



THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – NOVEMBER

US Markets and Economy: The American bull market charged ahead in November. Both the bellwether Dow Jones and the broader S+P 500 indexes hit new all-time highs during the month, and the NASDAQ Index moved closer to its all-time high of 5132 set back in early 2000 at the peak of the technology mania. Stocks were driven up by a confluence of factors: monetary policy remains very easy in the US, with short-term rates likely to stay near zero until next summer; the US economy remains in strong growth mode, with the latest GDP numbers showing the second and third quarters of the year to be the strongest back-to-back quarters of real (inflation-adjusted) growth in a decade; and a downward spiral in crude oil prices, which have already dropped \$40 a barrel this year, provides a shot in the arm at the gas pump for strapped American consumers, just in time for the holiday season.

Cheaper energy provides a strong boost for the US economy without generating inflation. It gives consumers more purchasing power at the same time that it reduces business costs. This favorable combination is just the reverse of the economic malaise that America suffered during the 1970s-1980s OPEC oil shocks. While OPEC's unwillingness to cut production during the current oil glut can explain some of the decline in oil prices, the remainder should be chalked up to the continuing boom in US oil and natural gas production. The "fracking" revolution has liberated massive quantities of fossil fuels previously locked in shale formations in the US. This increase in US production could continue for years, and eventually vault the US into the #1 position of world energy production. The low inflation that comes with falling energy prices means that the US Federal Reserve can maintain its easy money policy without fear of economic "overheating." The rise in the international value of the dollar, driven by even lower interest rates and weaker growth in Europe and Japan, means that US import prices stay low, further reducing inflationary pressure. Consumers feel richer because their homes and stocks are appreciating at the same time that the US labor market continues to strengthen, with monthly employment growth exceeding 200,000 almost every month this year. Spending by these more optimistic consumers drives GDP upward, and further increases income and employment, in a virtuous circle reinforced by low interest rates and falling gasoline prices.

World Markets and Economy: Although Europe's economy is again on the brink of recession, with fears of outright deflation in the Eurozone, stock markets on the continent generally followed the US market higher in November. The weak economic outlook on the continent is offset in part by the prospect of Quantitative Easing (QE) by the European Central Bank (ECB). Although the ECB must overcome national disagreements before it can engage in the kind of massive QE undertaken by the US and Japan, it is only a matter of time before economic weakness in Europe forces the ECB's hand. Another European recession would deal a near-fatal blow to nascent recoveries in the heavily-indebted and still-depressed countries like Greece and Spain, and once again cause speculation that the euro itself was doomed. The prospect of deflation, even in Germany, fuels worries of Japanese-style stagnation. The euro itself has been falling against the dollar in anticipation of even lower interest rates and weak growth compared to the US. **For US investors, a weak euro offsets some of the rise in stock prices denominated in euros.**

China's stock market was very strong in November, even as the economy continued to show signs of a slowdown. The 10% monthly gain in stock prices has pushed prices up over 30% for the year. This rally is a direct response to monetary easing by the People's Bank of China (PBOC), the Chinese central bank. While the PBOC is both opaque and secretive compared to the US Fed, the PBOC unexpectedly cut interest rates in late November. Although the bank said there was no change in monetary policy, the slowing of economic growth below the target of 7.5%, and slowing inflation, may push the PBOC to be even more stimulative, which will give a further boost to Chinese stocks.

Japanese stocks also rallied even though the economy has contracted for two straight quarters. The economic decline has forced the hand of Prime Minister Abe, who has called for early elections to confirm his decision to defer another scheduled increase in the national sales tax. The first increase in this tax earlier this year was the proximate cause of the latest economic recession. With another tax increase postponed, stocks (and the economy) can once again respond to the massive QE undertaken by the Bank of Japan (BOJ). The BOJ's monetary ease has driven the international value of the yen down sharply, which should provide a strong stimulus to exports, and create a bit of inflation domestically, which may help the Japanese finally slay the deflationary dragon.

OUTLOOK: In the short term, US stocks can push higher as economic growth continues with low inflation, low interest rates, and a strong dollar. Easy money in Europe, Japan, and even China can support stock prices worldwide. The months of December and January are historically two of the strongest of the year for the American market, which should provide a seasonal tailwind for stocks as we enter 2015.