Weekly Commentary **December 24, 2015**

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P-Es look Worse than they Are; Have we seen the Low for Oil?

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Stocks were under a little less pressure this week as fears of a credit rout eased, brining a nice recovery to the high yield markets. The news that supplies of crude were lower than expected also eased concerns and oil rallied. Equity traders now recognize that although low oil prices are good, *too* low oil prices can be very disruptive, and that stock might be better off with oil in the 40s or even 50s than in the 30s or below.

The economic indicators are coming in close to expectations but on the soft side. It now looks like Q4 GDP growth will be below 2%. If it comes in at 1.7%, that would make 2015 Q4/Q4 growth at 2%, below 2014 growth of 2.5% and 2014 growth of 2.4%. These are all horrible growth rates for an economic “recovery” as they are just a tad over historical productivity growth seen when there are no gains in the labor market. Yet we have added in excess of 2.5 million net new workers each year during the past 3 years. This just highlights once again a subject I continue to bring up – the virtual disappearance of productivity growth.

Although I know that markets close the year next Thursday, I did take a peek at 2015 year-to-date returns. For the S&P 500 it is +2%, almost identical to the return for the 10-year Treasury bond. We should not complain about this return since earnings were off more than 6% bringing current P-E ratios based on S&P operating earnings to over 19 (and over 21 on reported earnings). Small stocks did worse, falling 3% this year, gold was off 10% and oil a whopping 30%. It looks like the energy sector will contribute negative earnings to the S&P this year and has played a big role in depressing overall earnings and boosting the P-E ratio. The P-Es of the Financial and Telecom sectors are only 13 and the Industrial and Utility sectors 16, while the Tech sector is a tad above 18. These sector ratios are actually close to or below their historical averages.

This morning I was on CNBC giving my forecast. I thought earnings should be up 10% next year (which is still quite a bit below the always optimistic S&P consensus) and that the Fed would only hike 2 or 3 times, keeping interest rates low and P-E ratio elevated. This justifies a 10% return in the stock market, bringing the Dow to over 19,000 by next December. I think a stronger equity market will be apparent when we see earnings stabilize and move up, and the first sign of that must come from stabilizing oil prices. Will Tuesday’s $33.98 be the low for WTI crude? Actually it might well be. If so, 2016 promises to be much better.

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