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On January 2nd, 17 members of the clan Gardner arrived in Cancun for our quadrennial reunion. The weather was wonderful, the pool time refreshing and the daily communal dinners were full of hearty cuisine and laughter. Trish arranged a professional photographer to get a variety of pictures that turned out great. The above picture was of all the grandchildren that were there. This was the first year the grandchildren outnumbered the adults 9 to 8. If desired, I can share more pictures from the Cancun Reunion with you.

Trish & Gary in Cancun with the Grandchildren

Sincerely,
Gary Gardner

## $100 Trillion Up in Smoke

If energy powers the world, then whoever owns that energy must have power over the world. Ownership of our primary energy source, crude oil, is what made billionaires of John D. Rockefeller, H.L. Hunt and assorted Middle Eastern kings.

Oil in the ground is wealth only on paper - you may own that oil, but it earns you nothing until you recover and sell it. Yet paper wealth is still wealth.

The ongoing oil price collapse is having a severely negative impact on the wealth of those who own oil reserves. The numbers, as you will see below, are almost incomprehensibly big. They are so big, in fact, that many analysts have simply tuned out.

Today we'll stop dancing around the truth and call the oil collapse what it is: global wealth destruction of epic proportions.

*Simple Math, Hard Answers*

In mid-2014, crude oil prices were about $100, depending on which grade you wanted to buy. Now prices hover near $30 - roughly a 70% decline in 18 months. That's well-known, but we usually discuss the price collapse in terms of particular countries or companies: we don't look at the bigger picture.

Stop for a minute. Let that sink in. The total value of all the world's oil reserves is over $100 trillion less than it was just a year and a half ago.

If stock values were crashing to that degree, we would call the losses earth-shattering. Yet otherwise intelligent people are saying the oil collapse is a minor issue.

Economists talk about the "wealth effect" that occurs when asset values go up. If your assets gain in value, you derive no immediate benefit unless you sell them. Yet you feel wealthier and more confident. That confidence changes your behavior, so you spend more freely. You'll buy that second home, nicer car, or diamond ring. Yet we seldom think of the negative wealth effect that occurs when asset values decline.
It's safe to say that the owners of those 1.656 trillion barrels of oil are feeling much less wealthy now. Their paper losses are affecting their behavior as surely as falling US home prices affected consumer behavior in the last recession.

We can't put an exact number on this perceived wealth loss, but it is certainly in the tens of trillions - equivalent to a massive, worldwide bear market in stocks. Yet it is happening beneath the radar, almost unnoticed and unremarked.

*Drowning in Oil?*

Western oil companies and OPEC member states aren't so worried about oil reserves in the ground; their more immediate headache is too much oil on the surface. Supply far outstrips current demand - which, as we know from Econ 101, yields lower prices.

The problem is finding the balance between supply and demand. The current situation is primarily a result of higher supplies and only secondarily of demand weakness. The higher supply has come largely from US and Canadian shale fields as well as the 2014 Saudis' decision to maintain production levels.

These factors add up to an interesting group dynamic. All oil producers would benefit if production fell and prices rose - but they would not benefit proportionately unless the production cuts were also proportionate. There is no mechanism or incentive to make it happen that way. Even OPEC, which in theory is a cartel with strict quotas on its members, has no way to enforce its will.

Add in the further complication that shale oil fields, by their nature, are easy to turn on and off. If your oil costs $40 a barrel to produce and you can sell it for only $35, you can cap your wells and wait for higher prices. But here we hit another problem.

If you borrowed the money to drill your wells in the first place, you need cash flow to service your debt. So you might keep pumping even if you only break even or run a small loss. That seems to be what many small US producers are doing. The alternative is to default on their bank loans or high-yield bonds.
Indeed, the high-yield bond market seems to have calculated that more defaults are coming. Bond prices have collapsed as low oil prices make it hard to stay current on debt payments.

What will be the endgame here? If companies default and go into bankruptcy, courts will sell their assets to the highest bidder. Bondholders will push for quick liquidations.

If the assets consist of oil in the ground that can't be profitably extracted, who will buy those assets?

*Third-Order Effects*

Much of the recent market volatility results from the second- and third-order effects of lower commodity prices. The sovereign wealth funds of oil-producing nations are liquidating non-energy assets or at least not buying them. Changes in oil import/export patterns are affecting currency flows. Stung by energy losses, portfolio managers are reducing risk elsewhere.

Conventional economic wisdom tells us that lower fuel prices ought to spur consumer spending. It seems not to be happening this time. Why not?

Here is a theory: this price decline is different because it's affecting domestic oil and gas producers.

*Coup de Grâce?*

We don't know when or if the oil price will recover. Some analysts think it will stay in a range of roughly $30 to $60, the high end being the point where currently capped-off supplies come back online.

Something else is happening, too. Renewable energy has made huge strides. Costs have dropped and are still falling. Governments want everyone to reduce carbon emissions. It won't be good for oil prices if they get their way.

Source: Citigroup

Source: Citigroup

This analysis feeds into the thesis that negative interest-rate policies are going to proliferate even further. Central bankers fear deflation, especially in leveraged and debt-ridden economies.

And the Fed fought that fight pretty well for a long time. The tools they have now, though, are far more limited in their effectiveness. The more I think about it and the more people I talk to, the more I am convinced that we are going to see negative interest rates in the US, too, driven in part by the self-reinforcing downward spiral that Citigroup mentions above, along with overall lower costs across the world.

All that debt washing up on the shores of the world is going to have to be rationalized at some point. As we think through what that process looks like, as we "wargame" our portfolios and investment strategies, we need to make sure that we are not standing in front of the train of that rationalization as it comes barreling down the track.

Sources:

- [Maudlin Economics]

## Information to Share with Our Kids and Grandkids

Chances are, you know that it takes steady savings to accumulate wealth. A recent article in Business Insider actually calculated how much you'd have to invest each day in order to become a millionaire.

Suppose your investments earn an average 7% yearly return, and you want to have $1 million by the age of 65. At age 20, you'd have to invest just $9 a day to achieve your goal-which really makes you rethink the cost of a cappuccino grande and a bagel at Starbucks every morning (typically over $10). If you start at age 25, then 12 dollars a day would do the trick. At age 30, your required daily investment goes up to $18, and it stays manageable even at age 35: $27 a day.

Of course, the longer you wait, the more you're going to have to save. At age 55, your required investment has risen to $189 a day. If you've waited that long, let's hope you have an enormous income to help you catch up.

Source:

- [Business Insider]

## Millions of Millionaires


Here's a quick quiz: which country around the world has the most millionaires? How many total millionaires are there in the world today?

According to the 6th annual Credit Suisse Global Wealth Index, there are 33.7 million households worldwide with $1 million or more in total net worth-a 146% rise since 2000. More than 46% of these favored households are located in the United States-15.7 million millionaire households overall. The United Kingdom and Japan are far behind on the list, with 7% and 6.3% shares of millionaire households respectively. They are closely followed by France, Germany and China.

The trends are positive for the U.S., which saw 900,000 new households reach the millionaire club in the past year, and China, which added 150,000. Japan, meanwhile, had 680,000 households fall out of millionaire status, and Europe overall lost the most members of the club, shedding 2 million, primarily from France, Germany, Italy and Sweden.

Which countries are left out of the millionaire club? All of Africa and India combined make up just 1.3% of the total millionaire households.

Perhaps the most interesting insight from the survey is the fact that having a million dollars in assets is no longer an exclusive club. And it's becoming less so. Credit Suisse estimates that the number of millionaires will grow more than 35% over the next ten years.

**Sources:**

- Credit Suisse

## 2015 Year End Report

In year just past, we experienced many things-a prelude to an election, terrorist concerns, a trip to Pluto-but in the investment markets, we will look back and yawn.

The final three months of the year provided investors with gains that were tantalizingly close to wiping out the losses of the previous three. The Wilshire 5000 gained 5.89% in the fourth quarter of 2015.

Large cap stocks were comparably flat. The Wilshire U.S. Large Cap index gained 6.77% in the fourth quarter, and managed to finish the year up 1.27%. The Russell 1000 large-cap index finished the year up 0.92%, while the widely-quoted S&P 500 index of large company stocks was up 6.45% in the fourth quarter, but finished down 0.73% for all of 2015-its first yearly loss since 2008.

This was a year to forget for investors in small company stocks. Investors posted a 2.62% gain over the last three months, but in the end the index lost 4.86% over the year. Tech stock investors saw the Nasdaq rise 19.40% during the year. Real estate investments gained 7.47% during the final quarter.

Many investors will look at their statements and see lower returns, in part because a portion of their portfolio was invested in commodities-by far the biggest loser of 2015. By the end of the year, investors in the commodity index were sitting on a whopping 32.86% loss. Meanwhile, gold prices were off 10% , and gold investments outperformed silver, copper, platinum and palladium.

Bond investors started the year expecting that 2015 would finally see interest rates rise. According to Barclay's Bank indices, U.S. liquid corporate bonds with a 1-5 year maturity are yielding 2.74% on average. Moving out to 5-10 years brings the yield up to 6.40%, about 0.84% lower than the beginning of last year. 20-year Treasuries are yielding 2.95%, and 10-year Treasuries currently yield 2.46%.

What's going to happen in 2016? Professional investors are approaching the new year with an unusual degree of caution. By most metrics, U.S. stocks are pricier than their historical averages. Nobody seems to know exactly what to make of the high-yield bond market. Is the downturn is a sign of some long-term problems or a blip? One could make the argument that emerging market governments and companies with low credit ratings have gotten away with giving their lenders low interest rates.

Another possible warning sign is China, which is becoming the 800 pound gorilla of the global markets. The Shanghai Composite Index lost 43% of its value during a frightening summer selloff, and China's economic growth has clearly slowed from the pell-mell double-digit growth rates of the past 20 years. But lost in the hand-wringing is the fact that China's primary index finished the year with a 9% gain overall. The selloff simply wiped out most of an enormous bull run in the first three months of the year. More troubling than the losses is the government's willingness to try to manipulate its equity markets, which means it's hard to discern the fair value of individual Chinese stocks.

Finally, we've finally seen the Federal Reserve Board's first tentative effort to let the short-term fixed income markets find their natural level, which has already led to higher mortgage rates. Nobody knows if or when the Fed will raise rates again in the new year, or what the impact would be, but the fact that it's an election year, and the economy is still not exactly robust, suggests that the central bank's policymakers will proceed very cautiously.

All we can say is that the markets often punish those who try to outsmart them.

**Sources:**

- Wilshire Index Data
- Russell Index Data
- S&P Index Data
- Aggregate Corporate Bond Rates
- Wall Street Journal
- Bloomberg

## Important Privacy and Compliance Information

*Compliance*

Our 2015 Uniform Application for Investment Adviser Registration, known as the ADV II, is available upon your request. This document, which we are required to file annually, provides detailed information about our practice. There have been no material changes since our last update of 2014. We will be happy to supply you with an e-mail or paper copy; just let us know.

*Privacy Policy*

Annually we are required to provide our privacy policy. The following is the Life&Wealth Privacy Notice
Privacy Notice:

Pursuant to Regulation S-P adopted by the Securities and Exchange Commissions, it is the policy of Life&Wealth Advisors, Inc. ("Advisor") to keep confidential nonpublic personal information

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Should you have any questions regarding the above, please contact Gary P. Gardner, President of Life&Wealth Advisors, Inc. at 925-937-7800.

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