Losing Momentum

October 3, 2011. The third quarter of 2011 lacked much in the way of good news for investors or the economy. It was the quarter when Standard & Poor's downgraded the U.S. credit rating, in the wake of a contentious debate in Congress over raising the U.S. debt ceiling. Concerns over the European debt crisis were not resolved. Stock market volatility was severe, with the Dow Jones Industrial Average moving by more than 200 points on 18 different days. In August, the Dow moved by more than 400 points on four consecutive days!

More data points:

• In August the employers added zero net new jobs. The number of unemployed stood at 13.9 million, and has been above 13 million for 30 months.

• New home sales dropped 2.3% in August to a six-month low. Compared to the peak of the housing bubble in July 2005, new home sales are down 80%!

• A slight rise in consumer spending in August was coupled with a slight decline in personal income, the first decline in nearly two years. That means consumers are digging further into their savings to support their purchases.

With so much bad news, the fact that the Dow Jones Industrial Average fell 12% in the third quarter just feels like more of the same. This was the worst performance since the first quarter of 2009.

Nobel Prize-winning economist Paul Samuelson once wrote that "Wall Street indexes predicted nine out of the last five recessions!" We may hope that the markets are wrong again, but not everyone is so optimistic.

Recession chances

The Economic Cycle Research Institute (ECRI), one of the many firms following and predicting the course of economic events, warned in September that another recession is imminent. The call is based upon a variety of long- and short-term economic indicators.

Given that the last recession ended in June 2009, isn't it too soon for another one? Not necessarily. The firm points out that, "From 1799 to 1929, nearly 90% of U.S. expansions lasted three years or less, as did two of the three expansions between 1970 and 1981." We became accustomed to longer recession-free periods during the "great moderation" that began in the early 1980s, but that period may prove to be aberrational. The economy may now be returning to historically normal patterns.

Bill Gross, the founder of Pimco, the world's largest bond fund, expressed similar pessimism in late September. "If global policymakers could focus on structural as opposed to cyclical financial solutions, new normal growth as opposed to recession might be possible."

Remember the Bakken

There is one very bright spot in the economy to keep in mind, to counterbalance the gloom. Two years ago, America was importing about two thirds of its oil. Today, according to the Energy Information Administration, we import less than half. What happened? The massive Bakken oil fields in North Dakota are now producing substantial amounts of oil. New technologies,

including horizontal drilling and “fracking,” have unlocked vast reserves of oil and natural gas previously locked up in shale.

What kind of reserves might be available? The U.S. Geological Survey estimated that the Bakken reserves could be 4 to 5 billion barrels, but some industry experts project up to five times that amount of recoverable oil with these new techniques.

As a result of the oil boom, North Dakota has skipped the current recession entirely. In fact, the mayor of Williston, a town that has grown from 12,000 to 20,000 in the last four years, said in September that there are 2,000 to 3,000 job openings in town. Similarly, Oilman Harold Hamm asserted that North Dakota had 18,000 unfilled jobs paying $60,000 to $80,000 annually.

With encouragement, North Dakota might lead the way to an economic turnaround.

(October 2011)