Chart of the Month

December 2014

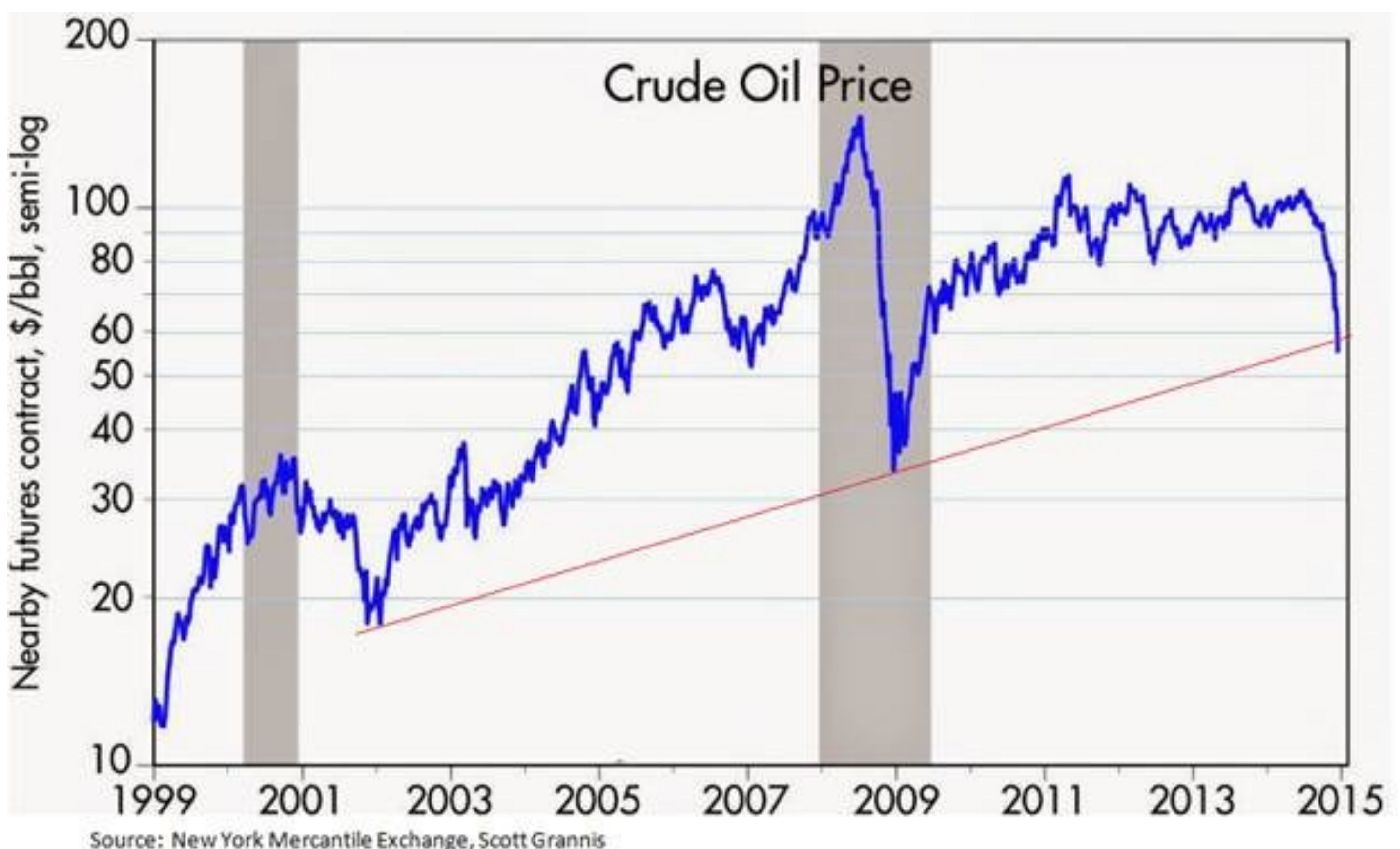
The market has been climbing one "wall of worry" or another for nearly six years now. During this time, concerns have rotated from the length and depth of the recession to the viability of the Eurozone to trillion dollar budget deficits to government shutdowns to a downgrade of the debt to various terrorist activities to the spread of Ebola and to the latest involving the plunge in oil prices. While stocks have undergone a number of corrections along the way in response to the fear du jour, they have recovered and ultimately made new highs each and every time.

Regarding oil prices, we believe that the near 50% decline since June (including a 30% nosedive in the past six weeks) should turn out to be more of a positive than a negative for the overall economy. Although oil producers and related service companies are feeling the pinch, most everyone else will benefit from the lower price of crude. The bottom line is that there will be a few big losers and a lot of small winners.

With gasoline prices down at least $1/gallon, two-income families that fill up their cars every 10 days or so are spending approximately $120 less per month, the equivalent to a pay raise (which, of course, would be subject to taxes) of about $2,000 annually. The newfound money should result in households paying down debt or increasing spending and investment. One way or the other, the huge drop in oil prices will prove to be a tailwind for the economy for as long as it lasts.

As the chart below suggests, the price of crude appears to be oversold in the short run. That said, it is unlikely to bottom until the supply and demand reaches equilibrium. With the global economy currently producing about one million more barrels of oil per day than it is consuming, the supply will need to fall and/or the demand will need to rise to stabilize the price. Importantly, the market will likely close the gap sooner than later.

Our Growth and Equity Income strategies are underweighted in energy relative to the sector's representation in the S&P 500 index. Conversely, we are overweighted in consumer discretionary with a focus on retail and entertainment businesses. Nonetheless, we believe that the largest and strongest oil and gas companies such as Chevron, Exxon Mobil, and Kinder Morgan will be in the best position to pick up distressed assets on the cheap. These stocks present an attractive combination of current dividend income and prospects for modest capital appreciation over time.



Source: New York Mercantile Exchange, Scott Grannis

5305 East 2nd Street, Suite 201, Long Beach, California 90803
Tel: (562) 495-5305 ▲ Fax: (562) 495-5306
www.lederer-associates.com