Infomail
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Markets Take the Stairs Up, But the Elevator Down
The Four "E's"

"This is the only business I have ever seen where the product goes on sale and no one wants to buy"
Anonymous

Even though markets have been looking for a correction for some time, they are still unnerving when they happen. Was there anything really new to spark the sell off? Not really, the same concerns which have been out there for years, which is slowing global growth, central bank policy effectiveness, ISIS/terrorism and possible deflation are the bigger issues, but the latest setback was caused by what I like to call the 4 E's:

- Economic concerns
- Euro worries
- Energy prices
- Ebola

There are lots of worries and lots of hype but let's break them down:

1. <u>Economic Concerns</u>

These mainly deal with the US economy and the change in Federal Reserve policy. The Fed is about to complete the final stages of its Quantitative Easing (QE) Part III later this month and the talk has been more "hawkish" from Fed members. Right now, the markets have priced in the first interest rate hike for some time next spring.

The reality is that $150 billion or so of mortgage backed bonds trade on a daily basis (or about $3 trillion a month) so the Fed stopping the purchase of $15 billion a month will hardly make or break the outcome.

Recent economic data out of the US have showed mixed results. The economy is plodding along in recovery but many are still waiting for the breakout momentum to kick in.

While the impact of the end of QE is not evident in bond prices, some have speculated that this has heightened investor concern over asset price valuation. It seems QE has not done anything for Main Street America except to prop up banks.

While the US is the main economic concern, the recent Geneva Report stated that an economic crisis is “imminent” in the “fragile eight” countries from high debt and slow growth. They are:

- India
- Indonesia
- Brazil
- Turkey
- South Africa
- Argentina
- Russia
- Chile

The incredible quick rise in the value of the US dollar will also make US exports more expensive, and worries are they will impact US corporate earnings, especially those of the multinationals.

2. <u>Euro Worries</u>

There are several developments that are problematic for the markets. For the most part, they are mostly traced back to Europe. In fact, the Socialists in Europe ran out of other people’s money a long time ago, and the European Central Bank cannot print enough money to make up the difference.

Europe is four years behind the USA and likely needs to go through more pain.

A confluence of factors led to the recent selloff, including the possibility that Europe, led by a slowing Germany, could be falling back into another recession, which ultimately will cross the Atlantic and pull down the US economy.

The slowdown has been further aggravated by the failure of the European Central Bank (ECB) to offset the deflation threat and slowing growth, but mainly by not being able to back the tough talk with actions.

The German economy, has in a big part, been hurt by a slowdown in trade with Russia following the adoption of sanctions against that country.

The main issue in Europe, which has been highlighted by the ECB as well, is that structural changes need to be addressed within the European Union (EU) but politicians have yet to step up to do so.

3. Energy Prices

Another worry for the markets has been the collapse of energy prices, from about $105 US to under $80 US per barrel, all in about 40 days. This will feel good at the pump, and often falling oil prices are taken as a positive since it gives consumers more disposable income to spend, but right now the bears are pounding the drums and raising a red flag that it’s more about declining demand as global growth slows, and as OPEC lowers prices rather than cut production.

In addition, oils precipitous decline, notwithstanding the cause, has resulted in margin calls both within the commodity level and within the energy sector; it was rumoured U.S. hedge funds were highly leveraged to infrastructure.

There are a few reasons to explain the amazing collapse of oil prices. Excessive production from Libya and other OPEC members, combined with slowing demand.

Being a conspiracy believer, maybe there was simply an agreement between the USA and Saudi Arabia to drop prices. Who gets hurt the most? Well Iran (enemy of the Saudi’s) and Russia (enemy of the USA) and the ISIS terrorists (enemy of the world) who were reportedly financing their terrorist activities from $3 million per day of underground oil sales.

The Oil Kingdom of Saudi Arabia has been there before when oil prices collapsed just over four decades ago. In the 1970’s, the Arab Oil Embargo sent prices to $35 a barrel by 1980. The Saudi’s reacted by keeping production low. It forced America to make drastic changes via conservation, and brought massive non-OPEC discoveries that included the North Sea that saw demand collapse and push prices down to $10 a barrel.

US Crude Oil Imports

Aug 1979	211,079 bpd
Aug 1985	96,547 bpd
Aug 2004	324,258 bpd
July 2014	236,310

(Source: Wall Street Strategies Oct 3, 2014)

The US shale drilling program has also been an economic miracle and has made the USA a step closer to energy independence.

4. Ebola Virus

The media has been doing its best to create an Ebola hysteria. Yes, there are many reasons to be concerned about this disease. It is a serious virus and 70% of those who contract it don't make it.

The Center for Disease Control (CDC) estimated the total number of cases in the Western African countries of Liberia and Sierra Leone could top 1 million by January.

But when compared to small pox which as recently as 1967, 15 million had the disease and over 2 million died, or the Spanish Flu in 1918-19 which killed 675,000 Americans, or Cholera, which the World health Organization (WHO) estimates 3.5 million people contract each year, and 100-120,000 die each year, or AID's, which killed 3.1 million in 2005 alone. The number of deaths "officially" attributed to Ebola in West Africa is somewhere around 4500, so while concern is merited, we need to keep some perspective before the hysteria turns to real, unjustified panic.

So now what?

My guess is there was a selling climax and intraday reversal last Wednesday. At that point, the market sell-off looked something like this at that days close:

Market Decline over a 30-Day Period Ending October 15th

Market	30 Day Return	YTD Return
TSX (Toronto)	-10.2%	4.1%
S&P 500 (USA)	-6.0%	2.4%
MSCI World Index	-7.2%	-1.9%
MSCI Europe	-9.4%	-6.3%

Markets like to sell the 10% as an official "correction." Intraday on Wednesday, at the lows of the day, the S&P500 has corrected……yep….9.9%.

So we might get a retest of Wednesday's S&P 500 low of 1809, but I wouldn't be surprised if we push up the balance of 2014, especially if in the upcoming US mid-term election in early November, the Republicans retake the Senate, setting up President Obama as a lame duck for his last two years.

I believe we are still in a new secular bull market and these pullbacks/corrections are an opportunity to add to good names.

Stay tuned,

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Investment Advisor

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