LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

You can have cheap equity prices or good news, but you cannot have both at the same time.
– Joe Rosenberg

Broadly speaking, the stock market is always in one of two phases: a secular bull market or a secular bear market. A secular bull market (such as the 1920s; the 1950s & early '60s; and the 1980s & '90s) is a long period of rising prices interspersed by cyclical (shorter) bull and bear markets. A secular bear market (such as the 1930s, the 1970s, and the 2000s) is a long period of declining prices interspersed by cyclical (shorter) bull and bear markets.

As a general rule, past secular bear markets have lasted about twelve to fifteen years. We are eleven years into this one, suggesting we could be nearing the end. If so, what could change in the economic picture that would cause the stock market to enter a secular bull market? There are three major developments—all of which have a high likelihood of occurring over the next few years—that would dramatically alter the way investors view the economic future.

The first development, being political in nature, would be an agreement toward solving the U.S. debt problem. For one thing, upcoming elections will hopefully result in some cooperation in Congress. As the late economist Herbert Stein stated, “If something cannot go on forever, it won’t.” Our increasing debt problem cannot go on forever. If we do not make changes, foreign central banks will eventually refuse to buy our debt. That event would slow the debt issuance, but with unwanted consequences.

A second positive development could be a return of manufacturing jobs to America. In an August 2011 paper, The Boston Consulting Group forecast that by mid-decade as many as 800,000 manufacturing jobs will return to America. Most of the returning jobs will come from China where rising wages, shipping costs, and land prices are rapidly eroding China’s cost advantages. While China’s wages and benefits are increasing 15 to 20 percent per year, U.S. manufacturing labor costs per unit of output in 2010 were 13% below the level of a decade earlier as workers became more productive, according to the U.S. Bureau of Labor Statistics.

The third development that holds profound implications for the U.S. economy is the prospect for energy independence. Many analysts expect that in the coming decade the U.S. will leapfrog Saudi Arabia and Russia to become the world’s largest producer of liquid hydrocarbons, counting both crude oil and lighter natural gas liquids such as propane and ethane. That optimism reflects the increasing flow of oil and natural gas from shale rock formations holding reserves which are being unlocked through new extraction technologies.

Hydraulic fracturing (pumping a mix of water, sand, and chemicals underground at high pressure to crack the rock) has transformed natural gas production, opening up reserves some estimate will last 100 years. This technique—used in places like the Bakken field in North Dakota (the largest oil find ever in the U.S.)—is having a similar impact on oil output. Already, the U.S. has cut its share of oil consumption met by imports from more than 60% in 2005 to 47% in 2010. Edward Morse, head of commodities research at Citigroup, believes it will be possible for the U.S. to cut imports from about ten million barrels per day to about three million barrels per day by the early 2020s. At that point all of the import demand could be met by Canada and Mexico. The implications of an energy independent North America are huge in terms of its impact on our balance of trade and on our national security, not to mention jobs.

Progress toward control of our federal debt, the return of manufacturing jobs, and movement toward energy independence are all developments with a high probability of happening. Only the timing remains in question. If these developments unfold, it completely changes the long-term outlook for the economy and the stock market could then enter a new secular bull market.

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