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by Greg Gann

Half Empty or Half Full: You Decide

Disclaimer: This is NOT about politics. This is not to be construed as a pro or a con for the Democrats or Republicans. This is strictly about economic reality. It is not about blame. Nor is it about proposing solutions.

Facts can so easily be construed to fit an intended audience that we often walk away questioning whether what we have just been told is lies, damn lies, or statistics.

Listening to the President's most recent state of the union address, made me feel that he and his administration should be treated as heroes. He reported that over his six year reign the stock market has soared, home prices have greatly recovered, the economy's gross domestic production has increased, industrial production is up, and above all else, the total number of jobs lost during the recession has been restored. I questioned how anybody hearing those statistics could possibly dismiss his accomplishments. I wondered why he is not getting the economic kudos that Clinton did. I pondered how anyone in his right mind could criticize this president. After all, this record is quite impressive.

Our President was conveying to us that economically everything is good, actually better than good, and that we have crossed the mountain, and that our troubles are behind us. Working with clients who are small business owners, professionals, and retirees, I had a hard time coming to grips with his message. There was such a disconnect.

My clients in each of these demographics are stressed. They are concerned about business growth and retention. They feel like the economy is resting upon a very precarious footing and that another correction could easily pop at any time, putting at risk their life savings. They also feel that the economy has been goosed and the market is rigged to make us feel better so that we spend more in order to lift the economy. They feel like a pawn in a chess game. And, furthermore, they feel that we could much more readily fall into recession, particularly if the punch bowl of monetary stimulus is removed, than we are likely to see another boom period like the 1980s.

So, who's right? And, is the economy half full or half empty? Are the statistics being mined to paint a picture that's prettier than reality? To help you answer these important questions, I would like to present some additional facts.

While what the President outlined was one-hundred percent true, there was some other objective data that was not revealed that might put things in better context. Again, this is intended strictly as a fact check and deeper overview. This is not an indictment on the President or the Democratic Party. Nonetheless, let's address those areas of the economy for which he takes credit.

President Obama took office literally at the depths of the financial meltdown and at a time where the stock market had lost 50% of its value. It is certainly a fact that the stock market is significantly higher today than when he was sworn into office. It is also true that monetary policies of historical significance have been enacted to depress interest rates to a point where money is virtually free. The government creates money by issuing debt. The federal debt since President Obama has been in office has increased roughly 70%. Most of the debt that has been issued has been absorbed by the Fed. How convenient. The issuer and the buyer are related entities.

Through the process of buying massive amounts of federal debt, The Fed has created a market and demand for those securities which would not otherwise exist in the market. This results in low interest rates. Low interest rates flood the market with cash. And, cash needs to find a home. More cash chasing the same number of shares of stocks results in stock prices surging. Low interest rates have also led to the stock surge because for very little amounts of money companies have been able to buy back massive amounts of their own stock, resulting in even fewer shares in circulation. When a greater supply of dollars chases fewer numbers of shares, guess what- share prices escalate. The Federal Reserve headed by Ben Bernanke and now Janet Yellen are most responsible for the rise in the stock market, not the President.

Any time you manipulate a market, inevitably there are unintended consequences. I believe that easy money helped get us out of the financial crisis. But, I also believe that it has been harnessed to an extreme and has not developed a solid foundation that will lead to on-going productivity. A house without a solid foundation eventually falls. And when the economy begins to tailspin after the zero fed funds rate policy is withdrawn, I wonder if President Obama will also take credit for the destruction since he certainly takes credit for the creation.

There are many other objective signs of weakness which might impact your view with respect to just how full is the glass. For one thing, the percent of the civilian work force age 25-54 currently employed is still significantly lower than January 2009. The number of Americans on Food Stamps is at a near all-time high, and significantly above the number on President Obama's original inauguration day. President Obama correctly stated that since he has been president, roughly two million jobs have been filled. What was omitted was the fact that the population has grown by approximately sixteen million over the same number of years.

Small businesses have always been the backbone of the American economy and the fulfillment and embodiment of the American dream. The Gallup Group reported that in the last six years, there have been more businesses going out of business than those being formed. In fact, there has been a net loss of some 70,000 businesses that have been laid to rest.

As reported in the September 27, 2014 issue of The Economist, which cited the Census Bureau and Sentier Research, under the Obama administration, GDP is up 8% and median household income is down 4%. In contrast, during Reagan's first six years in office GDP grew 22% and median income grew 6%. Clinton's first six years were even more impressive with GDP growth of 24% and median income rising 11%.

I don't quite understand how the standards for collecting Social Security disability benefits have apparently relaxed so much over the last six years, but a high and unsettling number of Americans are now not only working, but they are depleting funds from Social Security due to disability benefits.

Facts just now being released about the details of the final quarter of 2014 create a lot to mull over. Two for me were most impactful. The first is the huge and disproportionate percentage of personal spending that went to healthcare, which is not exactly productive or able to create a multiplying effect. The second is the Apple effect. Apple stock did so fantastically well in the fourth quarter due to its launch of the I Phone 6, and it is such a large component of the S&P 500 that fourth quarter earnings for the entire S&P 500 index would have been zero if Apple's earnings had been excluded. In other words, all the earnings growth for the entire index was attributable to just one single company, and its blow-put launch.

Is the economy half full or half empty? Everyone is entitled to his or her own opinion, and is free to use or excuse whatever data points he or she wishes. Regardless of one's choice data points, there are a few indisputable truths. They are that most of Europe is either flat lining or in recession. China is slowing. Argentina, Brazil, and Russia are on the ropes. Geopolitical risks in the Middle East could almost not be greater. Interest rates around the world are plunging to a point where are a large number of countries are literally charging for the privilege of lending to them, which is an indication of fear and a flight to safety. Greece might be forced to make a "Grexit" by being forced to leave the Eurozone. And, what happens to Greece has direct relevance for their cousins in France, Spain, and Italy. Yet, as ominous as all these truths are, the proverbial can just might continue to get kicked and kicked and kicked further down the road. And the market might just ignore the risks for a while. And, investors might scuff off anyone who speaks the truth as unknowing or negative or viewing the glass as half empty, and dismiss all the warnings that are flashing in big neon lights. They always do. And, then they say, "everyone with half a brain could see it coming". Except, they were part of the "everyone" who wasn't protected.

No one can predict the future with certainty. I have no idea where the market will close tomorrow or the next day or the day after that. However, I am confident that if interest rates don't elevate over the next 5-7 years, we will be in the midst of a deep global recession of significant magnitude.

Since the process of lowering rates has jacked up stocks and bonds, what has been a tremendous tailwind for these two assets will become a headwind once rates rise. So, over the next 5-7 years, we will either have higher interest rates or we will be in the depths of another 2008 type recession. In either scenario, stocks and bonds are not the assets on which you would want much of your retirement to rely. Investments whose performance depends on the underlying market moving north should carry a huge warning sign. The can might be kicked and kicked and kicked down the road, but at some point every road ends. These are not normal times. Therefore, they require alternative strategies and investments typically associated with institutions, pensions, and endowments, but where retail investors are seldom exposed. Betting aggressively over the last six years that the glass is half full has prevailed, and big time. I am not willing to bet that it is half empty, but I am clearly not willing to bet my future or our clients' futures that it is half full and that it will remain that way over the next critical 5-7 years.

No one person has a monopoly on all the good ideas. Plus, it never hurts to get a second opinion. If you would like sound "out of the box" investment ideas or a second opinion from a seasoned financial advisor who has survived numerous booms and busts, consider this my invitation for a personal consult either in person or phone.

All the best,
Greg Gann

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