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OBSERVATIONS ON THE MARKET

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The world has become a complicated tangled financial web, and everything is not neatly in its place. The only thing that seems to be keeping it all together is low interest rates, and even the Fed doesn't know exactly how or why. They would never have guessed seven years ago that they would still be debating if interest rates should remain at 0%. It has created some interesting results.

Top of the list would have to be Austria. It is a country that usually doesn't have much significance in the world of finance. However, last week the Wall Street Journal noted that bonds of Austria that will mature in 2062 are paying the sum total annually of .9%. So for the next 47 years buyers of these bonds, if they invest $100,000, get to cash a $900 check every year. This hardly seems like a value proposition, and the likely event that inflation shows up sometime in the next 47 years seems high, making these a very bad long-term investment. The best explanation of why someone would buy these bonds seems to be that in our currently artificially stimulated world, there is another buyer out there who currently thinks the stimulus will keep coming for a few more days, weeks, months, or maybe even years. We are at seven years and running.

Running a close second is Europe. A few short years ago, speculation was running high that parts of Europe would surely default. Not anymore. The five year interest rates for Germany, the rock of Europe, are -.112%. You get to go to the mailbox, but only to send them a check for buying their bonds. France's five year debt stands at .03%, the riskier countries of Italy and Spain stand at .527% and .581% respectively. These are all yields that were thought impossible only a few years ago and could never go below the yields of the U.S.

Next on the list is oil. There is too much of it currently. The number of rigs currently being employed has declined from 1900 to just over 1000. In the past this has been positive for oil prices in the intermediate future, along with the dramatic cuts in spending being taken by the entire oil sector. Stronger economic activity and rising sales of larger cars and trucks point to an increase in demand which is also positive. Now for the mystery. As the price declines, this should become an incentive not to produce. In many ways it has been what has happened. However, in the futures market where you can buy or sell oil that you plan to buy or sell months or years from now, the prices are actually incentivizing producers to pump more. Currently, oil is selling for $47.44. If you buy it and store it, and agree to sell oil six months from now, you can receive $53.84 for November delivery. It costs $.50 per month, or $3 to store it for six months, so that leaves you with a $3 profit. If you borrow money in this low interest rate world, the profit becomes even more attractive. In a normal world this kind of arbitrage doesn't exist. We are being reminded every day that we are not in a normal world. The fear with oil is that if all the storage tanks fill up, it could lead to a total collapse in oil prices. Refineries normally do their maintenance in the spring adding even more pressure since they will be drawing less from storage. The best predictor of oil currently may be the price of oil that trades six months from now.

The world of stimulus has made investing extremely challenging. Do you buy now, or wait thinking better values will present themselves. For those who have been waiting, moss is growing under your feet. The Fed is suggesting their first increase in interest rates will come before the end of the year. Finally, something more than zero. The market panicked at the hint of an increase a few years ago. Now, the 10-year Treasury bond has actually declined to 1.88%. This wasn't supposed to have happened. Since Europe has negative interest rates, it seems like the party isn't over yet, but one of these days whoever is holding those 47 year Austria bonds is probably going to ask themselves; "what was I thinking?"