Multiple Worries Continue To Hammer The Stock Markets

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Overview

The major US stock markets have turned in their worst January performance in history, as have many equity markets around the world – and the month is not over yet. As a result, we'll keep our focus on what is driving this extremely volatile move.

Before we get to that discussion, let's preview this Friday's first estimate on 4Q GDP. Based on the pre-report consensus, Friday's report is expected to be much weaker than the 2.0% growth in the 3Q and a fraction of the 3.9% growth in the 2Q.

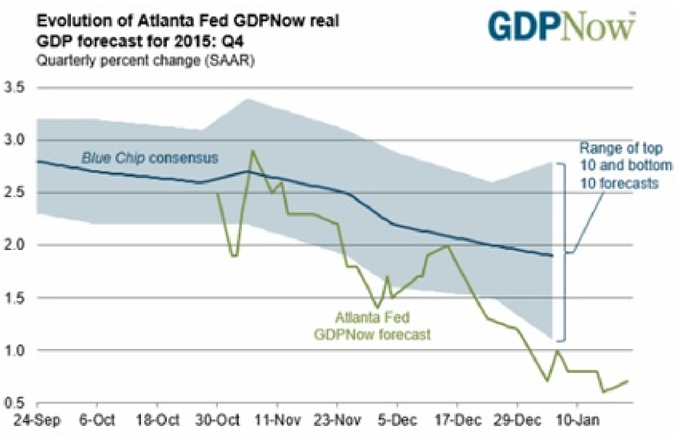
We'll finish today with an outstanding but very troubling article on President Obama's plan to empty the Guantanamo Bay military prison, without Congressional approval, before he leaves office. The writer believes Mr. Obama may also be planning to give the prison back to the Castro Bothers in Cuba by the end of this year. You will definitely want to read this!

Advance Estimate on 4Q GDP Will be Released on Friday

The Commerce Department will release its first estimate on 4Q GDP on Friday morning at 8:30 ET. Most forecasters believe that the US economy decelerated in the 4Q. The pre-report consensus is for GDP growth of only **0.9%** (annual rate) in the last three months of 2015.

That's down from 2.0% in the 3Q and 3.9% in the 2Q. If the 4Q advance estimate comes in at the pre-report consensus of 0.9%, that means the economy grew at an annual rate of only **1.85%** for all of 2015. Keep in mind that the 4Q GDP estimate will be revised two more times, at the end of February and March.

Of course, there is a chance that Friday's GDP report will come in below expectations. The Atlanta Federal Reserve Bank's ***GDPNow*** forecast – which is designed to estimate GDP in real time – stood at only **0.7%**as of January 20, up slightly from 0.6% a week earlier. This reading has declined sharply since the 2.0% estimate on December 17.



Multiple Worries Continue to Drive Stocks Sharply Lower

The major US stock markets have turned in their worst January performance in history, as have many equity markets around the world – and the month is not over yet. As a result, we'll keep our focus on what is driving this extremely volatile move. Let's run through what most consider the main drivers of this massive sell-off.

Overvaluation. One standard measure of stock values is the price-to-earnings ratio, or PE. It compares the market's average stock price with the earnings (profits). If a stock sells at $10 a share and has earnings of $1 a share, the PE is 10. By this indicator, the market was high last year. The average PE for the S&P 500 Index stocks since records have been kept (1870) is **16.6**, according to Standard & Poor's. By contrast, the market's PE was apprx. **21.5** at the end of 2015, suggesting an overvaluation by this measure of nearly 30%.

China is Weakening. Just a few years ago, China's economy was growing by 10% or more a year. Last week, China announced that its economy grew by **6.9%** in 2015, slightly better than most forecasters expected. It also said the official target for 2016 is **6.5%.** The problem is that there is a healthy distrust of the economic figures published by the Chinese government.

Whatever the real numbers are, China's appetite for raw materials (metals, foodstuffs, fuel and many other commodities) has fallen significantly, resulting in surpluses of many commodities around the world. Many emerging market commodity producing countries (Brazil, South Africa, Indonesia, Asia, etc.) that sell to China have been hit hard, and their economies are suffering.

This has raised concerns about a new global recession in 2016. However, we should keep in mind that the International Monetary Fund estimates that global growth will be **3.4%** this year; emerging countries will grow by **4.5%;** and Europe by **1.7%**. While these estimates are likely to be revised somewhat lower in the months ahead, the IMF does not see a global recession this year or next.

Collapsing Oil Prices. Normally, lower oil prices are considered an economic stimulus, as consumers save money at the pump. But it's unclear now how much of these savings are being spent. Meanwhile, oil companies are laying off tens of thousands of workers and reducing their exploration and development budgets. Abroad, producing nations that rely heavily on oil revenues for their budgets face serious pressures to cut spending.

Rising US Dollar. Since the middle of 2014, the dollar has appreciated about **15%** against a basket of foreign currencies. Paradoxically, this weakens the US economy since it makes American exports more expensive, while also reducing the conversion of foreign profits from local currencies into dollars. Most economists agree that the dollar's appreciation has cut the profits of the S&P 500 companies by at least 5%.

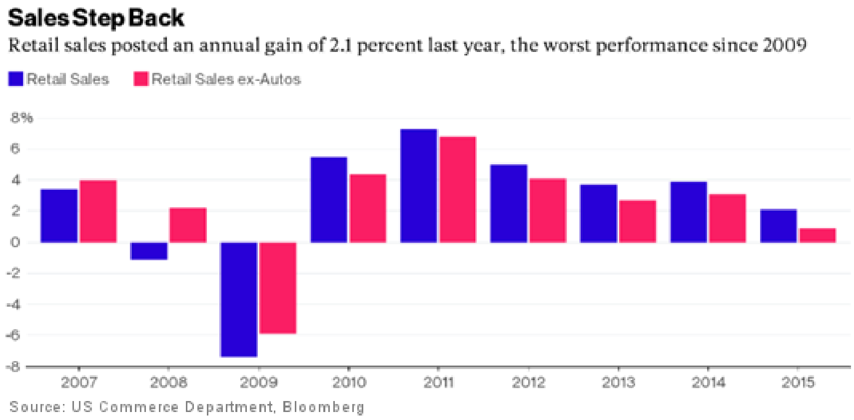
Meanwhile, the rising US dollar means **increased debt servicing costs** for countries around the world that have gorged on dollar-denominated debt in recent years, with historically low interest rates. I could write an entire E-Letter on this topic alone and probably will in coming weeks.

Fed Rate Hikes. The Federal Reserve is also contributing to the sense of dread in the markets. In December, the central bank finally hiked interest rates up from near zero for the first time since 2008. The increase was tiny, but it signaled that the days of easy money that fueled the post-recession bull market were officially drawing to a close. Some are concerned that if the Fed continues to raise short-term rates, it could also slow the economy substantially.

In addition, higher US interest rates are likely to drive the US dollar even higher. When things go bad in the world economy, investors turn to good old American assets as a safe haven, driving up the value of the dollar. When the Fed raises interest rates, that also attracts more investment to the US, driving up the value of the dollar even more.

The Fed says it wants to hike short-term rates four times this year – but I doubt they will in light of the latest market meltdown. The first Fed policy meeting of 2016 is this Thursday and Friday.

Consumer Spending Wobbly. Consumer spending accounts for apprx. 70% of US GDP. Retail sales declined slightly in December and rose by only 2.1% in all of 2015, marking the worst year since 2009. The decline in December sales came as a surprise since we were led to believe by the media that holiday spending was stronger than expected. Retail spending growth has been in a downtrend, despite the windfall of sharply lower gasoline prices.



Protectionist or Socialist President. This one is admittedly a stretch as a reason for the stock market selloff, but follow me on this. Donald Trump promises he will raise tariffs on imported goods from countries like China – anti-trade policies are never good. Bernie Sanders is an admitted Socialist who has suggested raising taxes on millionaires to 90% – also not good.

Yet both men are gaining in the polls as their respective party presidential nominees. Trump has held a sizable lead in the GOP race for several months now. And Bernie Sanders leads Hillary Clinton in several polls in Iowa and by a wide margin in New Hampshire. Who would have thunk it?

I mention this only because some analysts are now suggesting that the stock markets are plunging because it now looks likely that we could have either a Protectionist or a Socialist in the White House come January of next year.

Putting the Latest Stock Market Plunge in Perspective

Most stock market analysts have focused in recent days on how much the major indexes have declined since the first of the year. As of last Friday's close, the S&P 500 was down **6.7%** since January 1, the Dow was down **7.6%** and the Nasdaq was down **8.3%**. It has been the largest January rout of stocks in history and the month's not even over yet.

Yet the equity markets have been in a downtrend since May of last year when the S&P 500 peaked at **2130.82** on May 21. Since then, the S&P 500 is down about **13%**, the Dow is down apprx. **14%** and the Nasdaq is down apprx. **14%** as of the end of last week. Given these numbers, the question is whether stocks are now in just a "correction" or a new bear market?

On Wall Street, the conventional definition of a bear market is a fall in stock prices of **more than 20%** from the previous peak. Anything less is generally referred to as a correction. But these definitions can be misleading. In any event, as of last Friday the major indexes are still in a correction but could cross into bear market territory with just a few more nasty down days like we've seen so far this year.

Obama Continues to Betray America's Best Interests

Long-time clients and readers know that I have many problems with President Obama. Like most conservatives, I was absolutely livid over Obama's deal with Iran last year, which guarantees that the world's greatest sponsor of terror will get nukes – probably sooner rather than later.

I have argued for years that this president does not have America's best interests at heart. Take his vow to close the Guantanamo Bay prison, for example. Since Congress won't cooperate, Obama is using executive orders to slowly empty the prison which houses some of America's most dangerous enemies.

I read an outstanding article last week on this disturbing topic by **Monica Crowley** in *THE WASHINGTON TIMES.* I have reprinted it for you below. You need to read this!

Obama Saves Most Dangerous Betrayal for Last

Monica Crowley, Washington Times January 21, 2016

It's now clear that despite escalating jihadi attacks and threats worldwide, nothing will dissuade President Obama from releasing or bringing in [to the US] some of the world's most vicious Islamic killers.

Within 24 hours of the Islamic State attacks in Paris last November, Mr. Obama released five Yemeni detainees from Guantanamo Bay to the United Arab Emirates. The timing, optics and dangerous reality of a terrorist release coming immediately after mass slaughter committed by their fellow jihadis-in-arms did not concern him.

After all, he's done it before. Just a week after the jihadi massacre at Charlie Hebdo in Paris in January, he released five Taliban leaders from Guantanamo to Qatar, where they stayed in "luxurious" confinement until their release one year later.

And who could forget his infamous exchange of five top Taliban commanders for the alleged deserter, Army Sgt. Bowe Bergdahl, in May 2014? Or the more recent example of Ibrahim al-Qosi, released from

Guantanamo in 2012 and currently running al Qaeda's franchise in Yemen? Just last week, he released 10 more Yemenis to Oman.

Mr. Obama's own director of national intelligence has estimated the recidivism rate [return to the battlefield] for Guantanamo detainees at roughly 30 percent. Once freed, they re-establish communications with their fellow combatants and then plan, plot, inspire and arm them. In fact, former detainees are treated as jihadi "rock stars" who outlasted the American infidels.

None of this matters to Mr. Obama, who has accelerated his plan to close Guantanamo. Given that his rabid leftist ideology guides his every move, even those that directly imperil American national security, this isn't a surprise.

On his first full day as president, Mr. Obama issued an executive order demanding the immediate closure of Guantanamo, which he and his fellow leftists had argued was a blight on the rule of law and a terrorist recruitment bonanza. Never mind that al Qaeda jihadis hit America on Sept. 11, 2001, before Guantanamo existed as a prison. Never mind that the terrorist suspects held there are foreign enemy combatants who are not entitled to the full panoply of U.S. legal rights and privileges, and that the Supreme Court had held that they could be held "indefinitely" until the end of the war.

Never mind that they already have legal representation and due process through the right to federal court review. Never mind that they have three full meals a day, religious services and state-of-the-art medical services, all under the watchful eye of the International Committee of the Red Cross.

Never mind that the United States itself is a jihadi recruitment tool — which will become even more magnified once [the remaining] detainees are transferred to U.S. soil.

Under Mr. Obama, military tribunals, which had been in use since Revolutionary War times and held constitutional by the Supreme Court, were to be ended, with some military trials — such as that of Sept. 11 mastermind Khalid Sheikh Mohammed — stopped after they had already begun. Mr. Obama originally wanted terrorist suspects held at Guantanamo to be matriculated into civilian criminal courts.

Mr. Obama and the left expected that the enemy (as well as the rest of world) would view this as humility when, in fact, it displayed a haughty arrogance that only inflamed anti-Americanism. The "we're better than they are and we'll show them through our judicial system" attitude did nothing but reinforce our enemies' belief that America was as arrogant and deserving of violent attack as ever. It also telegraphed to the enemy a sign of weakness that we weren't interested in pursuing ultimate victory. Hence, the rise of the Islamic State and expansion of Islamism.

Bringing top al Qaeda terrorists to New York to stand trial near ground zero may have satisfied Mr. Obama's leftist fantasy of showing the world that we're "better" than the terrorists, but the policy was advanced without a plan, a comprehensive new legal structure to deal with the detainees, or political support, including from many Democrats.

In the end, Mr. Obama kept Guantanamo open and operational, although he hasn't ordered a single terrorist suspect sent there since he became president. It's easier to kill them on the battlefield without due process than have to deal with the messiness of interrogation and detention.

Mr. Obama now intends to return to his original plan: release all but about 59 of the most incorrigible jihadis, including Khalid Sheikh Mohammed, who will be transferred to supermax federal prisons in the United States. Further, as national security expert K.T. McFarland has suggested, once it's emptied, <u>he's also likely to turn the base over to his new friends, the Castros of Cuba.</u> This could have been one of the main drivers for his rapprochement with Cuba in the first place. If President Carter can give away the Panama Canal, Mr. Obama can give away another vital strategic asset, this one just 90 miles offshore. [Emphasis mine.]

He will close Guantanamo, even if it means replenishing the terrorist ranks, endangering the American people, and aiding and abetting the enemy. After all, his quarrel with Islamism is secondary to his quarrel with American power. END QUOTE

Best regards,
Gary D. Halbert

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