# John Dessauer Investments, Inc.

www.johndessauerinvestments.com

**John Dessauer's market review and update as of Wednesday October 7, 2015**

**The disappointing September jobs report is all about the plunge in the oil price. The ex-energy underlying economy is no stronger or weaker than it has been the past couple of years. What's amazing is that so many experts do not seem to remember the role of energy in job creation during this recovery.**

There were 142,000 new non-farm jobs created in the United States in September. Economists expected more than 200,000. Worse, the figures for job creation in August were revised down by 37,000 and July was revised down by 22,000. Last year, between January and September the average monthly job creation number was 238,000. This year the average is down to 198,000 and sinking. Economists and media pundits are blaming the slump in job creation on slowing growth in China and turmoil in the global economy. To be sure those are factors, but the bigger factor is the steep decline in the price of oil.

Remember that 86% of the new jobs created during the recovery before the oil price collapsed were in two states, Texas and North Dakota. Oil and gas exploration and production was the driver behind all those new jobs. With the oil price now $45-$50 a barrel, there has been a dramatic reduction in energy exploration activity. Oil and gas exploration is no longer a source of new job creation.

The U.S. labor market is and always has been very dynamic. Every month millions of jobs are lost and millions of new jobs are created. The monthly labor department report is the net result of all the changes. Because of the complexity of the U.S. labor market, it is difficult for economists to pinpoint the reason for disappointing

numbers. However, when you step back and simply ask what major changes have there been over the last year the oil price collapse stands out. In my opinion there is no need to search for explanations such as slowing growth in China or turmoil in the global economy. They have an impact on jobs in the United States, but it is minor compared with impact from the oil price collapse. What we are seeing in the monthly jobs report is the U.S. labor market without the boost from energy exploration. In other words the economy without energy exploration was creating far fewer new jobs than many realized. No wonder the labor participation rate is so low. No wonder the underemployment rate is so high.

The good news is that the recovery is still limping along as it has been for the last several years. The disappointing September jobs report does not mean the U.S. economy is sliding back towards another recession. It simply means we are no longer creating large numbers of new jobs in the oil and gas exploration business.

**Americans are not the only ones selling stocks and bonds.**

Over the last six months Saudi Arabia has withdrawn as much as $70 billion from global asset managers. Saudi Arabia is selling to cut its widening deficit and to finance the war in Yemen. The 50% fall in the oil price has slashed the Kingdom's revenue and opened up a huge government deficit. Saudi Arabia's foreign exchange reserves fell from a peak of $737 billion in August 2014 to $661 billion in July 2015. This should not be a surprise to anyone. Proceeds from oil sales are the main source of revenue (90%) for the Saudi government. Saudi selling is the direct result of the fall in the oil price. The selling won't go on forever. The oil price will stabilize. The world still relies on oil and natural gas for most of its energy needs. There is a sizeable basic demand for oil and gas.

Supplies are reacting to the price decline. New exploration has been cut and existing production is being downsized to be more on line with demand. In coming months the oil market will be back in balance and the oil price will stabilize. After that the selling pressure from Saudi Arabia will diminish.

**Dow 20,000 still possible in 2016**

Wharton School Professor Jeremy Siegel appeared on CNBC last week, explained why he sees the Dow Jones Industrial Average climbing to 20,000 next year. He spoke about the "earnings recession." Pessimists use that term to describe two back-to-back quarters when the earnings for the S&P 500 index decline. Third quarter S&P earnings are expected to be down and analysts think the same will be true for the fourth quarter. The steep decline in energy prices is the primary reason S&P earnings will be down. When energy related companies are excluded, earnings for the remaining companies are growing - up almost 4% for the third quarter, according to analysts' current estimates. Professor Siegel explained that when energy company earnings stabilize, the drag on the S&P 500 will be gone. He thinks by the first quarter of next year the earnings recession will be over and S&P earnings will be growing again. For all of 2016 he says earnings growth of 8% is achievable. That is why he sees a full recovery followed by new highs in the coming twelve months.

**Professor Siegel is not alone. Morgan Stanley also sees opportunity in stocks**

"The global economy has expanded for six years, compared with a post-1974 average expansion of 6.2 years. If growth and animal spirits are rolling over, recent market weakness is only a taste of what could lie ahead. We think, however, that this cycle has further to go. First, we find the idea that the expansion is in danger because of

how long it lasted unconvincing. Growth in this cycle has been unusually muted and unsynchronized across regions, at times hobbled by legacies of the worst financial crisis since the 1930s. This recovery has battled unusually tight fiscal policy and credit conditions on its way toward normalization. It seems reasonable that it will take longer than normal to overheat, in our view." (Morgan Stanley, *On The Markets,* October 2015)

And, the team at Morgan Stanley is honest. "Much has changed since mid-August but, even after lowering our targets, we have a positive bull-bear tilt and strong upside to our base cases. **We did not anticipate the correction**, but we think that it creates opportunities." (Emphasis added)

The new Morgan Stanley twelve month target for the S&P 500 stock index is 2,200, 14.5% better than the close on September 30. That might not seem very attractive after the bigger gains in the years following the recession of 2008, but twelve months from now a 14.5% capital gain plus dividends is likely to be very satisfying. It certainly will be better than holding cash, and better than bonds as well.

I will have the next market review and update for you one week from today on Wednesday October 14, 2015.

All the best,

John Dessauer

©October 2015