Secure Planning Inc.®
The Financial Counselor Program

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Oh What a Year: 2013!

A Paradigm Shift in Energy!

Six or seven years ago, the U.S. was very concerned that the balance of payments was showing large deficits year after year. Much was attributed to importing oil from overseas. Oil production in the U.S. was in decline and the large reserves found in Alaska were beginning to dwindle. The picture was not good. A byproduct of this was that energy costs in the U.S. were going up, reducing the capital spending of corporations and consumers as they spent more on energy.

This has all changed! The U.S. now has the largest reserves of oil and gas in the world due to new extraction technologies. This is a game changer. Natural gas in particular is important because the use of natural gas has a lower impact on the carbon footprint. For this reason, utility companies are converting to natural gas and moving away from coal. Even more important is that manufacturing costs in the United States, using natural gas, are less expensive than anywhere else in the world. This low cost energy, along with high U.S. productivity, high quality workmanship and a stable government, is driving new high tech manufacturing to the U.S. This has a long-term positive impact on U.S. growth. In the third quarter of 2013, the government reported a growth rate of 4.1%! This is the type of growth you'd expect from a developing country, not a mature country like the U.S.

In addition to the lower costs associated with natural gas, the U.S. is now importing less oil and is actually exporting oil. These changes have had a material impact, reversing the U.S. balance of payments from negative to positive. The U.S. is likely to become energy self-sufficient. Oil we had been buying overseas is now available for other countries. This change may keep worldwide oil prices in check. The leveling off of energy costs can have a favorable impact on the European and the Japanese economies as well.

In the U.S., the advantage of gas will be felt the most in areas where pipelines already exist. We will likely see more gas pipelines being built in the future as states realize that they are at a strategic disadvantage without a source of inexpensive natural gas. By the end of 2014, three major new pipelines should be completed, bringing more oil into the state of Texas to be refined. This will have a major impact on the U.S. ability to export more oil.

A year ago, economists were thinking that a growth rate of 3.0% to 3.5% in the U.S. would be the best we could do. Given the results of the third quarter of 2013 at 4.1%, is it possible that the U.S. could be looking at a growth rate of 5% or more in the future? If that happens, the U.S. would have an expanding economy similar to emerging market countries, but with the infrastructure to handle the growth.

The impact of this shift in the U.S. energy position is difficult to predict but I believe we are at the beginning of what could be a major boom period and a return of manufacturing to the U.S.

Read more of Ed's thoughts on his blog at http://secureplanninginc.blogspot.com

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A Change in Policy

For about two years, the Federal Reserve has been purchasing bonds and mortgages in the amount of $85 billion each month. This has helped with the liquidity of bonds and mortgages and has kept interest rates down. The lower mortgage interest rates allowed consumers to begin buying existing and new homes again. As interest rates fell, low longer-term rates became a major factor in the upsurge in home values, the stock market--due to high levels of liquidity--and in bond principal. Consumers saw their worth increase, began to feel better about their investments and became more open to spending. Because about two thirds of the U.S. economy is based on consumer spending, this added wealth was beneficial.

In May, the Federal Reserve indicated a reduction in purchases of bonds and mortgages was imminent. This announcement roiled the bond markets, with interest rates rising and bond values dropping, and stock prices falling. Mortgage interest rates went up and the housing market slowed. When the Fed met in December, they voted to reduce bond and mortgage purchases by $10 billion in January of 2014. They did this after determining that the economy was becoming stronger and could weather the change.

As the Fed reduces their purchases, bond interest rates and mortgage interest rates will continue to rise. This will result in intermediate and longer-term bond values decreasing. It may also have a dampening effect on the rise of stock prices.

The Fed must next address the discount rate. Since early 2009, the discount rate has been set at 0%. The intention was to drive down short-term interest rates to 0%. If you look at money market funds, interest checking or CD rates, you can see that the Fed was very effective with this reduction. The discount rate is used to prop up the economy in bad times by reducing the rate, thereby creating more liquidity in the financial system. Given the melt down of banks that occurred in 2008-09 the Fed succeeded in stemming a collapse of the financial system by going to 0%.

The Fed must, at some point in the future, begin moving the discount rate back up. If they don't do so, we stand a chance of higher inflation. Allowing inflation, which has been in check for the past 10 years, to rise sharply is not desirable. Although there has not been much talk about this change, I would not be surprised if it is addressed at the upcoming meeting at the end of January.

Conclusion

I foresee that the U.S. can have the most robust economy we have seen in many years. In the short run, intermediate term and long-term bonds will likely suffer losses. When the Fed stops purchasing bonds and mortgages, we should return to a normal interest yield curve, and longer-term bonds will be a major investment factor again. In a robust economy, inflation will be likely to pick up. If the Fed can move the discount rate up soon enough, and at a reasonable rate, inflation should be contained. Wages, which have been stagnant for the past five years, will likely begin to increase as the pace of hiring accelerates. The stock market will do well as companies invest in new production, expand businesses and become more profitable. Manufacturing should continue to grow. Natural gas and pipeline development should do well in this environment as demand increases with economic growth. It is possible that the growth rate in the U.S. will exceed the predictions of 3% to 3.5%.

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