November Economic and Market Outlook

Summary

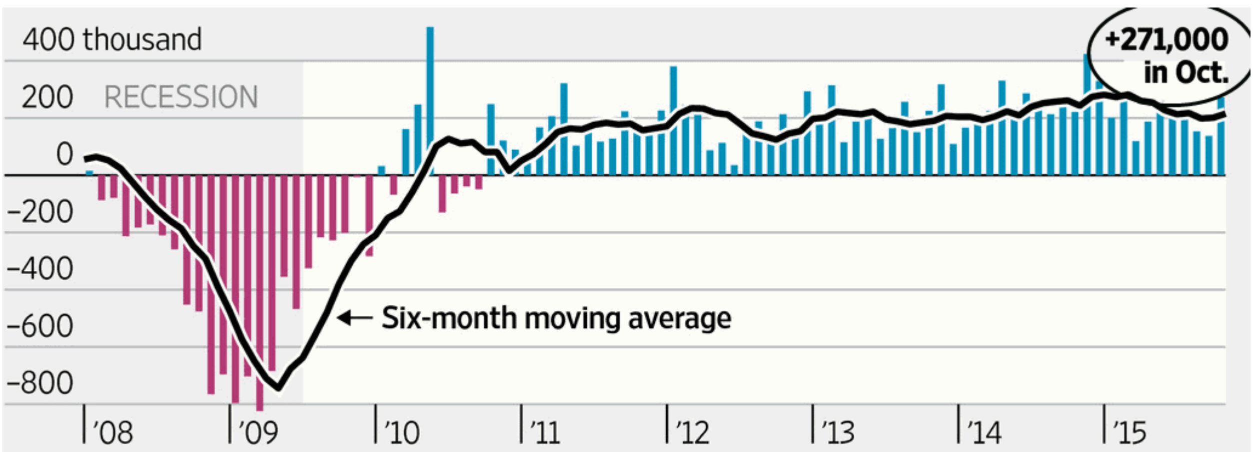
- The U.S. economy continues to add jobs, and consumers continue to buy homes and cars.
- External risks have risen
- Many major market indexes are topping, a red flag.

Economic Outlook

The consumer is about 70% of the U.S. economy, and the consumer has been buying, homes, autos and spending online, and at some brick-and-mortar stores. Some retailers are seeing sales declines.

Employment

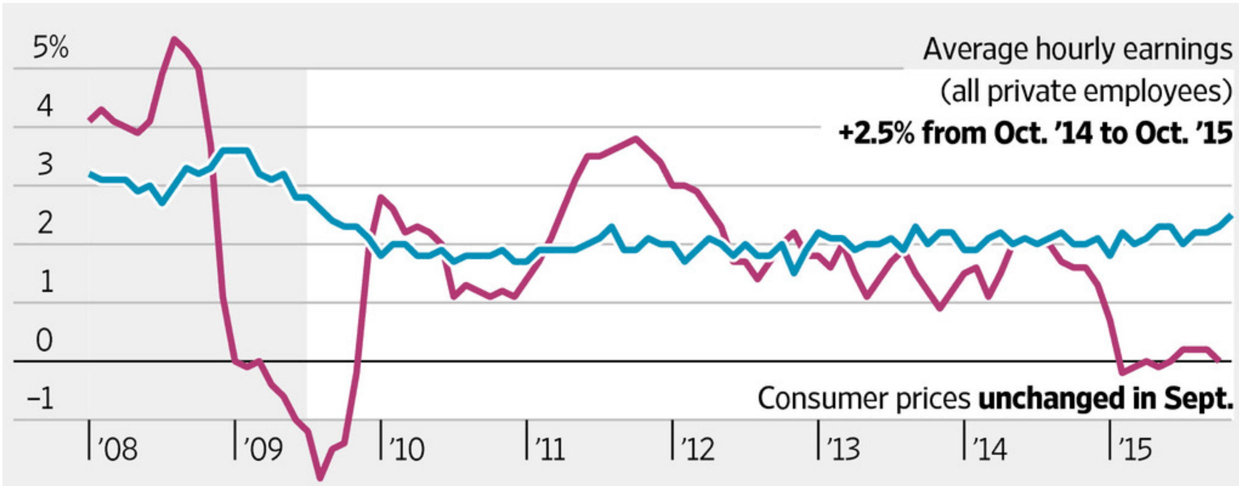
The improving employment picture has helped consumer confidence:



SOURCE: Labor Dept. WSJ

The October employment report was much better than expected: 271,000 new jobs.

Also, we are starting to see some wage gains:

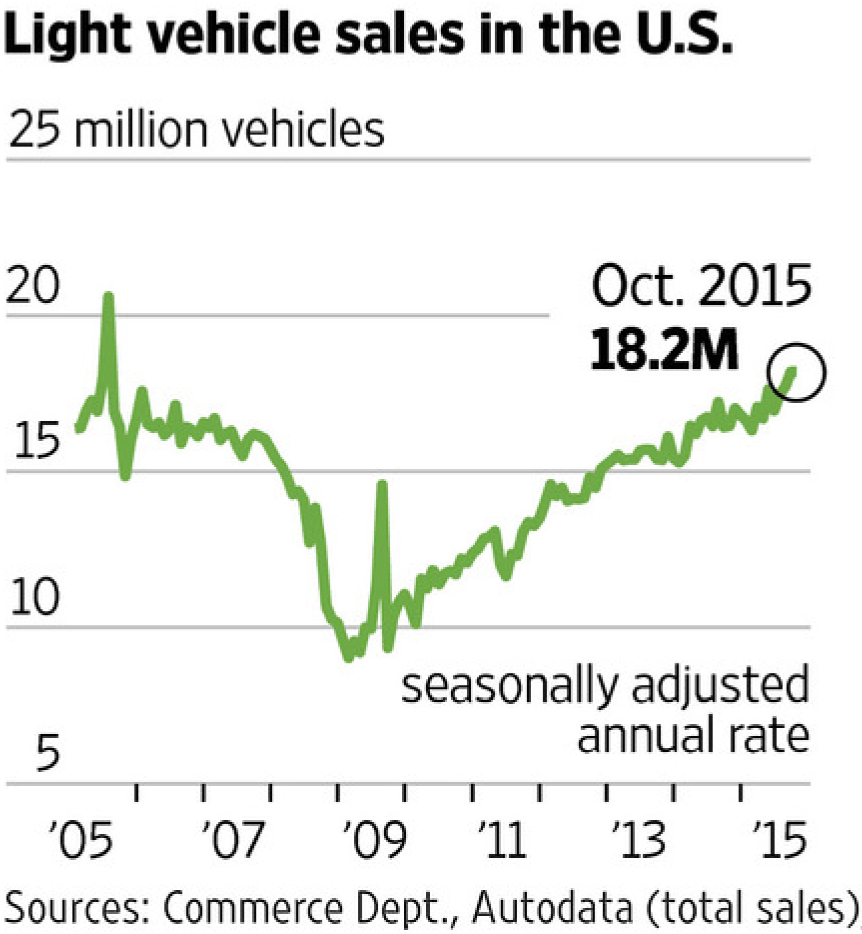


SOURCE: Labor Dept. WSJ

We see that wages are starting to improve while CPI (inflation) remains very low.

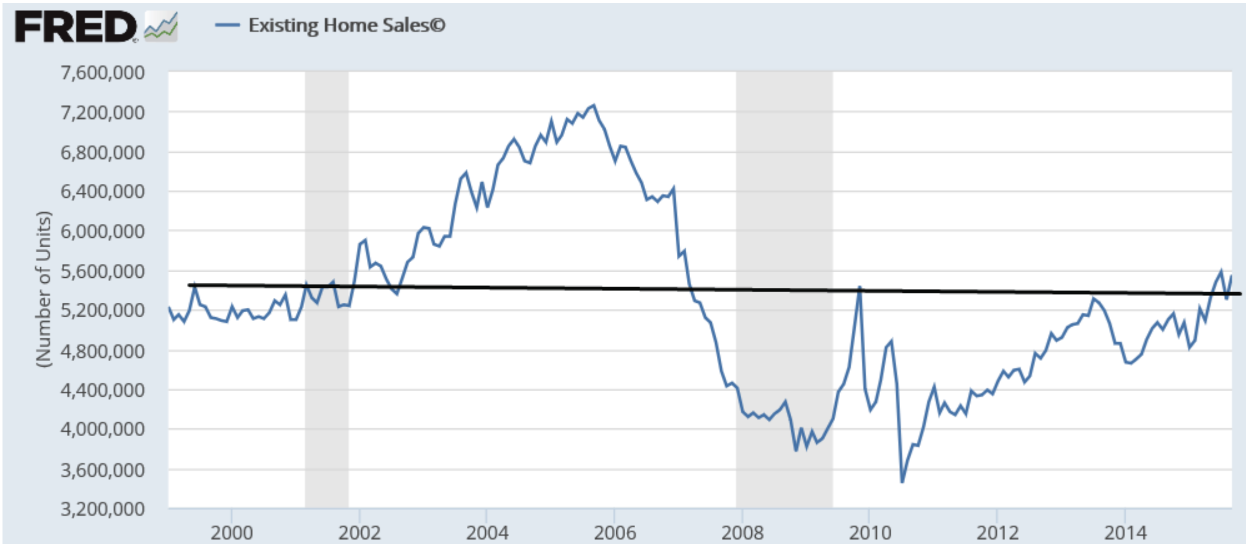
Autos

Auto sales are being helped by low interest rates and rising employment:



Auto sales are now above pre-recession levels.

Home sales continue to improve:



Source: Federal Reserve Economic Research Bank of St. Louis

Home sales have improved to pre-bubble levels.

Slowing Global Economy

China is now the 2nd largest economy in the world (approximately $11 trillion). As I've written about in previous issues, the Chinese economy is trying to shift from a manufacturing, export and investment driven economy to a consumer, service oriented economy.

The shift has not been smooth:

As the chart above shows, investment growth and exports have slowed. Consumption has not grown enough to make up for the loss in exports and investments.

The chart above shows growth has contracted to about 6.9%. Many analysts don't believe this number:

China has reported GDP growing at about 6.9%. But some analysts that study the Chinese economy by looking at different components including electricity production, bank lending, rail freight volumes put growth at around 2.8%.

China emerged as a major economic power major and investment trend in the 2000s. China's economic boom also created a commodity boom. The shift of economic priorities in China is causing a major reversal in the commodity boom. I wrote about this trend reversal, click here to study this important Special Report, *China & Commodities – the First Major Trend Reversal of the 21st Century*.

There are many commodity based gobal economies and China's trading partners that are in or near recession: Canada, Brazil, Venezuela, Australia, Indonesia, Russia, Japan….

The question is – can the U.S. remain an island of prosperity as the global economy is slowing, especially China and natural resource based economies.

Risks from Russia, and the increased conflicts and tensions from the energy rich Middle East get worse instead of better.

November Market Outlook

Below is my November market outlook:

2015 FORECAST					
	EARNINGS ESTIMATES	RISK,GRWTH ADJ P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1079.28	15.5	16,728.84	17,754.00	-6.13%
SPX	125	16.5	2,062.50	2,081.00	-0.90%
2016 FORECAST					
	EARNINGS ESTIMATES	RISK,GRWTH ADJ P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1157.12	15.5	17,935.36	17,754.00	1.01%
SPX	132.53	16.5	2,186.75	2,081.00	4.84%
HIGHER P/E 2016					
	EARNINGS ESTIMATES	RISK,GRWTH ADJ P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1157.12	16	18,513.92	17,754.00	4.10%
SPX	132.53	17	2,253.01	2,081.00	7.63%

Source: Consensus earnings estimates from Barron’s, Thomson Reuters, Factset

2015 is essentially over, so let’s focus on 2016.

Because risks are rising, I’ve lowered the P/E on how much I believe investors should pay for S & P and DJIA’s earnings. Using a lower P/E multiple, the DJIA is fairly valued for next year, and the S & P has about a 7% total return potential (4.84% appreciation potential plus 2% dividend).

If the problems in China, Japan, Brazil, Russia, Iraq, Iran Syria…. improve, then the markets have slighly more potential, and we can use a higher P/E.

Below is chart that visulizes the price targets for the Dow 30:

Source: www.erlangerchartroom.com

If the earnings forecasts are met, and the global economic picture improves, the market could move higher from current levels.

If we do have a bear market, and we don't make new highs the market could pull back to the 12,800 level (18,300 market high in this market cycle times 70%, the average bear market is down about 30% leaving an investor with about 70% of their investment capital).

Most indexes, including the Dow 30, are establishing topping patterns, a red flag. The Dow 30 is developing a rounding top/umbrella topping pattern.

This late in the cycle, it is best to be cautious, and to raise cash. There are two good reasons to raise cash: 1. The risk reward relationshipe upside is about 7%, downside is about 30% 2. When we eventually go into a bear market you will have cash to take advanatage of lower prices, valuations.