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WHAT'S FUELING THIS MARKET RALLY?

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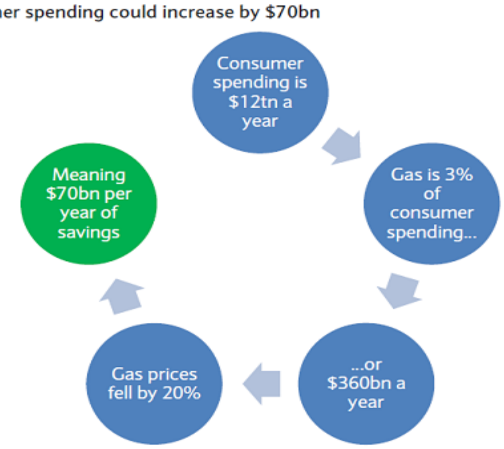
While there's no doubt that low interest rates and a generally improving economy have played important roles in fueling the current market rally, the nearly 30% drop in oil prices and the potential impact on consumer spending has surely contributed to recent market enthusiasm.

The below chart from Barclays Capital depicts the estimated impact of a 20% drop in gas prices on potential consumer behavior. Of the $12 trillion dollars consumers annually spend, approximately 3%, or $360 billion is spent on gasoline. As a result, a sustained 20% drop in gas prices from the highs therefore results in roughly an additional $70 billion per year in consumer's pockets. Looked at another way, every $0.10 drop in gas prices represents a roughly $10 billion annual savings for consumers. The economic impact of the savings is actually larger due to the velocity of money.

We project consumer spending could increase by $70bn



Source: Barclays Research

Combined with the “tax break” consumers are already enjoying from historically low interest rates, this new oil related relief should further strengthen household disposable incomes. Furthermore, despite well-deserved enthusiasm for a domestic manufacturing renaissance, the last time we checked the U.S. was still a consumer driven economy.

There is rarely one single factor that drives the market one way or another. Rather it is a mosaic of ever changing inputs, some big and some small, that every investor must decide how to interpret and reflect in their valuation models and approach to asset allocation. The goal is to be able to identify and weigh various market headwinds and tailwinds and conclude if, on balance, current valuations are justified. For the time being, it would appear the oversupply of oil and the corresponding drop in gas prices is one more piece falling on the side of the market bulls.

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