Market Update: 1/13/2016
Written By: Douglas Ciocca

Good evening. Regretfully I am reaching out to you tonight at the conclusion of another difficult market day.

After moving higher the first couple days of this week, the US stock market gave back its gains and then a bit more during Wednesday's session.

I highlight the US above as they broke the global synchronicity which has recently included Asian and European markets since both of those regions finished higher on Wednesday.

Also, for the very first time in 2016, the price of a barrel of oil, (whose perpetual plunging has been stock market enemy #1 this year and last) actually rose 4 cents on the day.

It is then fair to ponder to what was today's drop attributable?

We think 4 things:

1. Selling by institutional funds that hold positions in commodities that were purchased w/ borrowed money. When the value of those commodities fell below a certain price, the fund managers are forced to sell holdings to pay back the borrowed money. Often, positions other than the commodities get sold as their value may be more stable/higher;
2. Concerns about US corporate earnings which begin in earnest this week;
3. A report from the Federal Reserve Bank known as the Beige Book, which could provide clues as to any policy action when they meet later this month and;
4. A firestorm of negative and cataclysmic prognostications that went viral overnight;

Let's look @ each briefly.

1. ***Forced Selling by funds that hold commodities.*** Below is an excerpt from ValueLine this morning that characterizes the general lack of a negative market catalyst up until the cash-raising necessitated by paying back securities loans, also known as margin loans:

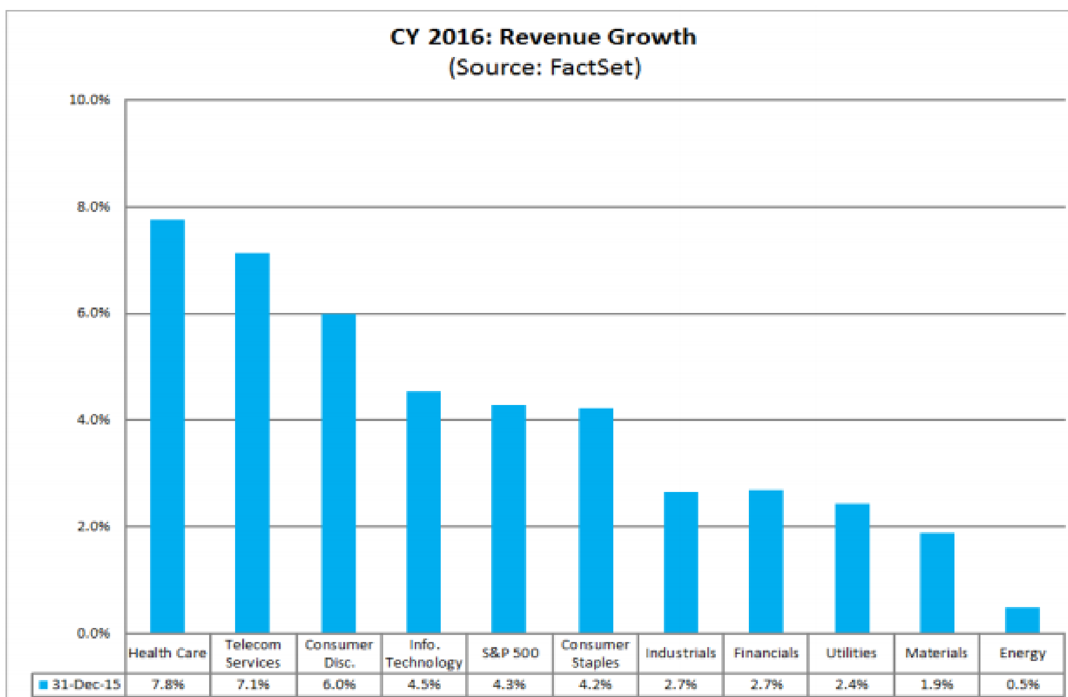
> *The lack of new headlines has created a trading vacuum, with all of the recent negative sentiment, most notably slowing growth in China and worries about that country's currency devaluation, depressed oil prices, concerns about Middle East, and worries about the credit markets, unnerving investors. The resultant outcome has been a global selloff and an environment where investors, expecting yet another shoe to fall, are hesitant to go on a bargain-hunting spree.*

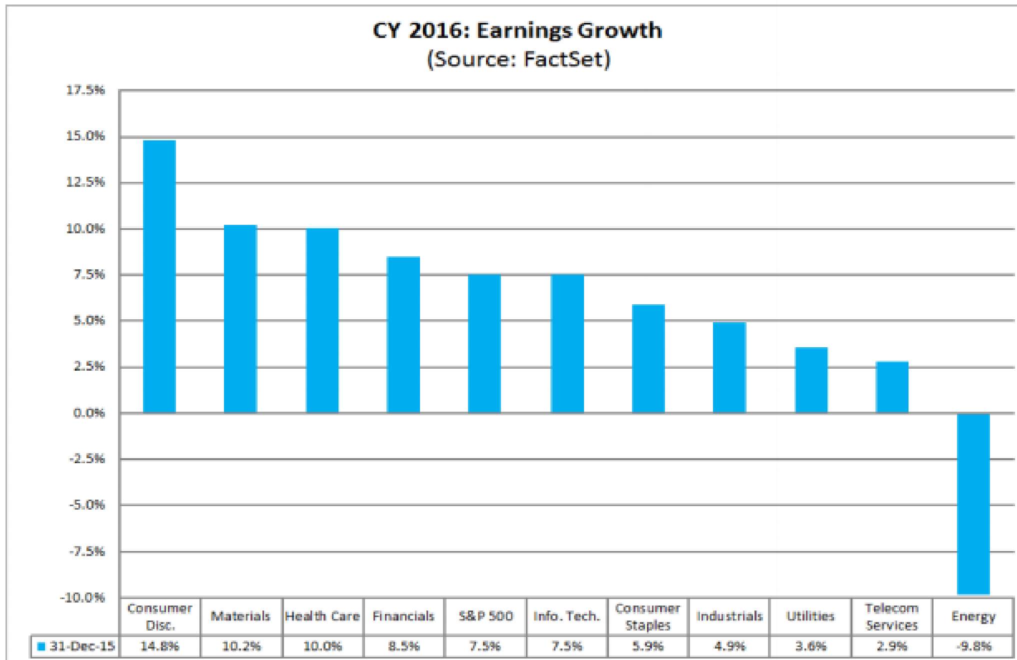
With regards to today's late-day sharp selloff, we think it was partly due to margin calls at the mutual funds, especially those with sizable positions in the commodities markets. Those funds may be facing a liquidity crunch from rapidly falling commodity prices that are forcing them to now dip into their equity holdings to meet their margin calls.

2. ***Concerns about US corporate earnings.*** Every 3 months, publicly-traded companies report their operating results from the prior quarter and offer an outlook on the upcoming quarter and often as far out as the next year.

   Such reporting by some of the largest companies begins this week. In the midst of a market gripped by such negative sentiment, it is natural for investors to express apprehension as to what they may hear from the companies in whom they own stock. Surprises and markets are not friends. Negative surprises and markets are mortal enemies. Certainly a way to avoid a negative surprise is to exit the position ahead of any such revelation.

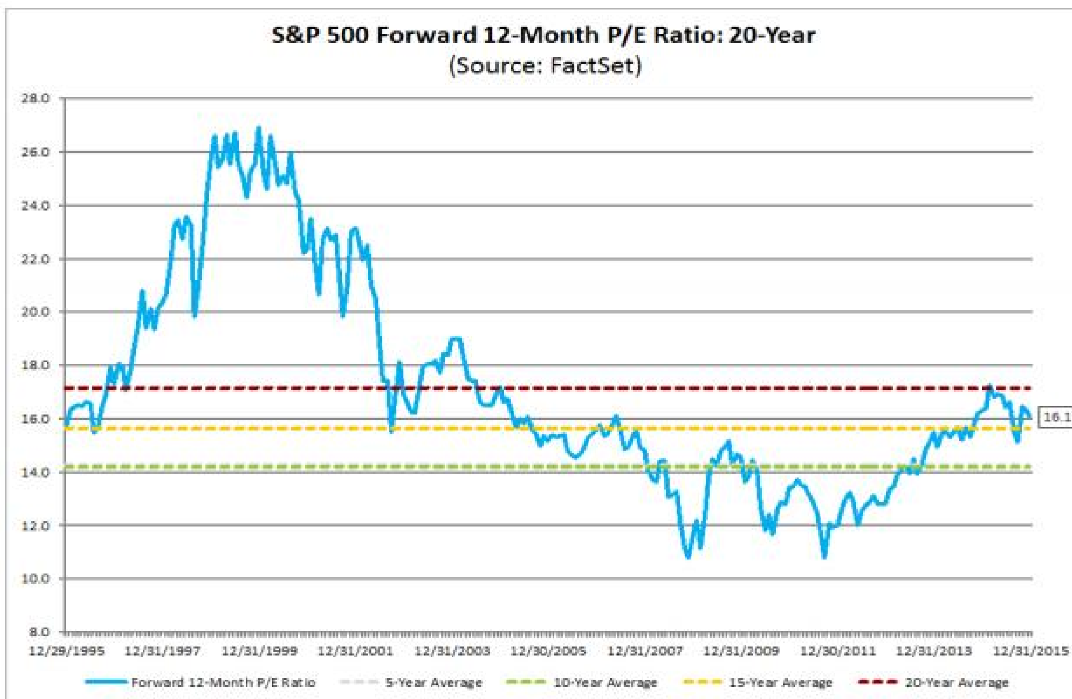
   While it would be impossible to discuss the fortunes of every specific impending report, we do offer a composite perspective on the broad market (S&P 500 Index) from FactSet that does paint a mildly positive picture on most all sectors - the lone exception being Energy. See below:





Pair those outlooks w/ a valuation of the S&P 500, using a standard price-to-earnings-ratio measurement (p/e ratio), which does not appear very expensive historically then perhaps the perception will not align with reality.

(Keep in mind that the chart below only goes out to 12/31/15. Given the drop in the S&P 500 so far this year, the actual forward p/e ratio is 14.89, using FactSet's estimate of aggregate earnings of $126.94.)



3. ***A report from the Federal Reserve Bank known as the Beige Book.*** A few edited highlights below:

- Growth was described as positive in Boston, Philly, Chicago, KC and Dallas , moderate in ATL/SF and modest in most others.
- Most manufacturing sectors are displaying weakening activity – citing the strong dollar's negative impact on demand and low energy prices had a smaller, mixed effect.
- Consumer spending ranged from slight to moderate in most districts.
- Auto sales are mixed as activity is dropping off from previously high level.
- Tourism was mixed.
- Residential and commercial RE was generally improved, stronger activity cited for multifamily construction.
- House prices and rental rates rose somewhat.
- Most districts reported loan demand growth and improved credit quality.
- Labor markets continue to improve though wage growth is not significant.

The last bullet point seemed to be the one that the market fixated on since the vicious-cycle logic goes:

a) If there is no wage inflation, then it is difficult to have any product inflation;
b) Economic strength is often signaled by inflation;
c) The Fed raised rates (and may again soon) based upon a strengthening economy;
d) In the absence of economic strength, then the rate rise could hamper incipient growth and have an unintended impact on the economy;
e) Weak economies, especially those that are in interest rate tightening cycles, make for poor stock market hosts.

While we think that is a stretch based on the otherwise mundane tone of the report, the current path of least resistance is a path of very negative interpretation.

4. **A firestorm of negative and cataclysmic prognostications that went mainstream overnight.** The bulk of this lies at the hands, or the iPad, of an analyst from the Royal Bank of Scotland, Andrew Roberts.

   Roberts has basically advised anyone who would listen (no need to take any personal objectives, time frames or situations into account, right?) to sell anything and everything and do it now.

Certainly, anyone with such future-predicting powers would have a great track record of historical correctness, correct? Or…..maybe not. See the link below for the last 2 dire predictions from Roberts and I have excerpted some of the more pertinent quotes below:

> ***2010: "We cannot stress enough how strongly we believe that a cliff-edge may be around the corner, for the global banking system (particularly in Europe) and for the global economy. Think the unthinkable,'***
>
> ***2012: 'People talk about recovery, but to me we are in a much worse shape than the Great Depression… Even the Congressional Budget Office, probably the most bullish forecaster in the world, is forecasting a US recession in the first half of next year. It's amazing stuff.'***

http://blogs.spectator.co.uk/2016/01/the-author-of-the-rbs-sell-everything-note-has-been-predicting-disaster-for-the-last-five-years/

Sorry that this went on so long. I guess it would have been easier if we just said that China and oil were to blame again, but they took the day off. The next couple days will be interesting with the aforementioned earnings coming out as well a slew of economic reports. We'll keep in touch as things develop and look forward to some parting in the stock market's clouds at some point soon.

Have a nice night, dc

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