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John Dessauer's market review and update as of Wednesday October 21, 2015

It is still early, but there are signs the U.S. economy is benefiting from low cost energy. There also are signs that the downward pull from the oil price collapse is easing. Better yet, the benefits from low cost energy will be long lasting.

"Household spending climbed more than forecast in August, and incomes also rose, as the biggest part of the U.S. economy continued to power past a global slowdown." (Bloomberg news)

The Commerce Department revised July consumer spending upwards to a 0.4% gain and the initial figure for August also was a plus 0.4%. For the third quarter, U.S. consumer spending rose at a 3.6% annual rate. Economists attribute the strength in consumer spending to cheaper gasoline prices. Consumers account for roughly two-thirds of the U.S. economy. Thanks to American innovation - fracking in particular - oil prices have collapsed and American consumers are enjoying the benefit every time they fill up at the gas station.

Because the oil price collapse is recent, some economic data are weak. But that will change as the oil market stabilizes. For example, the Commerce Department reported that U.S. retail sales barely rose at all in September. However, the September sales figure was weighed down by declines in gasoline service station receipts. Likewise, there are reports of declines in business investment as oil companies cut back on oil exploration. This weighs on measures of U.S. industrial production.

With so much confusing economic data it is easy to lose sight of the long term effect of the collapse in oil prices, and the shift in oil-based power from the Middle East - Saudi Arabia in particular - back to the United States: Texas, North Dakota and the fracking states in particular. We suffered for decades after oil prices soared in the 1960s and 1970s. Now we can look forward to at least a decade, probably more, of lower cost energy and American oil independence.

To be sure there are many significant near term concerns. China's growth rate is slowing – it's down to 6.9% in the third quarter. Oil and commodity based emerging economies are suffering. In the U.S. there are too few pockets of prosperity and too many still looking for full time work at a decent wage. Add the recent stock market volatility and it becomes easy to fall prey to the pessimists' gloomy forecasts. But it seems there are always those who see the future as foreboding and dangerous. Pessimism always sells better than optimism. At every stock market low the optimists are ridiculed and the "I told you so" pessimists celebrate. When stocks recover, and so many people have lost because they followed the "sell all stocks now" advice, the pessimists' response is always, "don't worry, stocks are overvalued and headed lower."

There was a long period when the pessimists prospered. That was from 1965 to 1982. During those seventeen years the Dow Jones Industrial Average was not able to climb above 1,000. The Dow first reached 1,000 around year end 1965. In the 1970s there were a series of serious downdrafts followed by recoveries that ended at the 1,000 level. The major fundamental economic development that coincides with the seventeen dismal stock market years was the shift in oil pricing and power. By the mid-1960s, American domestic oil production could no longer satisfy the growing U.S. demand.

Saudi Arabia and neighbors in the Middle East became the power brokers in oil. What followed was a long period of economic pain in the United States. The reason the U.S. abandoned the gold standard in the early 1970s was because Middle Eastern oil producers wanted gold, not paper money. The destructive inflation of the 1970s was caused by a spike in the oil price. During those dismal years - and for decades after - it was widely believed the world was running out of oil, and that the U.S. in particular was permanently at the mercy of foreign oil producers. The idea that in 2014 the U.S. would be producing light crude oil in massive quantities was not even considered, and had anyone proposed it, they would have been ridiculed.

Things were very different when the U.S. had plenty of affordable oil. From 1950 to 1965 the Dow Jones Industrial Average rose from 200 to 1,000. Those were the post war years when Texas was the world oil power and the U.S. was pumping all the oil it needed. In those years, affordable oil from domestic sources was taken for granted. The U.S. economy prospered and no one thought about far away desert kingdoms. The point of this look-back is to show that oil has been a major force in the U.S. economy and stock market for a very long time. The combination of lower oil prices and ample domestic supplies is a game changer for the better. Will the Dow Jones Industrial Average follow the post war pattern and multiply by five in the next fifteen years? There is no way of knowing. All we can know right now is that oil is no longer a threat to our economy or the stock market. On the contrary - it is a major positive. Over the next few years we will see the benefits in stronger economic growth and more prosperous consumers. The odds are, in this new oil environment, that the Dow Jones Industrial Average will go *up* more than *down*. Professor Jeremy Siegel's forecast of Dow 20,000 is likely to be just the beginning as the benefits from affordable domestic oil emerge.

I said the U.S. economy looks like the first to show the benefits from lower oil prices. That is largely because gasoline plays a larger role in American consumer budgets. In addition, governments in Europe place heavy taxes on gasoline. Those taxes don't change when oil prices fluctuate. Europeans, therefore, are not enjoying the same budget relief as Americans. But, the benefits of low oil are far reaching. Lower gasoline prices will be followed by lower heating costs, lower electricity costs, and lower costs of producing goods and services. Lower oil, even in this still difficult post 2008 recovery, will likely be enough to boost overall U.S. economic growth above 3%, and help other oil consuming economies, including China.

Our best strategy is to ignore the pessimists. Owning stocks in quality companies is the best investment choice.

More bad news for the pessimists:

"Globally, the cereal harvest this year will be very close to last year's huge record. The Food and Agriculture Organization's food price index is now well below where it was throughout the 1960s and 1970s: that is to say, It's proving cheaper and easier to feed seven billion today that it was to feed three billion in 1960. According to the eco-gloomsters who had talked for decades about a coming food crisis, this was not supposed to happen." Professor Mark Perry's blog Carpe Diem

I will have the next market review and update for you one week from today on Wednesday October 28, 2015.

All the best,

John Dessauer