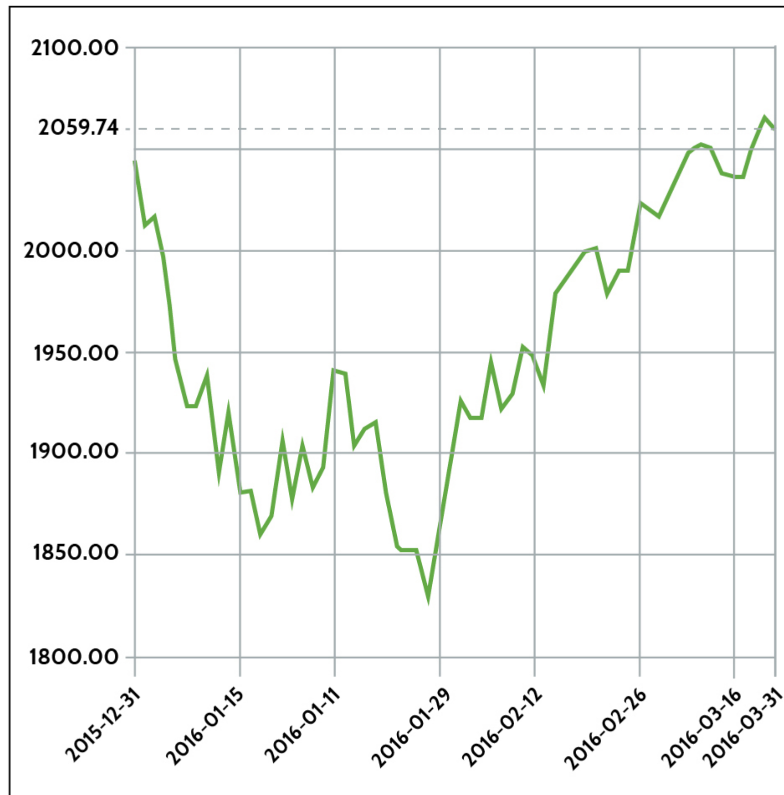
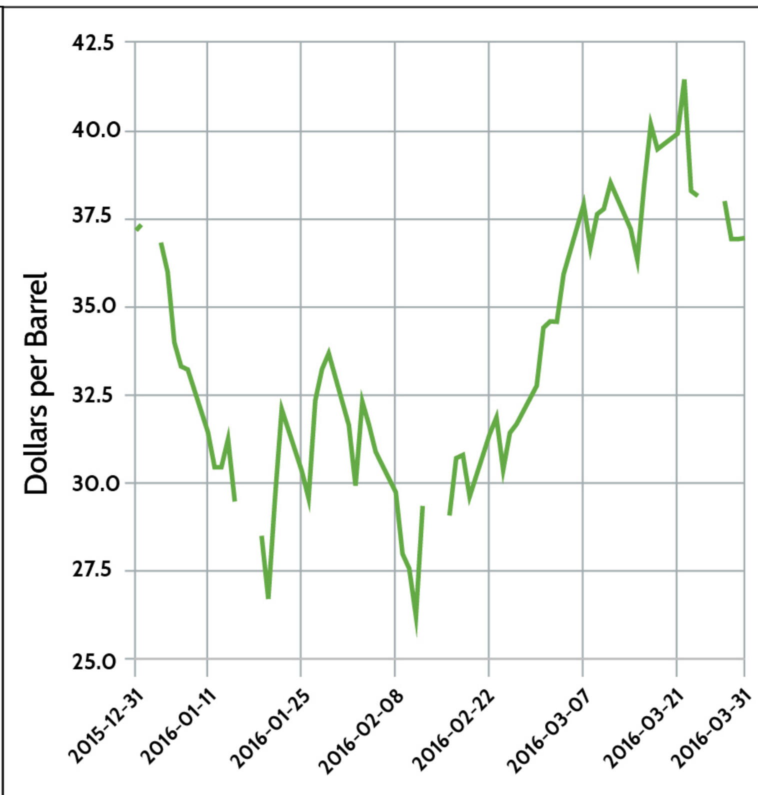
MARKET OBSERVER

The first quarter for the stock market was a perfect example of drama that takes you nowhere. If you only looked at the market at the first and last days of the quarter, you wouldn't know the difference—no real change. In between, you saw a decline of 11% and subsequent complete recovery, mirroring the swing also experienced by oil prices.



Source: Yahoo Finance



Source: US Energy Information Administration, research.stlouisfed.org

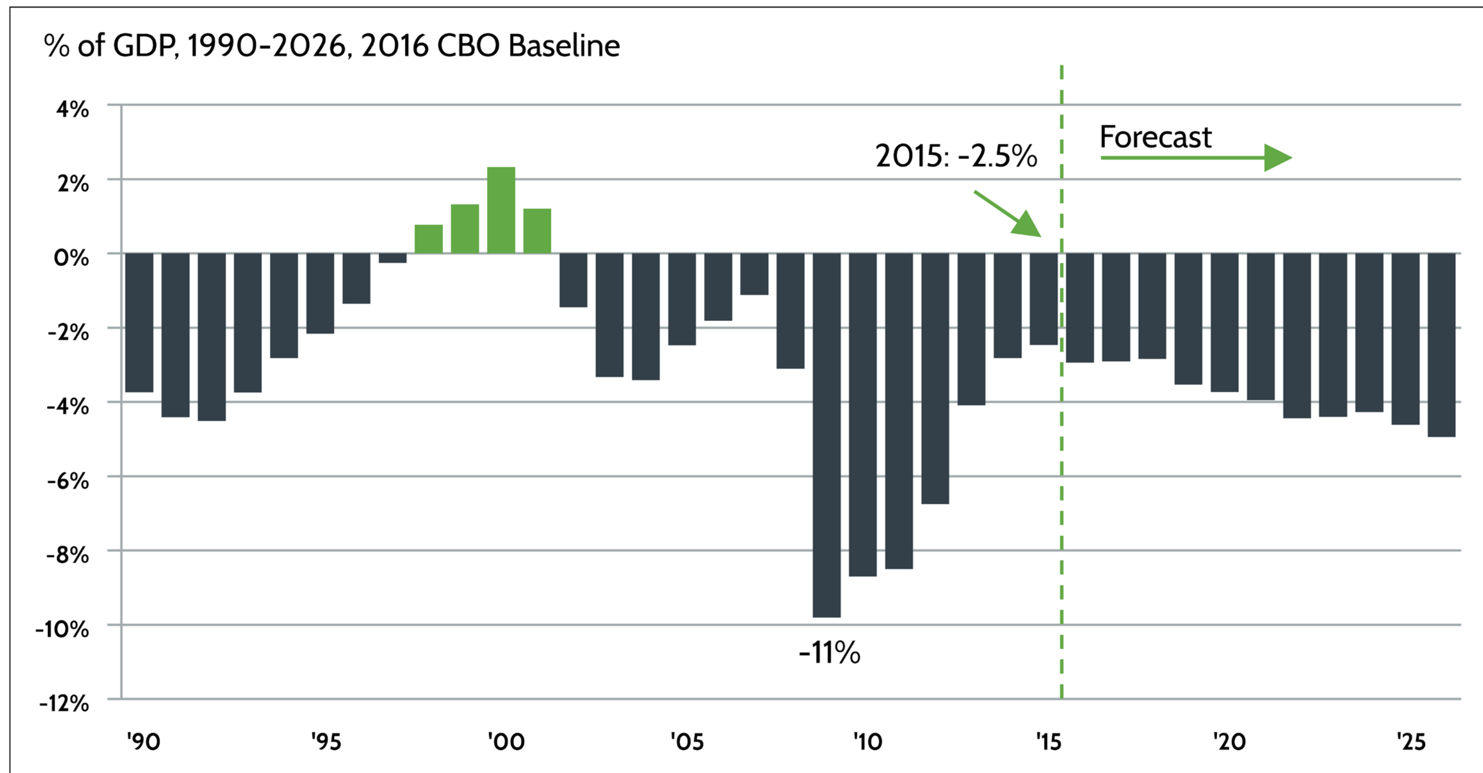
Oil's impact on stock prices resulted partly from expectations that, if oil prices stay low, profits for oil production and related companies would continue to drop, and losses would steepen as more projects put in place over the past few years at higher oil prices became uneconomical.

Partly due to oil's impact, GDP growth for the first quarter of 2016 was a sluggish 0.5%, a first quarter phenomenon we have become familiar with. Similarly, corporate profits were soft—both because of oil as well as the strong dollar. In a period with a strong dollar, overseas profits look weaker when translated back into US Dollars.

On the positive side, wage growth has been increasing. While not having an immediate impact, some economists believe that this will lead to greater consumer demand and consequently higher profit growth in the second half of the year.

Another positive that has not been talked about much is the budget deficit. In 2009, coming out of the crisis, the budget deficit was 11% of GDP. It's now down to 2.5%, a level we haven't seen for 10 years.

Federal budget surplus/deficit



Source: CBO, J.P. Morgan Asset Management; BEA

The latest quarter picture leaves us with no clear direction. A recovery of oil prices from their lows, the leveling off of the appreciation of the dollar and signs of real wage growth are providing some hint of stronger growth through the end of the year and into next year. The budget deficit is still growing, but at a lower rate. Because of growth uncertainties, the Fed has slowed down its plans to increase interest rates. Where does this all lead in terms of investment strategy?

Balance between your cash flow needs and your long-term plans. We would reasonably err on the side of caution for your more immediate to intermediate liquidity needs. Make sure you have money available for cash flow in case we do run into a recession, but long-term money should stay where it is today—in line with your long term allocation plan.