Hardenbergh Financial Services **Newsletter**

State of the Economy September 2014

State of the July 2014

Did we start the fire? The 3rd quarter of 2014 played out like an extra verse from Billy Joel's hit song. Conflict throughout the world flooded the news. Russia advanced further into the Ukraine, triggering sanctions against them from Europe and the United States. The Hamas and Israeli conflict lasted 50 days, as missiles were launched back and forth. A new terrorist group (ISIS) began to dominate our attention, as President Obama declared war against this group. The Ebola outbreak has killed thousands and has yet to be contained. Nevertheless, the stock market kept chugging along, while hitting many new highs in spite of these world events.

Consumer spending improved during the 3rd quarter of 2014. For instance, retail sales through August were up 5% from the same month a year ago. This was the fastest rate of increase since July 2013. Other positive economic news includes the fact that consumers are spending less on oil and the job market is improving. So far in 2014 oil prices are lower compared to last year. The United States is in the early stages of an energy boom, helping to produce more oil and gas domestically. Additionally, unemployment insurance claims ran to their lowest level since May 2000 during the middle of September. The decrease in jobless claims could signal future gains in non-farm payroll employment going forward.

The stock market continues to benefit from the support of the Federal Reserve. In mid-September Fed Chairman Janet Yellen reiterated the Reserve's plan to end their current bond-buying program, known as quantitative easing, after October. To prevent the economy and stock market from getting too jittery, Yellen stated that rates would stay low for a "considerable time", after the bond buying program ends. Her assurance on interest rates, helped to contribute to the stock market's ongoing rally. The central bank has kept the federal funds rate near zero since December 2008, and is targeting mid-2015 for a rate increase.

Share repurchases have also helped sustain current stock prices. Many companies are buying back their own shares at the fastest rate since the financial crisis. With low trading volume during the summer, companies' stock buybacks helped fuel a market rally. Corporations bought back $338.3 billion of stock in the first half of 2014, the most for any six month period since 2007. The companies with the largest buyback programs by dollar value outperformed the broader market by 20% since 2008, according to an analysis by Barclays PLC. However, investors differ on the benefit to company buybacks. Some investors favor repurchases because it involves the company returning idle cash to shareholders. Buybacks also increase per-share earnings, which is an important metric in determining the fundamental value of a company. These benefits help to increase the share price of the company engaging in this type of transaction. Conversely, buybacks can signal that management is not reinvesting as much as it could in its business and artificially boosting the per-share earnings. Company buybacks could also indicate a lack of long-term confidence in a particular sector or the economy as a whole. In any case, company buybacks have been a catalyst for the market's recent climb to new highs.

Turning our attention overseas, it appears that Europe is trending in the opposite direction of the United States from an economic standpoint. The European Central Bank (ECB) President, Mario Draghi, surprised investors in early September by cutting interest rates instead of launching a widely expected quantitative easing program. Similar to the Fed's strategy since 2009, President Draghi mentioned that the ECB plans to buy asset-backed securities and bonds. The ECB is even contemplating a broader asset-purchasing plan in the future. Europe is struggling to recover from a recession, and the sanctions against Russia will have a negative impact on their economy. Growth is almost certainly going to head downward. The ECB moves suggest lower rates and a weaker euro for the foreseeable future.

It seems perplexing to the average investor as to how the stock market can perform so well, while the world around us appears to be coming apart. According to the 2014 American Values Survey released by the Public Religion Research Institute, nearly three out of every four Americans believe the United States is still in a recession. The temperature of the general public feels lukewarm about the economy overall. The unemployment rate is falling, but remains higher than economists would prefer. Many new jobs are simply part time, and do not require highly skilled employees. The stock market is rising but there may be an artificial component, due to stock buybacks and the help of the Federal Reserve.

It is important to understand that stock prices are a measure of economic value and not a measure of world peace. The profits of companies tend to rise and benefit from persistent economic growth. As these companies increase their profits, their value will tend go up as well.

Sincerely,

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