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Values-Centered Financial Planning
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Dear Friends,

First, as I usually begin, to allow you to save time from reading this whole tome, here is the conclusion: the financial markets are currently disconnected from the real economy. What is transpiring in the actual day to day activity of business and commerce is positive and growing slowly. Along with this, in our economy, is a significantly lower use of leverage or debt by businesses and individuals, very low inflation, very low interest rates, lower energy costs, lots of cash, a growing GDP, and an unemployment figure very close to breaking into the 4.00%'s. This very much feels like a market prediction of an economic downturn that is not coming. This prediction is like last night's confident pre-game predictions of the Panthers winning the Super Bowl. The Broncos didn't know that was supposed to be the outcome last night. The current economy doesn't know we are supposedly going into recession.

Energy
Yes, there are some real concerns. The stress in the energy sector, equity and debt, is having some ripple effect in the economy. And the decline of the energy sector will cause aggregate earning numbers to be lower for a while. Without the energy numbers, earnings are stable or up. The strength of the dollar will be a greater influence on earnings over time. That increase in strength is leveling off. Of course, we are also benefitting enormously from the lower energy prices. When energy (oil and gas) prices settle and perhaps begin to moderately increase, this effect will have been absorbed by the general economy and not have an undue influence on all the future earnings comparisons on which Wall St. fixates every 90 days. Unless producers simply produce an increasingly greater amount of oil for a long period of time, a new supply and demand balance (=price) will be reached.

China
And, yes, there is a slowdown in China. But it isn't what the doomsters relish as justification for preaching that the end is near. More on this for diehards and insomniacs below.

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Interest Rates

And yes, the phenomenon of negative interest rates is here. Like all hitherto "unthinkables," this concept/tool is now part of the modern central bank toolbox, albeit in a very defined and targeted application, intended to produce very specific results. But as counterintuitive as it seems, this isn't as simple as it is made out to be by those who want to use negative interest rates as another sign of imminent doom.

To be sure, none of these concerns is pleasant or a sign of a booming global economy. But they aren't the end of the economic world as we know it. That would have to come from geopolitical perils overcoming the economic self-interest that drives it all. What are the chances of that? Slim…unless, as Bob Dylan observed in an earlier pessimistic observation, "When you ain't got nothing, you got nothing to lose." There is only one country I can think of that has put itself in that situation by choice: North Korea.

So, yes, we are in one of those periods where the markets, which love drama as much as the financial press does, may be talking themselves into a tizzy, which will "miraculously" become positive and self-correcting later, after they frighten as many people as they can.

If the history of the financial markets isn't enough to demonstrate the power of human ingenuity, aspiration and creative labor, then ask the defining question: who benefitted more over the last hundred years-those who sold, or those that invested? Why do the Buffetts of the world buy when others are irrationally selling? No secret. If there is a secret it is in the discipline to continue to own and add to the shares of the great companies of the world through what is a known temporary market dynamic and not be enthralled by the sirens of doom who thrive on all the deliberately created drama. As has been said, by three far wiser financial wizards than I:

Sir John Templeton: "Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria." Anyone see any euphoria out there?

J.P Morgan (attributed): "In bear (down) markets, stocks return to their rightful owners." Those with vision.

Nick Murray: "A bear (down) market is a period of time during which people who think this time is different sell their common stocks – at prices that will never be seen again – to people who know that this time is never different." As my mother used to say, "In the land of the blind, the one eyed person is king/queen."

Even with all this market activity, the averages are still higher than they were during the selling that went on last August.

Now, for those with great endurance or, at least, curiosity, get a cup of coffee, tea or juice and a comfortable chair. Here's the rest:

If the markets were temporarily declining against a more worrisome economic picture, then it might be time to prepare for a greater or longer period of lower share prices and the opportunity to accumulate more ownership at lower prices. However, this is not the case and as the improving economic conditions continue, the selling now becomes the buying of the next phase of rising share prices. Thus it has always been for investors. The desire for economic growth remains greater than the temporary counter forces, including geo-political tensions. The growth forces are now largely global and inter-dependent. Few economies have the insulation that the U.S. economy has. We are largely self-sufficient and do not fundamentally depend on exports to sustain us. For example, only 0.9% of our exports are to China. This is a tremendous strength, which buffers us from the more turbulent dynamics of other economies. It is what China aspires to and into which it is attempting to transform. More on this and other counter forces at work, below.

The current selling in the financial markets has been unexpected, but not unusual. Selling periods like this happen fairly often, but are quickly pushed to the background of memory. We had one in 2011, 2012, 2014 and 2015. There is always something for speculators and traders to seize as the next “end of the world” scenario. These are simplistic minds confronting a complex and subtle economic realm of interpenetrating interests, comprising billions of decisions by billions of people every day.

And it wouldn’t be a marketplace without contrary opinions. It is by seizing and magnifying the areas of concern that traders and speculators, with the willing cooperation of the financial media, dominate the consciousness of those not willing to look deeper. One doesn’t have to look too deep to find all the positive and encouraging dynamics of the U.S. economy, the positive directions and unfolding patterns in the larger global economy. Most economic concerns are self-correcting. Few are long term changes in fundamental patterns. Those that are, are transformative, like the end of the Cold War. The end of the Cold War, as one example, unleashed a long pent up desire for the freedom to pursue one’s own economic, political and social destiny. The massive global shift this initiated is ongoing, with expected detours.

Given the daily deluge of opinions (and mere opinions) about the economy and financial markets, from myriad sources, which in most cases, aren’t worth the ink, paper, electrons or photons through which they travel, it is occasionally useful to review. Otherwise we are subject to losing the context and thread by which the circumstances of the moment reveal a meaning that can illuminate and inform our experience and give perspective to the otherwise swirling energy and forces of the money realm.

To better understand this moment we have to reach back to the last quarter of 2013. Yes, 2013. You may recall that there had been rapidly growing and intense speculation about when the Federal Reserve would end its “quantitative easing.” “QE,” as it has been called, was the program intended to inject huge amounts of capital/money into the banking system by buying billions of dollars of bonds each month. This program was a step beyond the already established “zero interest rate” policy. Largely, by using QE, the Fed expanded its balance sheet from about $800 Billion to $4+Trillion.

When the Fed announced that they intended to stop QE, the worrying began. “What’s next? Will the Fed start selling bonds, thereby pushing interest rates up? Will some measure of the sky begin to fall?” What the Fed did was to allow attrition to begin shrinking their massive ownership of bonds. They stopped buying and did not replace maturing bonds. This is still going on and has been a gradual process for two years. Subsequently, the speculation, which the Fed did not clearly dissipate, began about when the Fed would actually raise rates and at what pace. This went on for another year.

Markets dislike uncertainty (to put it mildly). For markets, better a piece of bad news known, even if it has to be made up, than uncertainty. The Fed itself was not giving clear guidance. Ben Bernanke was replaced by Janet Yellen. More uncertainty. Finally the Fed made it very clear that the first interest rate rise would take place in December 2015. Markets had endured two years of uncertainty. The initial reaction was positive, very briefly. After all, with markets addicted to fear and uncertainty, they couldn’t go cold turkey. So falling oil prices and China became the new objects of attachment. They still are.

Low energy prices have many effects. First, it is a good thing for anyone using traditional oil or gas: individuals and businesses. Even with the addition of alternative energy produced by solar or wind, the world still runs on oil. In fact, low oil and gas prices hamper the rationale for alternatives. The lower prices don’t lower the environmental benefits of alternatives, just the economic argument. As has been pointed out by Harold James in an article in “Project Syndicate,” this phenomenon has been named “The Green Paradox” by German economist Hans-Werner Sinn. As oil prices decline, more is produced to compensate for the lower price. So not only does the low oil price add resistance to the adoption of alternatives, but it causes even more oil to be produced.

Low energy prices also cause strain on producers who need higher prices to justify new production. We have seen the additional oil production in America scale back significantly in response to the price drop. This causes bankruptcies, bond defaults and layoffs. All of these are negative for the economy and the markets. In the current case, the negatives are not sufficient to undermine U.S. economic growth or the decline in unemployment, but they hurt.

Since the smaller energy companies often issue high yield bonds to finance their operations, the default on these obligations puts pressure on the high yield market. But the segment of that market that is concentrated in energy companies is limited and will not bleed into the banking sector, as did the implosion of the mortgage market, which was massive in 2008, in comparison to the energy market.

Also, lower energy prices have a huge beneficial effect on individuals and businesses. This benefit has not gotten much press. And we know that as a general principle, good news has much less impact than bad news. In fact, energy demand has been growing about 1.50% a year, even now. It is the supply, not the demand that is a significant part of the issue. This is very rarely acknowledged in the discussion.

Finally, China. China is going through an expected and well understood transition from a cheap labor, low cost manufacturer, to a higher cost, service based economy. Rising standards of living do that to a country. China now outsources manufacturing to Viet Nam, Malaysia, Myanmar and other Southeast Asian countries. Britain went through this in the 19th century, the U.S. went through this after WWII, Japan did as well. Remember when "made in Japan" was considered a badge of poor quality? South Korea has gone through this more recently and now produces luxury cars and high end electronics. Each of these countries took less time than its predecessor to transition from the cheap labor, low cost manufacturer to high end production of goods and services and to also transition from being virtually totally export dependent to greater internal consumption, as their own standards of living rose.

China is attempting to transition, in the shortest time ever, on the largest scale ever. 1.4 Billion people. China, growing at 6.90% on an $11 Trillion economy, produces a huge amount more economic activity than a China growing at 10.00% on a $4 Trillion economy. There is no surprise to this and it has been anticipated for a long time. The markets seem to act as if this is a surprise. It's like discovering gambling going on in Rick's Café Americain in Casablanca. I date myself.

Take the "ghost" cities of so much concern to the West just a few years ago. If you intended to move 300 million people from the countryside to the urban parts of the country, in a short period of time, would you build the cities AFTER they arrived or BEFORE they arrived? The imperative for China is to raise the standard of living for a billion people fast enough to offset the social unrest of the disruption and concentration of wealth in the coastal cities.

Oh, and don't forget that India is just now entering the acceleration process that China has experienced. India, with 1.2 billion people had a growth rate last quarter of 7.3%. Soon you will be hearing all about India, which McKinsey expects to not only surpass China in population, but in GDP by 2050.

And remember Africa, with 1 billion people. Africa is beginning a strong growth period.

The world, for better or worse, is in the earlier stage of this burgeoning materialism. Rising standards of living are happening all over the world. The task and responsibility is to accomplish this with care and attention to the Earth and each other. Humans are problem-creating creatures. We are also problem solvers. These important human, environmental and economic purposes are unfolding right before us. This is a multi-generational process. Those being born today will bring with them new ways of living with and for each other. One only has to contemplate the "blue dot" picture of Earth from Pluto, recently published, to be inspired by the magnitude of what is before us. With all the stress and strain of our current issues, there is the wonder of it all. That is impelling us to move ahead.

As the financier Bernard Baruch said, "Markets have a tendency to fluctuate." In the almost 38 years of my work in this realm, even with all the world's problems, we have accomplished a great deal. This selling period is part of the dynamic, not separate from it. And it too shall pass.

As ever, Here's to (Y)our Good Wealth!

Jerry!