



What to Look Forward to in 2016...

Q. First, how was 2015? What grade would you give it?

The year gets an A-. Why? Monthly job growth was above the 200,000 but with some large variations, while vehicle sales, which were helped by low gas prices just kept on rising, and rising, seemingly defying the laws of economics (and even marketing!). Housing starts are now above the 1 million mark and income growth is picking up. In spite of weak global growth (aka no help from our trading partners), GDP growth will turn out to be a good 2.5% gain in 2015, but with the see-saw nature of the stock market made for a white-knuckle ride this year.

Q. How do you expect the U.S. economy to perform in 2016?

Since 2011, the average GDP growth of the U.S. economy has been just around 2.0%. Like it or not, this is our “new” potential growth rate of the economy i.e. when GDP growth does not create inflationary pressures. In 2016 we are expecting it to do better than this 2.0% rate but not by too much. BUT this was enough for the Fed to do its first rate hike in December. They have to wait to see how it plays out, especially in the stock market (hopefully no more drops of 10%-plus in less than a month as seen in August), and then they will do another one in March 2016. The Fed will likely wait until the presidential election hoopla is over in November 2016, and then become a tad more aggressive with their rate hikes. For 2016, we expect GDP growth to be about 2.7%.

Q. What are the implications of the Fed hike for the financial markets?

If the expected economic growth is better than the potential of 2.0% in 2016, which the Fed confirmed by raising rates this month (otherwise why would they move!?), then the stock market should perform better in 2016 than its sideways movement in 2015. This month's Fed move will also bring out the fence sitters in the housing market to buy, giving growth a boost. However, chances of a 30%-plus market gain as seen in 2013 are slim so expect moderate growth in single digits. That said the volatility we experienced in 2015 will remain in 2016 too as the global economy outside of the U.S. is still quite shaky. Net-net the Fed hike will be good for the stock market unlike in the past!

Q. What is the outlook for oil prices and spending by the consumer?

Will oil prices go down to \$20 a barrel and stay there in 2016 as one hears? The answer is no. Will they stay in the current \$35-45 range? Yes, in the first half of 2016. But the oil market is more fickle than the stock market. When everyone starts to think oil will remain low forever, that is when the market will surprise you. So, I expect oil prices to move up to the \$50-60 range by late 2016. The U.S. consumer will keep channeling their gas savings (compared to when oil was above \$100 in late 2014), in conjunction with drawing down their savings, to keep buying cars and trucks that are being heavily marketed by automakers (by discounting, lengthy loan terms and an LTV above 100% for subprime borrowers). Thus, vehicle sales will again be great in 2016, but just a tad lower than the 2015 rate as somewhat higher interest rates do slowdown auto demand a little bit. But, the side effect of that will be retailers will not feel the love of the consumers as they use their cash flow to service their vehicle loans rather than going out, or buying a new TV or a new pair of shoes. The purchases of these discretionary items will be hurt since income growth has yet to achieve the pre-recession levels. This is the classic substitution effect that has been at play since 2013, and not going anywhere in 2016.

Q. Finally, what do we need to watch out for in 2016?

- How aggressive will the Fed be in raising rates?
- How will presidential election brouhaha impact business investment that ultimately creates job growth?
- Will China's measures to jumpstart their stalled economy work, and soon?
- How will Europe handle the tide of refugees and its impact on the Eurozone unity which has implications for business investment and trade flows?

We wish you a prosperous 2016 and look forward to seeing you at our conference on **February 24th**

