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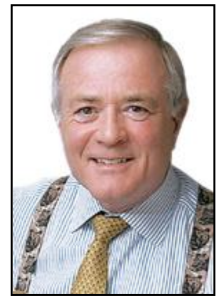

William Rutherford

Outlook for global economy's fourth quarter is mixed

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As we head into the fourth quarter of this year, the outlook is decidedly mixed. European bank worries, the Federal Reserve and interest rates, elections and corporate profits all weigh on the economy. After a long period of negative interest rates, the European economy is softening and its banks are struggling. The negative rates have hurt those most intended to benefit. Bank profits have fallen, interest yields have collapsed and European economies have suffered.

The most notable bank to suffer is Deutsche Bank, with over 100,000 employees and 1.6 trillion euros in assets. Long a bulwark of the German economy and itself a large investor in German companies, Deutsche Bank has seen its market capitalization plummet. Other banks have declined to do business with Deutsche Bank, and hedge fund managers are shorting the stock. Market value has dropped dramatically. Nor is Deutsche Bank alone: Commerzbank, Germany's number two bank, is laying off 10,000 workers, Greek banks have become penny stocks and Monte De Peschi, the oldest bank in the world, is barely surviving.

It is not just that Deutsche Bank is struggling, but that it represents great systemic risk – perhaps the biggest financial risk in the world right now, according to Christine Lagarde, head of the International Monetary Fund. The implications of a failure of Deutsche Bank extend throughout the world. In addition to Deutsche Bank's internal problems, the U.S. Department of Justice has threatened to fine the bank $14.5 billion. I lived and worked in Germany for many years; my office was there when I was CEO of Dresdner Bank's international Asset Management Company and again when I did the restructuring of Metallgesellschaft. Deutsche Bank was the largest creditor of Metallgesellschaft. I can guarantee you that no one would ever have imagined that Deutsche Bank would be in this situation.

German Chancellor Angela Merkel has thus far shown no sympathy for Deutsche Bank. She has taken a hard line. Elizabeth Warren would be proud of her. Merkel has refused to intervene in the DOJ dispute and promised no financial help to the stressed bank. In this approach she is supported by some of Germany's principal newspapers, such as Frankfurter Allgemeine and Suddeutsche Zeitung.

In the U.S., we have seen our economy struggle. Corporate profits have slumped again for U.S. companies; they're now expected to report an earnings decline for the sixth consecutive quarter. This stretch will be the longest period of consecutive earnings declines since this data point was first tracked. Much of the decline is due to the decline in oil prices, which was supposed to aid consumers. Even as oil prices have stabilized, they remain far below their 2014 highs and marginally below where they were a year ago.

Analysts predict that in 2017 revenue growth will return to S&P 500 companies for the first time since 2014, with nine of the 11 sectors showing growth and consumer discretionary leading the way. But profits overall will decline. Declining profits have not kept equities from reaching new highs. The gradual nature of the decline has comforted investors (but notably not the disgruntled voters of the Trump and Sanders camps).

In addition, easy money has enabled the markets to hit 15 fresh new highs. Investors are not too worried about fundamentals if the central bank supports equity prices. However, equity prices are trading at 19.7 times earnings as opposed to the 16 times earnings of the past decade. Stock prices are forward-looking, so maybe the economy will resume its growth in the fourth quarter. Normally bull markets don't die of old age, but rather are murdered by the Fed or some "accident." Could Deutsche Bank be that accident?

With companies struggling, it seems unlikely that a new administration can push through tax increases without a serious impact on the economy and jobs. Supporters of Measure 97 in Oregon should consider that impact here at home.

Volatility will continue, so be prepared for large swings in the market. As we approach the elections, market swings will become more exaggerated. The market hates uncertainty, so stocks will welcome the end of the election campaign and will root for stability in the new administration.

Remain invested in a diversified portfolio.

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