Global Financial Private Capital

Why Haven't We Seen The Benefits Yet?

SYNOPSIS

- Cheap oil prices were supposed to ignite a boost in spending in other discretionary sectors within our economy.
- So far, consumers have opted to keep these savings rather than spend them elsewhere.
- Although increased savings for Americans is not necessarily a bad outcome, expect to see a rise in spending at some point down the road.

SAVING VS. SPENDING

When oil began its decline back in June 2014, most economists and investors believed that if prices could remain low for an extended period, those economies that import oil and/or consume lots of oil would benefit.

The logic goes that if consumers are spending less at the pump, and if companies are paying less for oil, then both would have more money to spend elsewhere in an economy.

The U.S. was supposed to be one of the biggest beneficiaries of cheap oil. Sure, those who work in the industry would suffer from job losses and bankruptcies, but the net benefit was expected to be big because our economy fits so well into this investment thesis for three reasons:

1. **We Still Import**: Despite the surge in domestic oil production over the last 5 years, we still import most of our oil.
2. **We Consume**: The U.S. is the largest consumer of oil in the world.
3. **Economic Composition**: Over 70% of our economy consists of consumer spending.

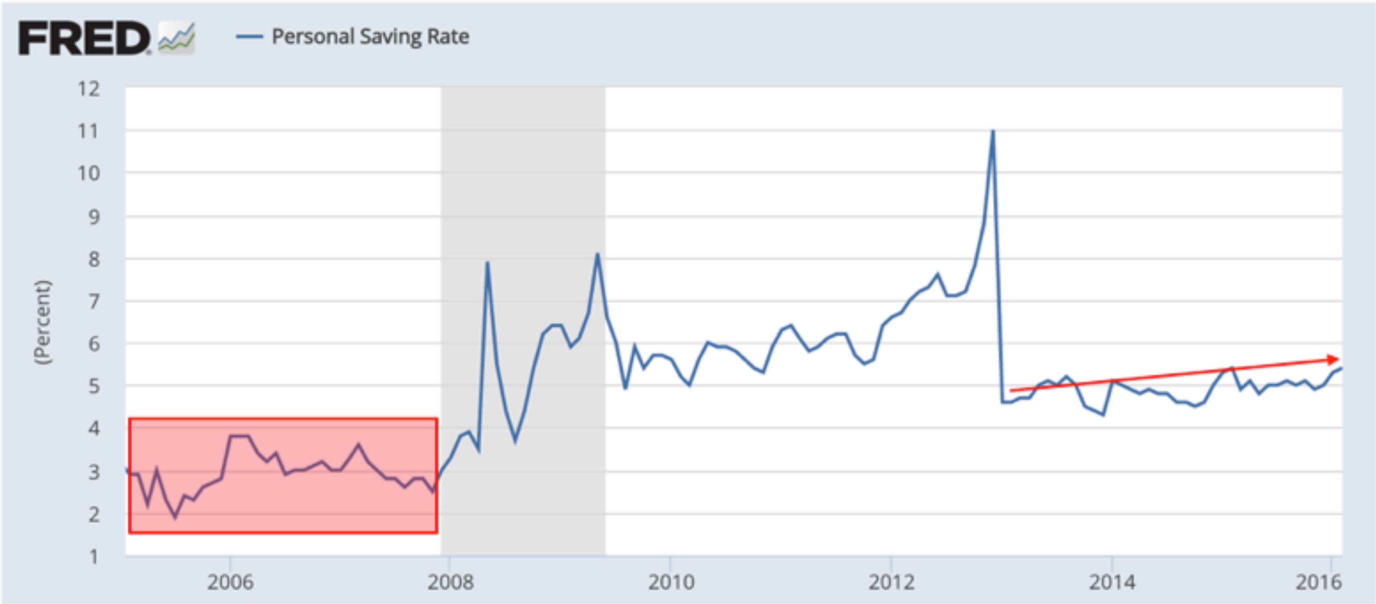
...the volatility in financial markets has caused a lot of concern amongst the general public, and when consumers are less confident, they tend to spend less.

Add these up and the output is the largest consumer of oil is now paying less for the commodity, so Americans should have a lot of money to spend elsewhere in the economy.

So far, only a portion of this thesis has played out. According to the Financial Times, lower gasoline prices saved Americans $126 billion at the pump in 2015, which equates to around $1,000 per household.

The other half of this thesis, the part where Americans were going to spend these savings elsewhere, has yet to happen. Admittedly, there have been some signs of spending reacting to cheaper gasoline. For instance, sales of sport utility vehicles surged last year to an all-time high of 17.5 million, and drivers hit the road to cover a record 3.2 trillion miles.

But consumer spending as a whole has yet to see any real bump. In fact, the data in the chart below point to Americans saving more that spending.



Source: U.S. Bureau of Economic Analysis, St. Louis Fed

The personal savings rate rose to 5.4% in February, which is the highest it has been in over three years (red arrow) and double the rate prior to the financial crisis (red shaded box).

Economists are perplexed and now trying to hypothesize why we haven't seen more consumer spending and increased economic growth from the fall in oil prices. Unlike many out there who claim to know the answer, I truly don't know because it's still too early to tell. However, I'm also not that concerned for two reasons:

1. **Only Upside**: Saving money at the pump is mostly a zero-sum game. Meaning, there simply cannot be a downside to the overwhelming majority of consumers by paying less for something that they don't even want to buy in the first place.
2. **Savings Matter**: Given the amount of debt accumulation and pain experience during the deleveraging years after the financial crisis, I don't necessarily consider a rise in the savings rate to be a bad thing.

IMPLICATIONS FOR INVESTORS

I wish I had a better answer, but unfortunately, I don't think one exists at the moment. If I had to guess, I would argue that the reason why Americans are not spending more has to do with the short-term, psychological effect of falling oil on consumers.

More specifically, the volatility in financial markets has caused a lot of concern amongst the general public, and when consumers are less confident, they tend to spend less. Our economy is not growing all that much, and consumers still remember the last recession all too well, so they may just be playing it safe for the time being.

If I am right, then this will most likely only be a temporary phenomenon. Falling oil has caused stocks to follow in tandem because traders are concerned that energy companies could go bankrupt, and the banks that loaned them money could then be at risk. However, once the weak companies begin to disappear, the stock market should then become less of a hostage to traders as oil-induced volatility wanes.

Like many other investors, I expected to see more of a rise in spending from cheap energy, but it looks like we will just have to wait a while longer. That's ok, because although timing these things is very difficult, it's still an indisputable fact that cheap energy prices are a net benefit to the U.S. economy over the long run.

Sincerely,

Mike Sorrentino, CFA
Chief Strategist,
Aviance Capital Management
mikeonmarkets.com