125 Boggs Lane
Cincinnati, OH 45246
Phone 513.481.8555
Toll Free 1.800.962.7920
Fax 513.481.8561
www.kehoe-financial.com

By Larry Blundred April 7, 2016

Registered Representative, Kehoe Financial Advisors

Investing Today: Are Oil Industry and Stock Market Friends, or Foes?

Oil and water don't mix, but what about oil and the stock market?

Both were in a lockstep decline, to the tune of an over 91 percent correlation when oil fell below $40 a barrel in December of 2015, according to Leo Chen, Ph.D., a quantitative analyst for Cumberland Advisors, in MarketWatch.com.

The good news is that what happened recently is a black swan, says Chen. He says that a correlation between oil prices and stock market volatility isn't the norm. "In fact, over a five year period, the correlation (between the S&P index) was a negative 71.8 percent, meaning stocks and oil tended to move in opposite directions." He goes on to say in his analysis that the correlation has been only 25 percent over the past 20 years.

So what happened this time around? A decline in oil prices should be good news for the economy, correct?

Well, like the 2009 movie with Meryl Streep and Alex Baldwin, "It's complicated."

Some believe the decline is associated with a slowing, sluggish world economy. If global GDP is softening, then this is bad news for corporate profits and demand for oil. This in particular involves China, which has reported slowing growth.

Another perspective relates to the strength of the dollar relative to other currencies. Tobias Levkovich, chief of U.S. equity at Citi, suggests in CNBC in a Citigroup research note that "it's not about oil and stocks, but rather the strong dollar affecting them both at the same time."

Lastly, there's the idea of "volatility momentum," which former Federal Reserve Chairman Ben Bernanke addressed to in his Feb. 19 blogpost on the Brookings Institute website: "If investors retreat from commodities as well as stocks during a period of high uncertainty and risk aversion, then shocks to volatility may be another reason for the observed tendency of stocks and oil prices to move together."

There are a lot of ingredients in this oil-and-stock soup, and some of them add flavor and clarity, while others may simply confuse the recipe. If there is any take-away that may make sense from a long-term investing standpoint, it's these three observations: the recent oil-stock price coupling is not the norm; we have no idea if the recent lockstep movement will continue either up or down; and history tends to reward those who have a long-term investment time horizon.

These are the investors who view stock market pullbacks as opportunities to buy shares of solid-performing companies that have weathered economic and equity storms and have grown over time.

While we cannot predict the future, investing in uncertain times like these tends to eventually reward the informed and strong-stomached shareholder with either rising dividends or share prices – or both.

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Larry Blundred of Green Township is a Registered Representative with Kehoe Financial Advisors of Cincinnati, a 33-year-old financial advising and services practice in Springdale. Kehoe assists clients in developing and implementing financial strategies to help meet retirement, estate and business planning objectives, business continuation and succession planning. For more information, go to www.kehoe-financial.com or call (513) 481-8555.

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