THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – FEBRUARY

US Markets and Economy:

US stocks swooned in early February, and then rallied back to finish the month almost flat. This substantial volatility, which has carried over since the August 2015 rout and recovery, is symptomatic of high levels of uncertainty about the US and world economy, the future path of interest rates, and the price of oil.

Uncertainty about the US economy is misplaced. **We see little to no chance that the US will slip into a technical recession in 2016**. Although the US rate of economic growth will continue to fluctuate from 1% (fourth quarter 2015) to 2.5% (estimate for first quarter 2016), neither collapsing oil prices nor economic weakness among US trading partners can drag the economy into recession. Although low oil prices do damage to the energy sector, low oil prices also act like a tax cut for consumers. At the same time, the US Fed, after inching up the Federal Funds rate in December, is quite likely to keep short-term rates below 1% for all of 2016. This is stimulative monetary policy, which should foster growth, not recession. Longer-term rates are also extremely low in the US, with the 10-year Treasury still yielding less than 2%, barely more than the current rate of inflation. These low rates encourage borrowing and capital investment, which buoy the economy in the short and long run. Some of that investment is in new home construction, which remains strong, while home prices continue to rise. A healthy housing market, fueled in part by historically low mortgage rates, steadily improves the balance sheets of American households, which had been devastated by the housing crash of 2007-09. Economists refer to this as the "wealth effect:" rising home prices (and rising stock prices) increase Americans' wealth, and some of that increase spills over into consumption spending, which is still 70% of GDP.

In a virtuous circle, this rising level of economic activity leads to more hiring, lower unemployment, rising wages, and more spending. Unemployment is now 4.9%, the lowest it has been in nine years. Employment has been growing at about 200,000 jobs per month, and even wages are now growing at about 2% a year, which is faster than inflation of 1%.

One downside of this economic strength is that the international value of the dollar remains strong, especially compared to our weakly-growing trading partners. A rising dollar makes it harder for American multinationals to export, and makes imports look cheaper. This weakening of the trade balance is to be expected, and it does act as a damper on growth. But it would be seriously misguided and self-defeating for the US to restrict trade in an effort to stimulate American growth. In fact, trade agreements like the Trans Pacific Partnership (TPP) should actually increase growth for all the countries which join. While US Senate approval of TPP in 2016 is still uncertain, Americans should not forget their history: the Smoot-Hawley tariff of 1930, designed to increase American prosperity by keeping out imports, instead helped lead the US and the world into the Great Depression.

World Markets and Economy:

European stocks followed the US down in early February, and then also rallied sharply for the rest of the month. Over the past year, however, European stocks have been much weaker than their counterparts in the US, reflecting the near absence of growth in most of Europe. UK stocks in February actually fell into bear market territory (traditionally a decline of 20% from a market peak). The UK has scheduled a June 23rd vote on leaving the European Union (known as Brexit), and, with the outcome uncertain, UK and European stocks now have an additional source of uncertainty. Brexit would probably be an economic negative for both Britain and the rest of the EU, and this vote could cast a shadow on European stocks for the next few months. The prospect of Brexit and weak growth could offset the stimulative effects of the European Central Bank's aggressive monetary policy of Quantitative Easing (QE) and negative nominal interest rates.

Japanese stocks also fell into bear market territory in February, before participating in the worldwide rally at the end of the month. The Bank of Japan also has a policy of QE and negative nominal interest rates, which has yet to bear economic fruit. Fourth quarter GDP fell at a 1.4% rate, and the outlook for 2016 is poor. Abe may be forced to postpone the sales tax increase now scheduled for 2017 (the last increase created a recession). Japan's growth has also been hurt by a rise in the international value of the yen, which has occurred in spite of zero growth and negative interest rates.

China's economic growth outlook is also dimming. Official statistics showed the economy growing at 6.9% in 2015, but no one outside China (nor many inside) actually believe this number. While even a true growth rate of 3-4% would be celebrated in the US, Europe, Japan, and many weak developing economies, the Chinese, the only country to set a GDP growth target, are prisoners of their own promises to deliver 7% growth, and to maintain the international value of the yuan/renminbi. Although a weaker Chinese currency would have little direct effect on the US economy, the surprise devaluation of the yuan in August 2015 precipitated a sharp selloff in world equity markets.

OUTLOOK: US stocks "tested" their January lows in February, and then rallied strongly for the remainder of the month. With the economy improving, oil prices stabilizing, and supportive monetary policy, stocks could continue their long bull market in 2016. There will certainly be more stumbles along the way, but long-term investors know that the investment race goes not to the swift, but the steadfast. Buffett-like concentration on the long term has always rewarded those with the requisite patience and discipline.