat.

Despite the gentle words from the Fed, the markets are still nervous about the Fed. I think Goldman Sachs analysts Noah Weisberger and Aleksandar Timcenko summed the situation up very clearly when they said: *"The winds have shifted with a looming U.S. tightening as the current source of market disquiet."* However, they also said *"the tightening will ultimately prove benign, though perhaps after some period of 'indigestion'."*

No, I didn't make up that quote. There are people who actually talk like that. No wonder you're reading this newsletter.

The dollar is going up

All across the world, investors are scrambling to put their money in America. That's odd, because America is pretty messed up. However, as big as our problems are, compared to the rest of the world, we look pretty handsome.

America

The Rest of The World

The dollar is going up for all the right reasons. But it's not all good news. Anytime something as important as the dollar fluctuates so much, it's unsettling. It's hard to do business globally if you have no idea what the value of the dollar will be. But the biggest problem with the rising dollar is that it makes American products more expensive to the world. That hurts profits, which hurts stocks, which hurts my clients. On the other hand, if the rising dollar slows the economy, the Fed won't have to raise rates as quickly, which would help stocks, which would help my clients. I'm tired of talking about the Fed.

Earnings

As much as I enjoy talking about the big economic picture, the stock market is about corporations earning money. That leaves us with a problem. Because according to the recent GDP report, corporate profits fell in the 4th quarter for the first time since 2008. A big reason for that is oil companies aren't making nearly as much money. But earnings are definitely slowing down across the board.

That's a big deal because stocks are already a little bit overvalued. If earnings start to fall, either stocks will fall right along with them – or we'll find ourselves in an even bigger bubble.

Oil and consumers

Over the last few months, the price of oil fluctuated between $45 and $55 per barrel. I think we can expect more of this in the coming months and years. However, if there's one thing that will make that prediction wrong, it's the fact that the Middle East is getting even more messed up.

I know, it's hard to believe.

In addition to ISIS, Syria, Israel-Iran, and everything else, now Yemen has become a war zone between Iran and Saudi Arabia. Only in the Middle East could America end up fighting on the same side with Iran against ISIS, but against Iran in Yemen, and also negotiating a nuclear deal with them. The world makes my head spin sometimes.

(Cont'd on Page 3)

Why'd it do what it did?......Cont'd from page 2)

At least we can count on low gas prices helping consumers spend more, right? Unfortunately, that's not happening yet. Retail sales have fallen for three straight months, and consumer spending has stalled. That's terrible news, right? Maybe not…

What if Americans were saving money rather than buying more stuff? As it turns out, they are. The savings rate has risen for the last three months. That's great news. I want my consumers to have nice little nest eggs.

So what should you make of all this?

This market is in a dramatic game of tug-o-war. Since the start of December, the markets are essentially flat. However, over that time, we've seen at least four big market swings. I think more of this is exactly what to expect. Neither side is winning this tug-o-war anytime soon.

Do You Remember That Time When America's Credit Was Downgraded?

It's the whole point of a credit score: The worse your score, the higher interest rate you'll pay. So, after Standard & Poor's downgraded America's credit rating back in 2011, you would have expected rates to shoot up. Instead, the exact opposite happened: The 10-Year US Treasury yield has dropped from 2.58% before the downgrade, all the way to 1.94% at the time I'm writing this.

Many things impact whether interest rates rise or fall, but it's clear the markets don't give a hoot what Standard & Poor's thinks. Come to think of it, in light of America's growing economy and strong stock market, S&P looks pretty silly. That has to be embarrassing.

Corporations Still Have Gobs of Cash

For years, one of the things that excited me most about the potential of our economy was the giant amount of cash sitting on corporate balance sheets. My rationale was that someday all that cash would start to trickle into the economy. A little bit here and there to hire more employees, or buy new machinery, or upgrade software… And then that snowballs into even more jobs, and more money, and more investment – and world is a happy place.

That's how this Capitalism thing is supposed to work.

But it hasn't happened yet. The economy is growing solidly, but all that cash is still sitting there. According to FactSet, corporate cash piled up to $1.4 trillion dollars at the end of 2014. That means there is still a huge ball of economic potential just sitting there waiting to be put to work. In fact, if you assume money has feelings, this becomes a question of social justice. I firmly believe every dollar bill should have a chance to reach its full potential. This is just one more way the corporate world is stomping on morality.

If all that wonderful money started to pour into the economy, we could be talking about a legitimate economic boom. But it's not happening. So why is all that money sitting around doing nothing? Can't our corporations come up with a better use for money than sticking it in a piggybank? I see two key things going on here:

1. Earnings are still near all-time highs, which mean corporations have plenty of money to throw at their best ideas. If businesses are able to fully fund their best ideas and have money left over after that, it's not such a bad thing. I don't want my businesses throwing money at stuff when there's no clear economic benefit. That's the job of government.

2. Just like most of the people I talk to, businesses are still scared. Having a giant pillow full of cash to help you sleep at night is not such a bad thing.

I'm not sure all that money will ever start to pour into the economy like I'd hoped. At the very least, it'll be a great cushion for the corporate world the next time they drive

This World Has Never Seen Rising Interest Rates

Way back in July 1981, nearly 34 years ago, the 30-year US Government Treasury Bond yielded nearly 14%. Although I was only 5 years old, I realized this was a once-in-a-lifetime opportunity, so I promptly recommended that all my clients buy those bonds. What followed was a wonderful period of low risk and huge returns for my clients. I'm glad I was such a smart kid.

Amazingly, rates have been going down ever since. But the fun is going to end sometime. A solid argument can be made that much of the amazing economic progress we've made over the last 30+ years is simply because the world discovered the wonder of borrowing money at increasingly low interest rates. It's true that borrowing money at low rates provides a strong economic jolt – the problem is, it's only temporary.

What happens to all that debt when interest rates start to slowly drift up? What will we do without that constant economic push? The world is a very different place than it was the last time rates rose for any extended amount of time.

I'm just happy policy makers across the world aren't racking up huge amounts of debt and wildly manipulating interest rates and currencies. That could really set things up for a potential calamity.

Don't get all scared – I'm not really predicting that rising interest rates will doom the global economy to decades of recession. But it's worth noting that in the coming years, we won't have plunging interest rates to grease the wheels of the global economy.

Any opinions are those of Brad Blackburn and not necessarily those of TradePMR or First Clearing. Any information is not a complete summary of all data necessary for making an investment decision and does not constitute a recommendation. Past performance may not be indicative of future results. The information contained in this report does not purport to be a complete description of the securities, markets or developments referred to in this material. The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete. The S&P 500 is an unmanaged index of 500 widely held stocks that's generally considered representative of the U.S. stock market. The Dow Jones Industrial Average (DJIA), commonly known as "The Dow," is an index representing 30 stocks of companies maintained and reviewed by the editors of the Wall Street Journal. The NASDAQ Composite Index is an unmanaged index of securities traded on the NASDAQ system.

If you would like to receive this newsletter via email, please email me at brad@blackburnfinancial.net.