April 2016 Commentary

During the first quarter of 2016, the stock market was the epitome of a rollercoaster ride. Stocks began the year with their worst weekly start ever. By February 11th, the Dow Jones had declined by nearly 10% for the year. When stocks experience a selloff of this magnitude, particularly over a few short weeks, it's not uncommon for us to begin fielding calls from nervous clients. We often hear the four most expensive words on Wall Street: "This time is different".

Headlines have been swirling with uncertainty surrounding interest rate hikes, the legitimacy of China's economy, plunging commodity prices and, most notably, our upcoming election this November. Maintaining the mindset of a long-term investor can be very difficult when we can't seem to make sense of the present.

Generally speaking, this time wasn't all that different for the economy or the markets. The global supply/demand relationship in oil, the main culprit of our recent volatility, has reared its ugly head numerous times in the past. The primary benchmark for oil in the United States is West Texas Intermediate (WTI). In 2005, WTI was hovering around $50/barrel. As a result of strong demand and stagnating world production, WTI nearly tripled by 2008. At that time, the highest recorded average price for a gallon of gas in Metro Detroit was $4.20, occurring on July 16, 2008. Oil has been on a rollercoaster ride ever since, bottoming out at $26/barrel in February. Today's over-supply and stagnating demand are virtually the opposite of what occurred in 2008. Nevertheless, WTI managed to rally by over 40% from February's lows to finish the first quarter where it started.

With consumer spending accounting for roughly 70% of GDP, lower oil puts a few extra spendable dollars in the pockets of the consumer. For example, with gas averaging $1.50/gallon in February, a consumer who fills up 15 gallons per week would save roughly $2,100 per year (compared to $4.20/gallon in 2008). Economists would argue that these excess funds can be used to purchase other goods and services, causing a positive ripple effect throughout many sectors.

While cheaper oil is great for the consumer, it depresses the profitability of drillers. This, in turn, leads to job cuts in the energy sector. It also negatively impacts banks and insurance companies, which lend money to drillers. Over the last year, the oil and gas industry has cut nearly 19,000 jobs, or 10% of its workforce. Interestingly, the rest of the US economy picked up the slack, adding about 2.4 million jobs over the same time frame.

Oil has had a profound impact on the stock market. In fact, the correlation between stocks and oil spiked to record levels in the first quarter. The persistent weakness in oil pricing has unexpectedly created a cash crunch in places like Saudi Arabia, Kuwait, the United Arab Emirates and Bahrain. These oil exporters require higher oil prices to balance their budgets. As a result, oil-rich countries need to tap their sovereign wealth funds, which collectively control over $5.7 trillion. Stocks go down when there are more sellers than buyers (and vice-versa). In turn, these sovereign wealth liquidations have created a substantial headwind for stock markets and asset prices.

When you chose Blue Chip Partners, odds are you considered our credentials, experience, first-class staff and our dividend-growth investment philosophy. We believe these qualities give our firm a competitive advantage. Ironically, you likely overlooked one of our most value-added services – helping manage your emotions. In a study produced in 2014, Vanguard estimated investors benefit by roughly 3% per year from working with an advisor. Of the seven categories considered to add value, behavioral coaching was estimated to account for half of the overall value added (1.5% per year).

We believe our coaching added real value in the first quarter. Instead of focusing on what Warren Buffet calls the short-sighted “voting machine” of the stock market, we focus on the fundamentals of great companies. This approach allows us to guide our clients to maintain a long-term investment perspective.   Ironically, the Dow rallied over 14% from the February 11th low of 15,503. The Dow closed on March 31st at 17,685, squeaking out a gain of 0.21% for the quarter.

In closing, a couple of housekeeping notes: A copy of our Privacy Notice is enclosed. It describes our policies for collecting and keeping your nonpublic personal information private.

There have been no material changes to our firm Brochure since our annual update on March 20, 2015. A full copy of our Firm Brochure dated March 24, 2016 is available upon request, and is also available on our web site www.bluechippartners.com by selecting the "Client Resources" tab, then "Forms/Useful Links" and "Firm Brochure Part 2A of Form ADV (updated March 24, 2016)."

Sincerely,

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