BARCLAYS

Wealth and Investment Management

In Focus: Markets as we see them

No need to fear – looking beyond the decline in oil prices (and US retail sales)

Global equity markets have spent most of the first two weeks of 2015 in negative territory, and the MSCI All Country World Index has underperformed gold by almost 6% as of this writing.[1] Furthermore, volatility has picked up: the VIX, the market's "fear indicator," is at the highest level since late October.

Many have been blaming market volatility on declining oil prices, which have more than halved since last summer. One fear is that declining oil prices are a signal that economic activity is slowing around the globe. Another fear is that falling prices will cause an economic slowdown because it will: 1) hurt the energy sector, a concern especially for the US economy, which has enjoyed the benefits of surging domestic oil production; and 2) create headwinds for energy-producing economies around the globe (i.e., Venezuela, Russia, Saudi Arabia, and Scotland).

A look back

To get a better sense of the implication of weaker oil prices on US Gross Domestic Product ("GDP"), we examined prior periods of rapid oil price declines, dating back to 1983.[2] The analysis (see Figures 1 and 2) reveals that weakness in oil prices is not necessarily indicative of GDP growth slowdown. For sure, in two of the four such periods, real GDP growth declined significantly, falling between 4 to 8%, as they corresponded with the global financial crisis and the Gulf War recession. During other two periods of significant oil price declines, there was no recession (November 1985 – March 1986 and May 2011 – September 2011) and the GDP growth rate either slowed while staying positive or continued to trend higher; it did not go negative.

Today's environment

Current economic fundamentals show anything but recessionary momentum. In fact, the Institute for Supply Management ("ISM") Manufacturing Index, one of the most robust measures of the health of the US economy, has remained solidly in expansionary territory for the past two years. (Figure 3)

[1] Source: Bloomberg, as of January 13, 2015.
[2] According to Strategas Research Partners, between 1980 and the end of 2013, a radical decline in oil prices occurred in the following time periods: November 1985 – March 1986, October 1990 – February 1991, July 2008 – January 2009, and May 2011 – September 2011.

January 16, 2015
For Americas distribution only

Americas Investment Strategy
Laura Kane, CFA
Investment Strategist, Americas
laura.kane@barclays.com

David Motsonelidze, CFA
Investment Strategist, Americas
david.motsonelidze@barclays.com

Inside

Declining oil prices: A headwind for some economies and market sectors, the fear that falling oil prices portend a global economic downturn is, in our view, not consistent with the facts.

The Swiss franc: In a surprise move, the Swiss National Bank set aside its cap on the Swiss franc versus the Euro, roiling already skittish markets.

Figure 1: Rapid oil declines pre-2000

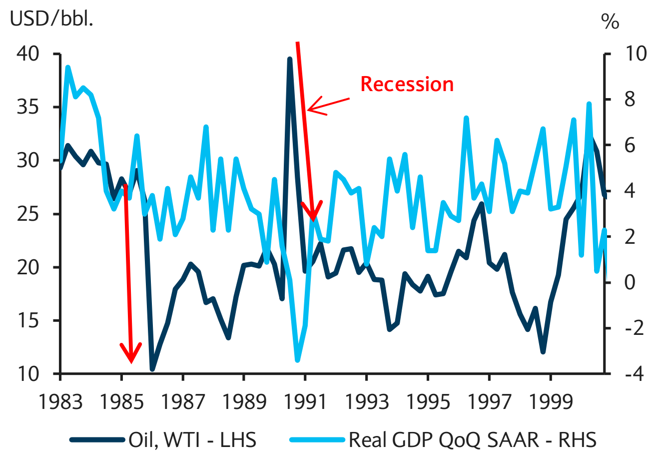
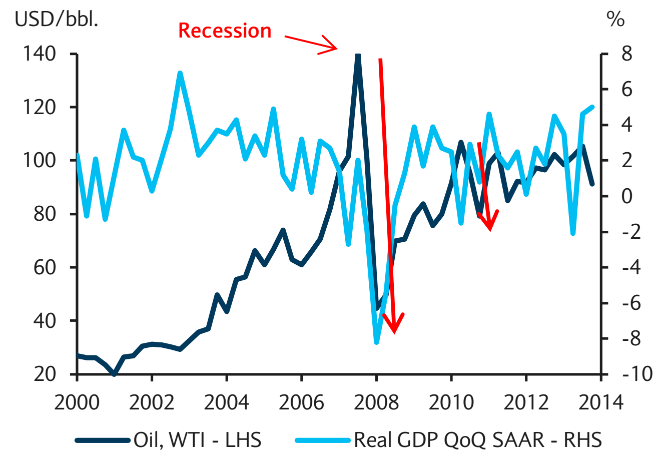
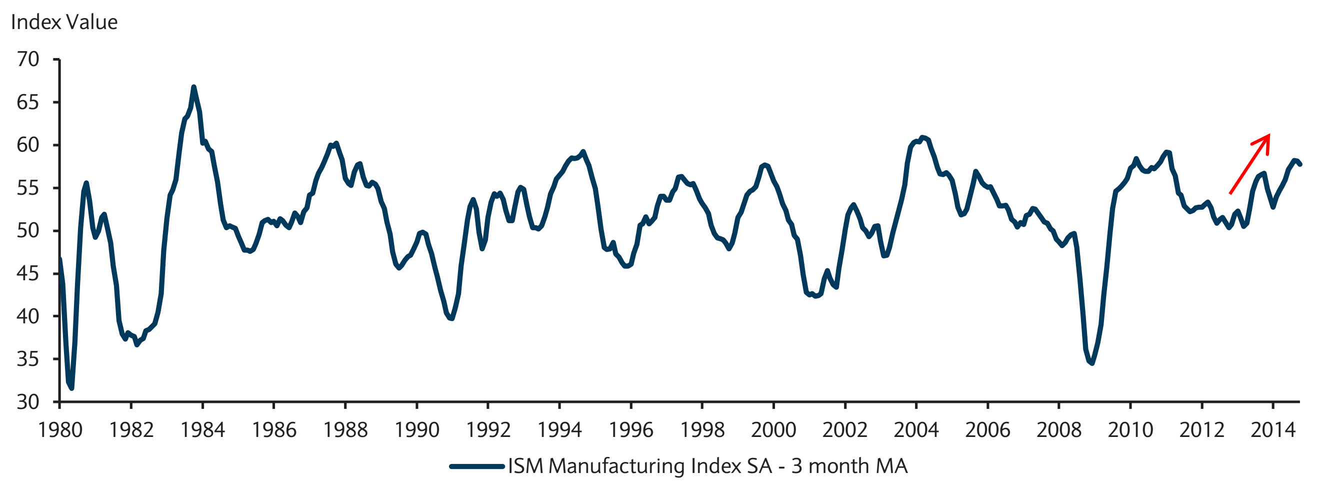


Figure 2: Rapid oil declines post-2000



Source for Figure 1: Bloomberg, as of December 31, 2000. Source for Figure 2: Bloomberg, as of September 30, 2014. WTI = West Texas Intermediate. SAAR = seasonally adjusted annual rate, quarterly data. QoQ = quarter over quarter. bbl = oil barrel. RHS = right hand side, LHS = left hand side.

Figure 3: Economic fundamentals continue to be strong



Source: Bloomberg, as of December 31, 2014. SA = seasonally adjusted. MA = moving average.

Furthermore, the latest Fed Beige Book release[3] confirms that US economic growth remains solid: "Consumer spending increased in most districts, with generally modest year-over-year gains in retail sales." The results were based on reports from the Fed's 12 districts gathered on or before January 5, 2015.

Another source of concern has been the effect of falling oil prices on employment and capital expenditure. US shale production has created many jobs and been a key area of investment for businesses. While capital expenditure ("capex") budgets for energy companies will likely decline and some jobs may be lost, the net effect on the overall US labor market and growth profile should be muted. Energy jobs number roughly 759,000 versus a total of 140 million in the US, or less than 1% of total jobs.[4] Also, even though capex in the oil and gas sector has grown faster than other sectors, it only represents 7% of total US capex.[5]

[3] Source: Bloomberg, as of January 14, 2015.
[4] Source: Strategas Research Partners, as of December 31, 2014.
[5] Source: Gavekal Research, as of December 31, 2014.

Into the mix of worry about oil prices add the weak December US retail sales that were released this week. Digging deeper into the numbers reveals some more positive indications than the headline number suggests. Holiday sales, which combine both November and December purchases, were the best since 2011. We expect support for consumer spending to continue. The windfall from lower oil on consumption will not take effect immediately. According to Gavekal Research, if history is any guide, real consumption growth accelerates within six to seven months after a significant oil price decline, and businesses start spending more on expansion projects to meet increased consumer demand shortly thereafter.

From a sector perspective, earnings are likely to be challenged for the following three sectors, as they are closely related to oil: Energy, Materials and Financials. In fact, expected earnings growth for Q4 is negative for the Energy and Materials sectors.[6] However, the remaining 8 out of 10 sectors are still expected to post positive earnings growth, bringing estimated earnings growth of the S&P 500 to a solid 4.9%.[7]

And in response to those drawing parallels between falling oil prices and the housing bubble, when home price declines fed into the market and caused a financial crisis, we find the comparison unfounded. Falling home prices directly devalued household assets and consumer financial wellbeing. In stark contrast, today's lower oil prices actually provide a *boost* to consumers' discretionary spending power. It is simply a capital transfer from oil producers to households, the latter having a higher propensity to spend.

The oil takeaway

Based on the factors above, it does not seem that weakness in oil prices is indicative of global economic doom. While there will be a few sectors and regions that will be negatively affected, the net effect should be an increase to consumption, particularly in the United States. European consumers will also get a boost, though subject to the constraints of government intervention and foreign exchange. Finally, keep in mind that US consumers will be shopping in a *global* marketplace, so the tailwind for growth will also be felt by the nation's trading partners, just with a bit of a lag. In fact, IMF economists noted that the recent drop in oil prices will help to boost global economic activity by up to 0.7% in 2015.[8] Fears over contagion risks from declining oil prices seem to be overdone.

The Swiss franc: another marketquake?

The Swiss National Bank (SNB) unexpectedly scrapped its three-year policy of capping the Swiss franc against the euro on Thursday.[9] Its surprise action roiled the markets: Swiss shares tumbled, while the Swiss franc surged 30% relative to the euro.[9] It's never easy to read the minds of central bankers, but this case was particularly perplexing, given that the SNB had expressed commitment to this policy just days before the announcement.[9] The timing of the move leads us to believe the central bank is anticipating a more drastic move in the euro next week after the European Central Bank reveals its plans. With a balance sheet already sitting at 85% of GDP,[9] it appears the SNB is shutting down its printing press in advance of any further depreciation in the euro.

---

[6] Source: S&P Capital IQ, as of January 13, 2015.
[7] Source: Datastream, as of January 13, 2015.
[8] Source: Reuters, December 22, 2014.
[9] Source: Bloomberg, as of January 15, 2015.

All end points of data for figures in this document are the same day as source dates unless otherwise indicated.
Chartered Financial Analyst Institute owns the **CFA** designation, which it awards to individuals who successfully complete rigorous certification requirements.

Asset class risks

Bonds are subject to market, interest rate and credit risk; and are subject to availability and market conditions. Generally, the higher the interest rate the greater the risk. Bond values will decline as interest rates rise. Government bonds are subject to federal taxes. Municipal bond interest may be subject to the alternative minimum tax; other state and local taxes may apply. High yield bonds, also known as "junk bonds" are subject to additional risks such as the increased risk of default. Debt securities may be subject to call features or other redemption features, such as sinking funds, and may be redeemed in whole or in part before maturity. These occurrences may affect yield. Like all bonds, corporate bonds tend to rise in value when interest rates fall, and they fall in value when interest rates rise. The longer the maturity of the bond, the greater the degree of price volatility. If you hold a bond until maturity, you may be less concerned about these price fluctuations (which are known as interest rate risk or market risk), because you will receive the par or face value of your bond at maturity.

Equities

Large Growth and Value Stocks – Portfolios that emphasize large and established U.S. companies may involve price fluctuations as stock market conditions change.

Stocks of small- and mid-capitalization companies tend to involve more risk than stocks of larger companies. Investments in small- and mid-sized corporations are more vulnerable to financial risks and other risks than larger corporations and may involve a higher degree of price volatility than investments in the general equity markets.

International/Global Investing/Emerging Markets – International investing may not be suitable for every investor and is subject to additional risks, including currency fluctuations, political factors, withholding, lack of liquidity, the absence of adequate financial information, and exchange control restrictions impacting foreign issuers. These risks may be magnified in emerging markets.

Index definitions

ISM Manufacturing Index – An index that assesses the state of US manufacturing sector by surveying executives on expectations for future production, new orders, inventories, employment and deliveries. Values over 50 generally indicate an expansion, while values below 50 indicate contraction.
MSCI All Country World Index represents a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. As of June 2009 the MSCI ACWI consisted of 45 country indices comprising 23 developed and 22 emerging market country indices. The developed market country indices included are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the United States. The emerging market country indices included are: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.
The **Standard & Poor's (S&P) 500 Index** represents a free-float capitalization-weighted index published since 1957 of the prices of 500 large-cap common stocks actively traded in the United States. The stocks included in the S&P 500 are those of large publicly held companies that trade on either of the two largest American stock market companies; the NYSE Euronext and the NASDAQ OMX. A selection committee selects the companies in the S&P 500 so they are representative of the industries in the United States economy. An investment cannot be made directly in an index.
VIX Index – The Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 index options. It represents one measure of the market's expectation of stock market volatility over the next 30 day period. The VIX is quoted in percentage points and translates, roughly, to the expected movement in the S&P 500 index over the next 30-day period, which is then annualized.

Indexes are shown for illustrative purposes only, may not be available for direct investment, are unmanaged, assume reinvestment of income, and have limitations when used for comparison or other purposes because they may have volatility, credit, or other material characteristics (such as number and types of securities) that are different.

This document is for informational purposes only.

"Barclays" refers to any company in the Barclays PLC group of companies.

Barclays offers wealth management products and services to its clients through Barclays Bank PLC ("BBPLC") and functions in the United States through Barclays Capital Inc. ("BCI"), an affiliate of BBPLC. BCI is a registered broker dealer and investment adviser, regulated by the U.S. Securities and Exchange Commission, with offices at 200 Park Avenue, New York, New York 10166. Member FINRA and SIPC.

Barclays Bank PLC is registered in England and authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Registered No. 1026167. Registered Office: 1 Churchill Place, London E14 5HP.

The wealth management products offered by Barclays in the United States clear through, and where applicable, assets are custodied by, Pershing LLC, a subsidiary of the Bank of New York Mellon Corporation. Pershing LLC is a member of FINRA, NYSE and SIPC.

Investing in securities involves a certain amount of risk. You are urged to review all prospectuses and other offering information prior to making any investment. Past performance is not a guarantee of future performance. Barclays does not guarantee favorable investment outcomes. Nor does it provide any guarantee against investment losses.

The investments discussed in this publication may not be suitable for all investors. Advice should be sought from an investment representative regarding the suitability of the investment products mentioned herein, taking into account your specific objectives, financial situation and particular needs before you make any commitment to purchase any such investment products.

Certain information is based on data provided by third-party sources and, although believed to be reliable, it has not been independently verified and its accuracy or completeness cannot be guaranteed.

1099860/1100309