Trust Matters by Dave Helscher

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It is the best of times; it is the worst of times. Such is the paradox not solely for fictional characters from literature but also of the current financial markets. It depends on which side of the equation you fall, which country, which industry, producer or consumer. The trick may be to find a method and not lose your head in the process.

In December, the Federal Reserve raised short term interest rates by a quarter point as it lifts off the normalization of rates. In the meantime, the European Central Bank, the Japanese central bank and several others have moved short term rates into a negative interest rates position. This further strengthened the relative value of the dollar and weakened other major currencies. A stronger dollar makes U.S. exports more expensive in local currencies and has hurt our export market. A weaker Euro or Yen, gives their exports the advantage, all else being equal, of being cheaper. Not so good news for exports by U.S. manufacturers or domestic agricultural products.

Crude oil prices have been volatile but decidedly trending lower. Cheaper energy is good for consumers, whether they be individuals or businesses, unless of course, the business is oil exploration or production or individuals employed by those firms. A decline in production and exploration moves along to vendors and suppliers of equipment and goods used, decreasing employment and further affecting manufacturing. It has been expected that savings at the gas pump would ramp up consumer spending on goods and services, increasing the production of these same goods and services to restock the shelves. But at this point, not so much, as consumers appear to be saving, rather than spending, the differences in prices at the gas pump. Personal savings has been trending up, but so have auto sales and housing demand. Some of these savings are being spent on new vehicles and homes, supporting the auto and construction industry.

The Chinese currency has employed a soft peg to the U.S. dollar for some time. As the dollar increases in value, so does the Chinese currency, making their exports more expensive relative to other currencies. Over the past several months, the Chinese monetary authorities have attempted, rather clumsily, to reduce the value of its currency. Their inexperience in currency matters also translated into moves to support its local stock markets, adding to general apprehension on what was being attempted. China is attempting to navigate from an economy dominated by exporting firms to creating a larger and more active market for domestic consumption. Against this backdrop, is a trend of slowing annual growth, a natural and expected byproduct of a much larger economy that the halcyon days of the past three decades.

A slowing growth rate for both China and U.S. creates less demand for a variety of commodities. Chief among these is oil. Lesser demand would normally equate to lower prices. Declining demand and increased production has exacerbated the decline in oil prices. Many emerging markets are heavily dependent on commodity exports, think of Russia, Brazil or Saudi Arabia. Reduced demand for their products has placed strain on these economies as well as their governmental revenue. In some cases, keeping production constant or actually increasing production is the only means of increasing revenue from an assets, whose value is declining.

U.S. job creation has been trending higher for some time. Unemployment stands at 4.9% and recent reports indicate an expanding demand for employees possessing the skills required. A tightening labor market places some pressure on wages, as new and existing employees are able to expect increases as there are fewer available replacements. Increased labor costs decrease the profit margin for the business. A stronger dollar further decreases this margin from the export market. With low inflation, passing this additional cost through to the end user is difficult. The potential of lower corporate net profit has placed some pressure or at least concern of the market values of public companies' stock prices.

These are a sampling of the current demands of the global economy. Uncertainty is not a friend of financial markets and this creates the current volatility of financial markets. These are big questions without easy answers. They cut across the globe with different solutions for different currencies, markets, economies and local demands. This raises a further paradox of what may be good for the many may not be for the few. Not all may be able to have their cake and eat it too.