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Market continues upward march

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The United States economy is strengthening.

November is historically one of the best months in the year for equities, and U.S. equity markets continued their upward trend in November. The broad market index, the S&P, gained 2.48 percent for the month while the Dow gained 2.52 percent.

Consumer prices held steady. The gross domestic product for the third quarter was revised upward from 3.5 percent to 3.9 percent. The GDP growth for the period from April to September was the strongest for a six-month period since 2003. This growth indicates that the U.S. economy is growing into the year-end shopping season. However, consumer confidence slipped from an estimate of 96.5 percent to 88.7 percent. Most of this seems to be because of downbeat job prospects.

Furthermore, the Chicago Purchasing Manager Index showed an unexpected decline of 8.1 percent while the Philadelphia Fed manufacturing index reached its highest level since 1993.

Oil prices continued their decline as oil traded as low as $66 per barrel. Oil prices are down in part because of more output in the United States from fracking, and because of reduced demand and the strong dollar. Oil prices are inversely related to dollar strength or weakness because oil contracts are typically priced in dollars. (There have been brief efforts to price in other currencies, to no avail).

An OPEC meeting to manage the price decline did not produce an agreement because Saudi Arabia said it would not reduce production. Since there is an oversupply of oil in the world combined with softening demand, we can expect the price of oil to continue under pressure.

In the past, Saudi Arabia, which accounts for about 30 percent of oil production, would vary its output depending on prices. However, with the increase in supply from U.S. fracking, which Saudi Arabia sees a threat to its long-term hegemony, it has decided to let prices float down in an effort to break the U.S. frackers. The strategy could be successful – at least against the weaker U.S. producers.

However, other countries are being negatively affected too. Russia claimed that it wasn't bothered by lower oil prices; however, the ruble fell 11.3 percent against the dollar last week and traded at a record low against the dollar. Venezuela, nearly broke as a country, needs higher prices.

Energy Investment Bank, Tudor, Pickering and Holt said that with oil at $70 a barrel or lower, no basin is safe. Also affected were suppliers such as Schlumberger, railroads such as Union Pacific, and the Canadian rails. Exploration and development will be negatively affected, so capital spending and employment can be expected to decline.

Factors that could cause oil prices to increase would be reduction in production in the Middle East. A severe winter could also influence prices. So, while there are imponderables, the likely scenario is low (in relative terms) oil prices.

Lower oil prices benefit consumers who see their purchasing power increase because of the reduced price of gasoline and heating oil. The drop in oil prices is like a $125 billion-dollar tax cut. Consumer spending has been revised upward to 2.2 percent growth – still a tepid number.

Lower oil prices could help the overall economy too, but the aforementioned consumer confidence numbers along with manufacturing numbers suggest some weakness is ahead. The improved GDP numbers are backward looking.

The stronger dollar is benefiting U.S. equity and fixed-income markets as money from overseas flows to the U.S. both to transfer assets to a stronger currency and because the U.S. economy is growing more than most economies.

Meanwhile, things are not so good for some of our trading partners. Japan has slipped back into recession as higher taxes have slowed its recovery. Prime Minister Abe has called for a snap election to deal with the problems. Abe and the central bank chair, normally friends, find themselves at odds.

China is showing signs of slowing and stress. The Chinese GDP has slowed to 7.3 percent from 11.9 percent in 2010. A high demand for cash because of IPOs and tax payments has raised the cost of borrowing. The Chinese central bank found it necessary to post a note on its website that liquidity in the banking system is ample. Also, the central bank made it easier for banks to loan to small business and agriculture.

The slowing Chinese economy has caused a slowdown in the rest of Asia. Australia has tumbled back into recession because of falling commodity prices owing to reduced Chinese demand. Other Asia economies have suffered too, notably Korea, Indonesia and India.

Europe is still in malaise. Germany has been the only bright spot, but even that glow has dimmed. The rest of Europe is in a funk. Fears of deflation haunt European central banks as consumer prices are at their lowest rate of increase this year. Only the U.K. is showing signs of life.

Russia and Ukraine still cast a pall over Eastern Europe, with Putin on his mission to make Russia a superpower again. Emerging markets are lackluster too.

We now head into December – historically the best month for U.S. equity markets. We expect the markets to do fine through the end of the year and into January; by then we will have a better picture of economic growth.

We will remain fully invested in a well-diversified portfolio.

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