Economic Essentials for Investors

Objectives:

- Learn basic economic principles and how they can affect your investment decisions
- Understand key economic indicators: what they are, where to get them, and how to interpret them
- Study real investment examples of how economics can be used to predict investment winners and losers
- Unravel the mysteries of The Federal Reserve; learn the theory behind monetary policy and how it can affect your investments
- Learn how government policy in trade, environmental, energy, defense, fiscal, agriculture, etc. can affect investment choices

Course Materials:

Your instructor has chosen the following course materials and will most likely refer to them in lessons and/or homework assignments. How the Economy Works: An Investor's Guide to Tracking the Economy

This practical hands-on investment guide arms individuals with the basic economic principles they need to know for personal financial planning. It discusses the key economic indicators reported regularly in the media, puts them in economic perspective, and explains their relation to investment problems. Charts, tables, graphs.

Lesson 1: Why Investors Should Care About Economics

Identifying Investment Opportunities with Economics

Many people view economics as a dull academic subject that should be avoided. But economics gets a lot more interesting once you, the investor, understand how it can provide you with the ability to identify profitable investment opportunities.

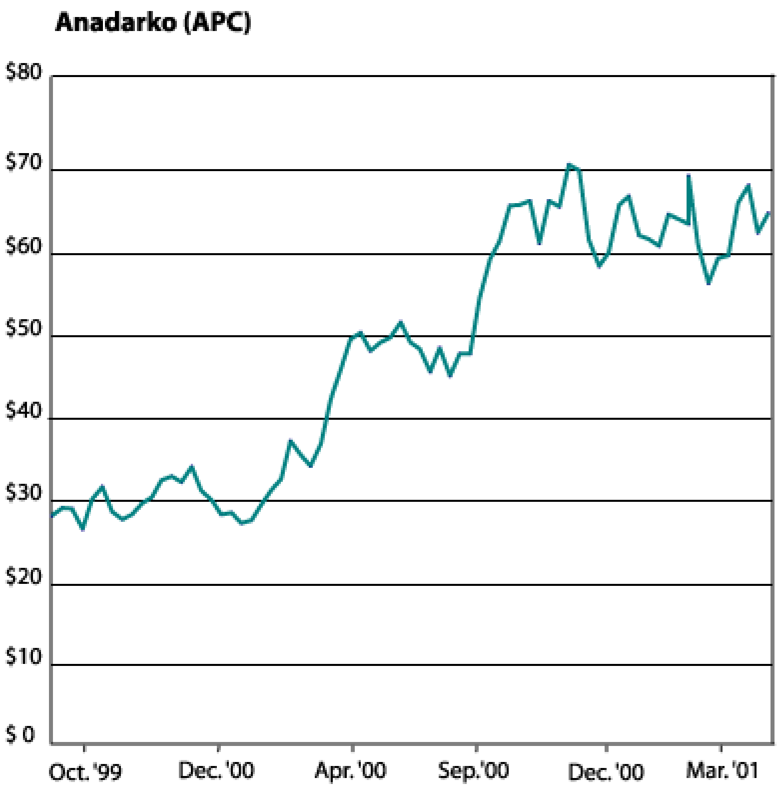
Changing economic conditions can affect how profitable certain companies, industries, or asset types will be. Investors who want to gain an edge over other investors understand the relationship between changing economic conditions and their impact on specific investments. They use basic economic principles to answer investment questions like:

- If the Federal Reserve lowers interest rates, should I own more or less bonds in my portfolio?
- If the U.S. dollar devalues against foreign currencies, which company or industry's stocks will benefit?
- If energy prices stay high, which stocks will be the winners and which will be the losers?
- Which stocks have the ability to weather an economic downturn better than others do?

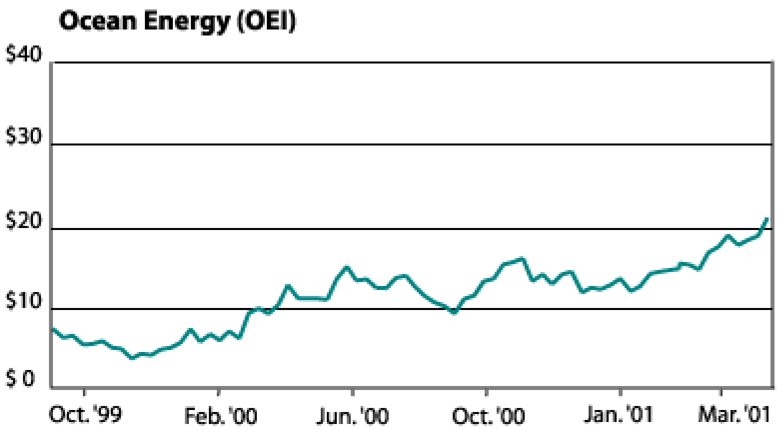
Although these questions may be a little too lofty or boring to get excited about, some economic-minded investors have doubled their money in 17 months. Are you getting a bit more interested in economics now?

Economics Was a Gas in 2000

In 2000, investors who owned natural gas companies were rewarded handsomely. And, since 2000 was not a stellar year for many investments, natural gas investors felt doubly blessed. Let's take a look at a couple of the more logical choices: Anadarko Petroleum Corporation (APC) and Ocean Energy, Inc. (OEI).



Anadarko Petroleum Corporation (APC) Stock Valuation



Ocean Energy, Inc. (OEI) Stock Valuation

Just a lucky guess you say? No, not really. All the economic clues to the natural gas phenomenon were fully in place by the fall of 1999.

Let's take a look at them:

Strong Demand

- Energy consumption was very high and growing. Whenever the economy is strong, as it was in the fall of 1999, it generally contributes to higher energy needs. The "new economy" was also driving energy demand, especially electricity, higher than usual all over the country.
- Almost all of the new electric plants going online during this time used turbines powered by natural gas, so the demand for this resource was increasing.

Low Supply

- Natural gas and oil prices had been at historically low levels for a number of years. In addition, oil and gas companies were financially troubled and, subsequently, they were not investing in new exploration and production. After all, who would invest in increasing production of a good or service that is going to sell at a low price?
- It takes a relatively long time to add new oil and gas production, so supply would continue to lag demand into the foreseeable future.

Restricted Market

- Unlike oil, natural gas cannot be imported from distant countries in tankers. Ground-based pipelines primarily transport natural gas. The existing pipelines feeding the U.S. can only support natural gas being produced in the U.S. or Canada. So if natural gas supplies in the U.S. are running low, there are no suppliers outside of North America that are going to be able to enter the market and rectify the situation.

Old Habits Die Hard

- Since the U.S. experienced a number of mild winters during the 1990s, demand had been unusually low.
- Energy prices had been low for a number of years, and energy-related stocks had been poor performers -- especially when compared to the technology sector.

Summary

Investors who understood economic essentials looked at all of the above clues and invested in energy companies that devoted a significant portion of their business to domestic natural gas. Things are always more obvious in hindsight, and not all economic clues will be this obvious or lucrative. But adding economic essentials to your investing toolkit is like adding another lens through which to view opportunity. This lens helps things come into focus much sooner and much clearer.

Economics is a vast and complicated subject, and some people can spend a lifetime understanding it's nuances and intricacies. But don't be daunted. The good news is that, for individual investors, there are just a few basic principles that can improve their investment vision and insight.

Relevant Economic Data

In the above example, supply and demand was the key economic condition that led economic-savvy investors to invest in natural gas stocks. Be sure to do this lesson's assignment to see what kind of economic data is available when assessing supply and demand conditions. The reading will also help prepare you for Lesson 2, which tackles supply and demand in detail.