

## Is There a Bubble in the U.S. Stock Prices?

### Not as long as interest rates remain at record lows

Since the Federal Reserve’s Quantitative Easing programs (QE) were launched in October 2008, the stock market, as measured by the Dow Jones Industrial average has soared by 10.9 percent, compounded annually. During this same period of time, U.S. GDP expanded by 2.4 percent, wages and salaries advanced by only 1.4 percent, employment climbed at a pace of less than 0.1 percent, and profits increased by approximately 7.6 percent (all compounded annually). The soaring stock price growth, compared to these other economic benchmarks, has forced investors to wonder if the stock market has come too far too fast. Stock price growth depends on three factors, all which swung in the direction of higher stock prices: 1) higher profits, 2) lower risk free interest rates (U.S. Treasury), and 3) lower risk. It can be argued that the prime factor driving the stock market higher has been record low interest rates generated by the Fed’s aggressive monetary expansion led by its three bond buying programs, termed QE1, QE2 and QE3. These programs have pushed rates into record low territory with the 10-year U.S. Treasury yield (interest rate) hovering around 1.7 percent. The record low yields have incentivized investors to abandon safe, low yield investments such as certificates of deposit and money market funds and to embrace higher risks, higher yielding stocks. My “back of the envelope” calculations indicate that if the Fed allows rates to rise by as little as one percent, the Dow will decline by as much as 6.0 percent assuming profits and risks unchanged. Should rates rise back to their pre-QE1 level, the Dow will slump by 12.7 percent. Thus, investors need to be on guard for unexpected rate hikes or upturns in risks such as a European debt eruption. Both changes would put downward pressure on stock prices taking air out of the Fed inflated stock bubble. Ernie Goss

## MAINSTREET RESULTS

### Rural Mainstreet Economy Bounces Higher; Record Expansion in Home Sales for Month

Tables 1 below summarizes the findings from the April survey with an index above 50.0 indicating growth and an index below 50.0 signifying weakness. [Index > 50.0 indicates expansion]

Table 1: The Mainstreet Economy	Apr. 2012	Mar. 2013	Apr. 2013
Area Economic Index	57.1	56.9	58.3
Loan volume	52.8	51.5	66.0
Checking deposits	72.6	69.4	63.0
Certificate of deposits	53.5	42.4	40.4
Farm land prices	69.4	67.2	66.9
Farm equipment area sales	62.4	60.5	57.3
Home sales	60.8	69.2	70.8
Hiring in the area	64.8	59.4	57.5
Retail Business	52.9	51.6	51.4
Economy 6 months from now	60.6	52.3	56.3

#### April Survey Results at a Glance:

- Rural Mainstreet Index indicates rural economy continues expansion.
- Home sales index rises to record level.

- Approximately 65 percent of bank CEOs indicate that federal spending sequestration has had no impact on their area thus far.
- Almost 29 percent of farmland sales were cash sales (not financed).
- Almost one-fifth of farmland sales over the past year were to nonfarm investors.

### Rural Mainstreet, Jan. '09 – April '13



Growth strengthened for the Rural Mainstreet economy over the past month according to the April survey of bank CEOs in a 10-state area. **Overall:** The Rural Mainstreet Index (RMI), which ranges between 0 and 100 with 50.0 representing growth neutral, climbed to 58.3 from March’s solid 56.9.

**Farming:** The farmland price index dipped to a still strong 66.9 from March’s 67.2. This is the 41st consecutive month that the farmland-price index has been above growth neutral. The farm equipment-sales index declined to 57.3 from 60.5 in March. Crop farmers and businesses linked to crop farming and energy continue to experience very positive economic conditions with improving balance sheets.

However, there are some negative outcomes from the agriculture expansion. Rapidly increasing farmland prices are causing concerns for bankers. David Callies, CEO of Miner County Bank in Howard, S.D., said, “Increased agriculture land prices and rent cost are hurting our smaller operators as well as younger, beginning farmers.”

The month bank CEOs were asked about the share of farmland sold to nonfarm investors and the proportion of farmland sold for cash. Bankers indicated that almost one in five, or 19.8 percent, of sales were to nonfarm investors. This is almost identical to last April’s 21 percent. Bankers reported that approximately 28.6, only slightly less than last April’s 29 percent, of farmland sales were for cash. Despite very strong growth in farmland prices, bankers are indicating little change in investors’ appetite for farmland. Likewise, farmland price growth over the past year in excess of 20 percent for parts of the region did not alter the share of land purchases for cash.

**Banking:** The loan-volume index moved above growth neutral for the month. The index soared to 66.0 from 51.5 in March. The checking-deposit index declined to 63.0 from March’s much stronger 70.5 while the index for certificates of deposit and other savings instruments sank to 40.4 from last month’s 42.4. Banking data validate the region’s healthy farm income and an expanding Rural Mainstreet economy. Jim Ashworth, vice chairman of CNB Bank and Trust in Carlinville, Ill., reported very positive economic

activity for both rural and urban bank locations with farmers in rural areas increasing their purchases of land and equipment.

**Hiring:** March’s hiring index slipped to 57.5 from March’s 59.4. The rate of new hiring over the past several months is now back to pre-recession levels.

**Confidence:** The confidence index, which reflects expectations for the economy six months out, strengthened to 56.3 from 52.3 in March. Despite recent pullbacks in commodity prices and questions about the global economy, Rural Mainstreet bankers are more upbeat about the economy. Additionally, weather concerns remain an issue. David Callies, CEO of Miner County Bank in Howard, S.D., reported, “Continued drought (is) still the biggest concern.”

**Home and retail sales:** For a third straight month the homes-sales index took a large positive jump. The April home-sales index advanced to a record 70.8 from March’s 69.2. The April retail-sales index slipped slightly to 51.4 from 51.6 in March.

Each month, community bank presidents and CEOs in nonurban, agriculturally and energy-dependent portions of a 10-state area are surveyed regarding current economic conditions in their communities and their projected economic outlooks six months down the road. Bankers from Colorado, Illinois, Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, South Dakota and Wyoming are included.

This survey represents an early snapshot of the economy of rural, agriculturally and energy-dependent portions of the nation. The Rural Mainstreet Index (RMI) is a unique index covering 10 regional states, focusing on approximately 200 rural communities with an average population of 1,300. It gives the most current real-time analysis of the rural economy. Goss and Bill McQuillan, president of CNB Community Bank of Greeley, Neb., created the monthly economic survey in 2005.

## MAINSTREET ON YOUR STREET

### COLORADO

For a seventh straight month, Colorado’s Rural Mainstreet Index (RMI) remained above 50.0. The April RMI slipped a bit to a still strong 73.1 from March’s 75.2. The farmland and ranchland price index expanded to 83.0 from March’s 71.2. Colorado’s hiring index for April expanded to 68.8 from March’s 67.8.

### ILLINOIS

While the RMI for Illinois declined in April it remained above growth neutral for the seventh consecutive month. The index declined to 56.7 from March’s 56.9. Farmland prices sank to a still robust 63.0 from 68.1 in March. The state’s new-hiring index decreased to 55.5 from 57.1 in March. According to Jim Ashworth, vice chairman of CNB Bank & Trust in Carlinville, “There seems to be an economic uptick witnessed at our two urban branches, while our rural locations continue to see grain farmers’ balance sheets flush with cash from last year’s crop insurance, resulting in both land and equipment purchases.”

### IOWA

The April RMI for Iowa dipped to 62.3 from March’s 65.2. The farmland-price index expanded 70.0 from March’s 66.7. Iowa’s new-hiring index for April weakened slightly to 60.2 from 61.3 in March. William Hess, CEO of Iowa Savings Bank in Carroll, said, “Recent rain has improved attitude and outlook, and forecast is more rain, so perhaps a return to normal conditions and yields which will impact the ag picture.”

### KANSAS

The Kansas RMI for rocketed to 61.8 from 52.8 in March. The farmland-price index sank to a still very healthy 65.5 from 69.1 in

March. The state’s new-hiring index decreased to 56.6 from 57.8 in March.

### MINNESOTA

The April RMI for Minnesota slid to 66.7 from 66.8 in March. Minnesota’s farmland-price index sank to 67.1 from March’s 72.1. The new-hiring index advanced to 61.5 from 59.8 in March.

### MISSOURI

The April RMI for Missouri soared to 71.7 from March’s 56.3. The farmland-price index for April fell to 70.8 from 74.1 in March. Missouri’s new-hiring sank to 60.7 from 61.1 in March.

### NEBRASKA

After moving below growth neutral for January, Nebraska’s Rural Mainstreet index broke above growth neutral for three straight months. The April RMI expanded to 57.3 from March’s 54.9. The farmland-price index for April was unchanged from March’s 65.4. Nebraska’s new-hiring index dipped to 57.1 from 58.0 in March. Jeffrey Gerhart, chairman of the Bank of Newman Grove, “Recent later winter, early spring rains and snow has helped our moisture situation and improved the farmers outlook. Crop ground and pastures will benefit.”

### NORTH DAKOTA

The North Dakota RMI for April advanced to 78.8 from March’s 61.2. The farmland-price index declined to a robust 75.6 from 79.8 in March. North Dakota’s new-hiring index decreased to 61.2 from 63.4 in March. DeWayne Streyle, CEO of United Community Bank of North Dakota in Leeds, said he expects farmers to reconsider their intended planting rotations. “North Dakota is experiencing extreme delays in spring planting due to the extensive snow pack in the Northern part of the state and additional snow received state-wide since April 13th.”

### SOUTH DAKOTA

The April RMI for South Dakota fell to 57.2 from 58.8 in March. The farmland price index grew to 67.4 from March’s 62.4. South Dakota’s new-hiring index for April slipped to 55.4 from 58.4 in March. David Callies, CEO of Miner County Bank in Howard, said, “Moisture this week has improved the spring outlook.”

### WYOMING

The April RMI for Wyoming advanced to 55.1 from 52.8 in March. The April farmland and ranchland price index decreased to 58.0 from 61.8 in March. Wyoming’s new-hiring index climbed above growth neutral with an April reading of 53.2 down from March’s 53.9.

## THE BULLISH NEWS

- The U.S. labor market added 165,000 jobs and the unemployment rate declined to 7.5%.
- The Case-Shiller U.S. home price index rose 9.3 percent over the past year with the index growing at its fastest pace since 2006, a year before the housing collapse.
- The U.S. trade deficit shrank by 11% in March as imports fell by the most in four years.

## THE BEARISH NEWS

- The national Purchasing Management Index (PMI) declined to 50.5, or only slightly above growth neutral (a clear

warning signal).

- GDP growth for quarter one 2013 was only 2.5% annualized.
- Q1, 2013 Productivity: Modest Rebound but still far below the long term average. This is going to hurt wage growth.
- U.S. retail and food services sales for March decreased 0.4% from February but were 2.8% above March 2012.

## WHAT TO WATCH

- **Purchasing Management Indices:** On June 3, Creighton releases its regional leading economic indicator (PMI) and the national Institute for Supply Management releases its national PMI for April. A decline in the national PMI below growth neutral 50.0 would be very, very bearish.
- **Jobs:** On Friday June 7, the U.S. Bureau of Labor Statistics (BLS) will release the employment report for May. A reading above 200,000 would be very bullish for stocks.
- **Consumer Price Index (CPI):** On May 16 and again on June 18, the U.S. Bureau of Labor Statistics releases the CPI. This index has been trending downward thus alarming the Federal Reserve about the possibility of DEFLATION. It is not a possibility but I don’t get a vote on the FOMC which could expand bond buying program.

## THE OUTLOOK

### FROM GOSS:

- U.S. inflation, as measured by the consumer price index, will continue to show very weak inflationary pressures. Instead of inflation, current overly aggressive Fed actions are inflating asset bubbles such as housing in some locales and farmland.
- I expect U.S. job growth to remain slow. The Affordable Care Act will begin weighing on the job market as many of the 10,000,000 U.S. workers that currently work 30-34 hours per week are pressured to work less than 30 hours. Employers are required to provide health insurance for all workers averaging more than 30 hours per week.

### OTHER FORECASTS:

- “The Success and the Effects of Dodd-Fran Act on the Banking Industry and the Proposed Brown-Vitter Bill.” The Dodd-Frank Act was designed to set high standards and create an environment that would prevent a repeat of the 2007-08 financial disaster. The Basel III requirements were designed to force big banks to hold enough capital to sustain a recession or market downturn that would put banks in jeopardy of the ‘too-big-to-fail’ scenario. What the Dodd-Frank Act failed to do was write enough details into the Act. The Act intended to create strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity, with significant requirements on companies that pose risks to the financial system. Dodd-Frank has and will continue

to significantly expand the regulatory burden on financial businesses, including community banks.

## GOSS EGGS (RECENT DUMB ECONOMIC MOVES)

- The U.S. Department of Energy continues to “drag its feet” in terms of allowing the export of liquefied natural gas (LNG). Compared to the U.S. natural gas price, Europe’s is three times higher and China’s is almost four times higher. Exporting LNG will stimulate U.S. growth and move the U.S. toward becoming more energy independent. The incoming Secretary of Energy is neutral on the export LNG. Huh?

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