THE AUSTIN ADVISOR

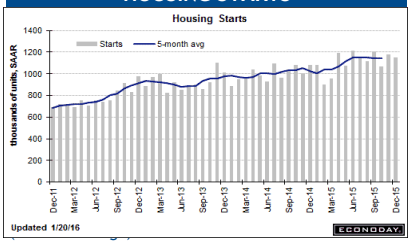
February 15, 2016

Markets	8-Feb	9-Feb	10-Feb	11-Feb	12-Feb	YTD%	31-Dec-15
DJIA	16,027.05	16,014.38	15,914.74	15,660.18	15,973.84	-8.33%	17,425.03
S&P 500	1,853.44	1,852.21	1,851.86	1,829.08	1,864.78	-8.77%	2,043.94
NASDAQ	4,283.75	4,268.76	4,283.59	4,266.84	4,337.51	-13.38%	5,007.41
SNL Bank Index	355.63	355.36	352.28	338.42	357.05	-17.25%	431.48
Fed Funds Rate	0.38%	0.38%	0.38%	0.38%	0.38%		0.35%
1 Month LIBOR	0.43%	0.43%	0.43%	0.43%	0.43%		0.43%
3 Month LIBOR	0.62%	0.62%	0.62%	0.62%	0.62%		0.61%
3 Month T-Bill	0.32%	0.30%	0.31%	0.28%	0.30%		0.16%
1 Year Treasury	0.51%	0.52%	0.52%	0.47%	0.51%		0.65%
2 Year Treasury	0.66%	0.69%	0.71%	0.64%	0.71%		1.06%
3 Year Treasury	0.83%	0.85%	0.85%	0.81%	0.89%		1.31%
5 Year Treasury	1.16%	1.15%	1.15%	1.11%	1.20%		1.76%
10 Year Treasury	1.75%	1.74%	1.71%	1.63%	1.74%		2.27%
30 Year Treasury	2.56%	2.55%	2.53%	2.50%	2.60%		3.01%

WEEKLY HIGHLIGHT

Investor fears of the risk of a credit market impact to low oil prices continue to drive equity prices down

HOUSING STARTS



Economy	Week of February 8, 2016	
JOLTS Index	5.607 Million	Solid increase from a revised 5.346 million, indicating further job growth in 2016
Retail Sales	0.2%	Better than expected, and up a strong 0.4%, excluding the negative impact of lower gas prices

Calendar	Release	Covering	Week of February 15, 2016
President's Day	Monday		Financial Markets Closed
Housing Starts	Wednesday	January	The housing sector continues to grow with starts expected to be 1.175 million, up from 1.149 million in December
Producer Price Index	Wednesday	January	Another month of declining wholesales prices is expected at -0.2%, with the core rate up only 0.1%
Industrial Production	Wednesday	January	Manufacturing activity has been dropping, with limited export and lower inventory build, with 0.1% expected
Capacity Utilization	Wednesday	January	The operating rate remains low, with no inflationary pressures from supply constraints at 76.6%
Leading Indicators	Thursday	January	This index has been generally weaker in the last six months, with another drop of 0.2% expected to be reported
Consumer Price Index	Friday	January	With an expected decline of 0.1% matching the drop in December, inflation risks remain very low

MONDAY MUSING

I have tried to avoid using anything from the current political environment is these weekly comments, but the material is just too tempting. I listened to the Democratic debate a week ago. (I can summarize the Republican debate from this weekend. "YOU ARE A LIAR"). According to the Democrats, the issue in this election is all about inequality. They seem to believe everyone should be equal. I know this is not true as does anyone who has worked in an office with only one thermostat. Did I treat each party equally?

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Commentary

The limited amount of economic data released last week was positive. The **JOLTS index** increased, and indicates continued job growth over the next six months. **Retail sales** in January was a solid rebound from the data for December. **Sales** were up 0.4% for the month, excluding low gas prices. This data does not reflect any slowdown in jobs or **consumer final demand** in reaction to the financial market volatility, which began in early January. The testimony before Congress by **Fed Chairwoman Yellen** did little to calm investors. It does appear from her comments **the Fed** may hold off another increase in managed rates at their March **FOMC** meeting, due to uncertainty in financial markets and foreign economic growth. The Fed did not raise rates last September, citing the same factors. She did repeat the position of the Fed of moving to **normalize monetary policy** as economic conditions dictate. The data released to date for January does not reflect any impact as of yet from the equity price declines experienced this year. The reason the Fed would wait is to insure this volatility does not affect what has been a better level of consumer final demand, as it drives overall economic growth higher.

The bond and stock markets have been pricing in another credit market shock from the declining oil prices. The risk is the lower commodity prices, including oil, will lead to losses in the banking sector. Cash flows in the **energy sector** have dropped, and debt servicing becomes an issue. An increase in oil prices would reduce this risk. There was some speculation that **OPEC** is going to reduce production to bring supply down. To date, OPEC has maintained production of oil and allowed prices to drop. This is unusual, as in the past when demand declined OPEC cut production in order to maintain prices. There are many reasons why they did not do it this time. Letting prices drop could harm political opponents of OPEC like Russia and Iran. Lower prices also reduces the incentives to develop alternative energy sources such as wind and solar. There is a limit to how long OPEC can tolerate these lower prices without creating political issues within OPEC. Less revenue will stall the economies of the members of OPEC. We have already seen these issues begin in Venezuela. Production cuts would cause the price of oil to rise. Rising oil prices will create some **inflation** pressures in the U.S. The risks of higher inflation from rising labor costs in a tight **labor market** are already beginning to be included in forecasts being used by the Fed. Our forecast is based on the expectation consumer final demand will be strong enough to drive total economic growth up in 2016. We view the stock market decline experienced this year as a transitory condition which will correct as economic data is strong enough to allow the Fed to continue its plan to move managed rates higher through the next two years.

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