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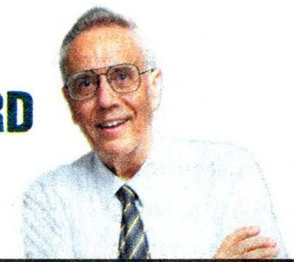
THE LAST WORD



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# The future is not-so-bad

MORE excitement last week: OPEC member, United Arab Emirates, said "Us too!" and agreed with Saudi Arabia that markets should rule. There was no need for OPEC to reduce oil output. Instead, the 12 nations would keep their customers and give them price discounts to match the lower world prices.

As for the future, call me a converted pessimist. I used to see disaster around the corner but I now think that low interest rates and low energy costs will make life cheaper and bring on a new era of good times.

It's not just stock markets. I am also talking about the real economy. Look for new highs for GDP and new lows for unemployment in 2015.

Like I said, we have to thank low energy prices and low interest rates. And since we have never seen both so low simultaneously, we have a perfect storm that puts us in uncharted territory. It means we can't predict the future based on the last time this happened, since it has never happened. Of course, that makes the future harder to predict.

## History

Do you remember December 2007, when it became clear something was going wrong with US housing? Respected banks made risky loans like never before called "no doc" loans because they required no documentation about the borrower. All the bank had to fall back on was the house for collateral.

That should have been enough since home prices had never fallen. In the past 200 years, US home prices had marched straight up and had never declined for even one year.

We now know "down is also possible" and US home prices fell by 1/3 in 2008 and 2009. That was a huge decline and sparked what we know today as "The Great Recession". It would have easily turned into a great depression if governments hadn't acted boldly by spending trillions of dollars to re-start economies.

In fact, the borrowing and spending eventually maxed out so that a country plunging deeper into debt would jeopardise its credit. What to do? More stimulus was needed and the very last act of desperation was to do something never tried on a massive scale: Print money.

No one thought it would actually work without generating inflation. But it did and until today no one can explain why. Following the maxim: "Anything worth doing is worth over-doing", Central Banks keep printing while two (Europe and Japan) are now readying a new round of Euro and Yen money-printing for this year.

> *Quick***Quote**
>
> **"Anything worth doing is worth over-doing."**
>
> Mick Jagger, 71,
> singer and song-writer

Miraculously, there has been no inflation for the past six years. If anything, the latest worry is deflation, which is falling prices. The thought is that rock-bottom oil prices will work their way through the economy and drop prices of everything. It brings on a new risk that the world could catch "the Japanese malaise" where people put off buying, thinking: "Why buy now? I'll wait a month or a year and buy more cheaply then."

So they wait and sure enough, prices are lower in the future. But the delayed purchase slows the entire economy, which has given rise to what we call, "The lost decade" in Japan, which was actually two decades, but that is not such a catchy phrase.

Japan is rather desperately trying to print money and generate inflation, in order to signal consumers they had better spend, spend, spend now before prices rise. Europe wants to do the same but has its 28-nation European bureaucracy to contend with.

At the end of the day, everyone craves prosperity and happiness. Everyone benefits from a booming economy. And that attitude alone is perhaps the biggest reason to expect boom times in 2015.

## Advanced lesson

This section is an advanced lesson in stock forecasting and is an experiment. Skip it if you feel it is not for you. But the reward is you will learn a valuable methodology for predicting stock prices.

First, stock prices are at all-time highs and low interest rates are going to hold them there. You only need one equation to understand this: $r = E/P$. It means the return on stocks equals its earnings divided by its price.

These days, r is super-low because of the low interest rates and, as a result, stock prices, P, are very high. For example, if E/P is 1 per cent, the inverse – P/E – will be $1/.01 = 100$. That's right, a P/E ratio of 100 times. Right now, the average P/E ratio on the world's largest stock market (the US S+P 500) is 20 times, so you can see there is still room to grow as long as interest rates remain low.

I know. You're thinking interest rates could jump. Yes, it is possible but unlikely since the rates are held down by low worldwide inflation, which is almost guaranteed to remain low after the sudden drop in oil prices.

So there you have it. What? You want a number? OK. Look for US and Singapore shares to end 20 per cent higher at year end, which is double the average gain of 10 per cent per year over the past 50 years.

**An adjunct professor at SMU, Dr Haverkamp contributes this column weekly to help our readers understand money matters better.**