Vol. 10, Issue 3
Jan. 22, 2016

Something to Think About

OAKWORTH CAPITAL BANK

COMMON CENTS

This week, the supposed leaders of the world economy are meeting in Davos, Switzerland, at the World Economic Forum 2016. To be sure, it is an august group of politicians, academics, celebrities, and the like. From all outward appearances, it truly does seem like a group which can effect change and steer the global economy on a vibrant path. Of course, appearances can be deceiving.

The more I think about such international meetings, including the G-8, the more The Lord of the Rings comes to mind. More specifically, the more the conch shell from The Lord of the Rings comes to mind.

If you have read the book, you may recall how the shell was lustrous when the boys first found it, and how he who held it had the power to speak at the assembly. In essence, it was a symbol of both power and order. However, as the boys descend into savagery and chaos, the conch loses its luster, both literally and figuratively. Once the boys reject its symbolism, it has no value.

This past week, I was in Las Vegas making an economic presentation to a group of people who were attending the International Builders Show. Along with the other conventions this week, the good folks at the local chamber out there estimate some 150-200K were in town. That is a lot of folks, and I am here to tell you: not a single one said a single thing about anything any of the elites were to discuss in Davos.

It might as well not have been taking place, for all its import on day to day business for these people. In fact, while I was making my talk, the Dow Industrials Index was down over 500 points on Wednesday, and it seemed like all heck was breaking loose. Davos? What's a Davos? Does it really matter if some Chinese bank is going to be "lean, mean, and green"? Or how about if the Argentine government is once again open for business? And then there was the new Canadian Prime Minister, Justin Trudeau, who proclaimed: "We shouldn't be afraid of the word feminist. Men and women should use it to describe themselves."

After breaking bread with a guy from Toronto two nights in a row, I have a sneaky suspicion the average Canadian is far more concerned with the collapse in commodities' prices and the swoon of the Canadian currency relative to the US dollar. It has lost about 40% of its value since the end of 2012, and 7.5% since Trudeau assumed office on November 4, 2015.

No, I am not suggesting he is to blame for such things. However, it is what it is.

As I have mentioned here in the past, there are two things which have consistently come to the fore in regards to economic activity. These don't include green bankers in China, business friendly bureaucrats in Buenos Aires, or feminists in Ottawa. Nope. They energy prices and interest rates. When both are low, good things ordinarily happen. When both are high, bad things do.

For every clever speech at an international meeting of political 'leaders,' investors will pay thrice as much attention to the Consumer Price Index and comments from central bankers. A whiff of stimulus in Japan or a clearer idea of policy in Europe goes a lot further in allaying investor concerns than the final communique from a G-8 meeting, let alone any of the tangential commentary.

Inside this issue:

"the conch exploded into a thousand white fragments and ceased to exist."

Something to Think About Cont.

The same could be said of Presidential speeches. I don't know how many times people have asked me whether I watched the State of the Union or some other seemingly important oration. They always seem stunned when I tell them I hadn't, and ordinarily that I completely forgotten about it.

Do you know who Dennis Lockhart is? What if I were to tell you he has more power to move the markets with his words than Barack Obama, Joe Biden, John Kerry, or, ugh, Donald Trump? How about the last three combined? Would you know who he was then? Okay, some of you will.

For everyone else, Dennis Lockhart is: "...the 14th president and chief executive officer of the Federal Reserve Bank of Atlanta. In this role, Lockhart is responsible for all the Bank's activities, including monetary policy, bank supervision and regulation, and payment services. In addition, he serves on the Federal Reserve's chief monetary policy body, the Federal Open Market Committee (FOMC)."

In other words, what he says about US monetary policy matters. As such, what he thinks about monetary policy has a direct impact on interest rates in this country, and therefore borrowing costs around the world. To that end, I googled "Dennis Lockhart lean mean and green," and there wasn't a single result on point. I guess such things don't matter all that much to investors.

Don't get me wrong, I am not exactly thrilled with the power Federal Reserve officials wield over the financial markets. In fact, I think it stinks, particularly the times when their comments seem more bureaucratic in nature than either academic or business related. The most recent Fed rate hike is a perfect example: there wasn't any immediate reason to alter monetary policy in the US. The economy isn't in danger of overheating, the official inflation gauges are well-contained, the US dollar is already sufficiently strong (and maybe even too strong), and upcoming capital requirements from the FSB will constrain credit in the country without the Fed having to lift a pencil. Nope; however, what the Fed says and does matters, rightly or wrongly, and whether it is right or wrong.

The same could be said of the Bank of England, the European Central Bank, and the Bank of Japan. It matters, really it does, and some of them more than others.

Do you care to know who we have to thank for the rally of the last two days? It isn't Matt Damon or Hermione Granger. Nope. It is Mario Draghi, the ECB's equivalent of Alan Greenspan….rock star. Here is what he said that gave everyone hope:

"It will therefore be necessary to review and possibly reconsider our monetary policy stance at our next meeting in March."

That is about it, several hundred billion dollars later.

The thing is, the Fed's rate hike at the end of 2015 set a series of events in motion which has led to much unpleasantness in January. Due to its timing in the year, investors wanted to wait until the first week of January to rebalance their portfolios to account for a lack of multiple expansion this calendar year. You have to remember, that was 12/16. If you can wait two weeks, you can put off your tax bill for an extra 12 months, you like? Judging from the price action in the

Disclosure

markets the last two weeks of the year, it would appear there is more to this theory than meets the eye, as the markets were for all intents and purposes basically flat that fortnight until the last day of the year.

So, the Fed set into motion some relatively standard rebalancing which engendered concerns about China and a whole litany of other negative things. These fed on each other, and the Fed couldn't talk them down without making itself look foolish in the process. As such, the only person left in the world, quite literally, with any ability to sooth investors' frayed nerves was Drgahi, and he did so.

Strangely enough, he did it in Davos, which would make it seem as though Davos is more important than perhaps I have suggested. However, it wouldn't have mattered if he had said it in Lisbon, Cork, Tallin, or Timbuktu. It was the speaker that mattered, and not the podium or platform. Draghi wields the power in Europe, and not the World Economic Forum 2016.

To that end, I suppose you could say Draghi is either Ralph or Jack (you pick) and Davos is the conch.