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John Dessauer's market review and update as of Wednesday February 10, 2016.

For the last 75 years, almost every economic crisis has been preceded by an oil price spike. With oil down you would expect economists and investors to be celebrating, anticipating stronger economic growth. Instead, economists are talking about a possible global recession and stocks around the world have fallen sharply. The reason for the growing pessimism is fear that low oil prices are doing more harm than good and are pushing the global economy into a tailspin. That is why stocks go down every time oil prices fall below $30 a barrel. Breaking this pessimism requires either a bottoming for oil or clear evidence that the benefits for consumers are greater than the pain from cut backs in the energy sector. Fortunately, both are likely to develop this quarter.

The current economic pain from low oil prices is greater than expected for several reasons. First, low oil prices have prompted companies to cancel dozens of capital-intensive projects -- like drilling wells -- which in turn means lower demand for machinery. Wood Mackenzie Ltd., an industry consultant, estimates that at least $380 billion has been put on hold. IHS Inc. puts it at as much as $1.5 trillion. Whatever the amount, the IMF says the impact on investment in oil and gas projects is "subtracting from global aggregate demand." The good news in this report is that low oil is finally having an impact on physical activity. For months there was little change in oil exploration and production. Falling oil initially had a financial impact, but did not cause a cut back in exploration and production. That is a major part of the reason oil prices kept

falling. Supplies of oil kept growing, feeding fears of still lower oil prices. Now we are seeing physical changes as company after company announces cuts in capital spending on energy related projects. This means the *supply* of oil will finally stop growing faster than *demand*. Bob Dudley, CEO of BP, has good reasons for his prediction that oil prices will bottom out this quarter.

Second, the world's economy relies far more today on emerging economies than it did 15 or 25 years ago -- the last periods of ultra-low oil prices. In another twist, the U.S. has emerged to vie with Saudi Arabia and Russia as the world's biggest oil producer. In the past, the harm done to exporters was more than offset by importers' gains. And, with the exception of China and India, most big emerging economies are oil and commodities rich. Those economies now account for about 40 percent of global gross domestic product, about double their share in 1990, according to the International Monetary Fund. From Russia to Saudi Arabia, Nigeria to Brazil, economic growth is slowing down to a crawl and, in many cases, is contracting. The pessimists use this data to support their dire forecasts of a coming global recession. But, what the pessimists are missing is that these oil and commodity rich economies were growing at the expense of the developed economies that were buying their natural resources. Our political leaders have severely criticized China for relying on exports to the United States. They rightly point out that American jobs were lost to Chinese competition. In other words, some part of China's remarkable period of double digit growth was at the expense of the United States and other importers of Chinese manufactured goods. China is now in transition, reducing dependence on exports and increasing domestic consumption. Analysts at Morgan Stanley call this change a "rebalancing" of global growth. The same can be said

of the consequences of low oil prices. Oil consumers are gaining while oil producers are losing.

Some understand the full consequences of the oil rebalancing. They do not worry about a global recession. The U.S. Federal Reserve Bank of Dallas, in a research paper released in January, said that a drop in oil prices brought about by rising supply -- like the current one -- should boost global growth by up to 0.4 percentage points. “This is mainly due to an increase in spending by oil-importing countries, which exceeds the decline in expenditure by oil exporters,” the paper said.

According to BlackRock Inc. Chief Executive Officer Laurence D. Fink, the market is focusing on the short-term adjustments and ignoring the potential gains, “The reality is 4 billion human beings are going to have cheaper energy, cheaper heating, they’re going to have more disposable income,” Fink said last month. “And ultimately that’s going to re-accelerate the global economy. It may take six months, it may take a year, but this is all good.”

Francisco Blanch, commodities analyst at Bank of America Merrill Lynch, argued that a sustained oil price plunge "will push back $3 trillion a year from oil producers to global consumers, setting the stage for one of the largest transfers of wealth in human history." So far, though, consumers in developed countries aren’t behaving as they have in the past: spending the windfall from cheaper energy. This time around, “the pickup in consumption in oil importers has so far been somewhat weaker than evidence from past episodes of oil price declines would have suggested,” the IMF said in January. The reason: cash-strapped consumers are using the savings to repay debts. JPMorgan Chase &

Co. economists estimate U.S. households, for example, so far have spent less than half their additional cash. No doubt the caution is due to uncertainty about future wages, too many part time jobs, and rising costs for basics such as health insurance. These concerns are not going to vanish overnight. The U.S. economy is not going to go from slow growth to a boom this year or next. But the data, especially about the U.S. labor market, point to better times ahead. Stocks fell after news that the U.S. created only 151,000 new jobs in January. Economists were expecting 175,000 or 180,000. However, the details say the stock market went in the wrong direction. For the first time since labor market data have been collected, total U.S. employment topped 150 million in January. The shortfall from January expectations was due to post holiday changes. For example, 15,000 courier jobs were lost. In addition there were other quirks in the data that indicate a strong job creation month in January. Even better was news that wages rose at an annual rate of 2.5%. I have already written about rising wages at Wal-Mart, which will likely be followed by others. Now we have government data supporting that conclusion.

Last week some NASDAQ-listed high flying stock prices came tumbling down. Their fall from grace dragged some of the solid technology stocks down as well. The fall in the high flyers is healthy. Stocks trading at extremely high valuations are always vulnerable. They may grow sales and earnings at high rates for a while, but eventually those rates come down. I see the fall in the high flyers as overdue and healthy for the overall stock market.

I will have the next market review and update for you one week from today on Wednesday February 17, 2016.

All the best,

John Dessauer

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