THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

Jeffrey W McClure CFP®

PO Box 1029 / 918 N. Main Street
Salado, TX 76571

Jacob A McClure CIMA®

(254) 947-1111
(800) 914-7526

Serving Investors Since 1982

www.tpwc.com

jeff@tpwc.com

jake@tpwc.com

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TPWC Market and Economic Update

The Markets

The S&P 500 closed today down 1.94% for the week at 2,085.18. To continue our slightly longer and off calendar perspective, the Index is still up 14% from mid-February but down 2.14% from its high back in May of 2015.

As we have reported in past weeks, the presidential election campaign is depressing the stock market, or as the *Wall Street Journal* (WSJ) put it today, "Tightening polls in the presidential election have dragged down stocks and pushed Wall Street's 'fear gauge' to its longest-ever stretch of gains." A consistent stream of reports indicates that traders and investors are fearful of a Trump victory. Their reported reasoning is fairly simple and is centered on a single issue. Much if not most of the business represented by publicly traded stocks depend on international trade for a significant part of their profitability. The auto industry, for example, is highly dependent on a free trade zone into Mexico. If the North American Free Trade Agreement were to be scrapped, as candidate Trump has promised, in the short term it might halt much of the automobile production in the United States, and longer term would very likely make American cars uncompetitive in world trade.

This is not a political issue, but rather is financial. More than a few commenters have noted that as Donald Trump's poll figures rise, the stock market falls. Note that the changes in the polls are not sparking a panic, but instead are causing those who would be selling anyway to not reinvest and new investment money to continue to wait on the sidelines. That is the recipe for a future bull market.

According to the WSJ, equity strategists at Barclays estimate that if Donald Trump wins the election, the stock market will drop between 11% and 13% based on recent moves in stock futures as the polls shift. If Hillary Clinton wins, the same strategists are anticipating a 2% to 3% rise. Factually, no one knows what impact one candidate or the other will have on corporate earnings or the economy. What investors do know is that they fear uncertainty and a Donald Trump presidency brings a lot more uncertainty to the scene than does a win by Hillary Clinton.

The last time the S&P 500 had a losing streak this long without a single up day (9 days) was in December of 1980 as Jimmy Carter was on the way out and Ronald Reagan was the President-elect. In that case the instincts of the market were correct as we faced a major recession in the first two years of the Reagan presidency. Still, we recovered from that downturn and went on into one of the greatest bull markets in American history. There is a difference this time. Our economy was in shaky condition in 1980 with both inflation and interest rates at double digits. Today we are actually in quite good shape, although you wouldn't know it from the election rhetoric.

In short, fasten your seat belts, but do not despair, no matter who wins on Tuesday. As Warren Buffett commented recently, …the United States of American will do just fine no matter who we elect. "For 240 years it's been a terrible mistake to bet against America, and now is no time to start."

The benchmark ten-year U.S. Treasury Note yield dropped to 1.776% as once again money from multiple sources sought a safe haven where a ten-year purchasing power loss was an acceptable price to pay for a U.S. government guarantee of a fixed dollar amount. The European economy reported a slight uptick in inflation, which is good news there.

As a side note, world stock indices are reacting to the presidential election polls in much the same way as they are here. In testimony to the central position the U.S. has in the world economy, foreign major markets appear to actually be more sensitive to the polls than those in the U.S.

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The Economy

The big economic news this week was that according to the Bureau of Labor Statistics (BLS) total nonfarm payroll employment in the United States rose by 161,000 in October, while the unemployment rate dropped to 4.9%. Digging deeper into the numbers, very little has changed in the last year except the number of discouraged workers who are out of work, would like to work, but don't believe there is any point in looking. There were about 665,000 potential workers in that category a year ago but only 487,000 in October, a decline of about 171,000. There are 152,000 fewer unemployed now than a year ago as well. This translates into what we have been seeing in other numbers as well as anecdotally; the recovery continues.

It is not particularly surprising that unemployment has held steady, bobbing up and down between 4.9% and 5.0%. For several decades, the upper 4% range for unemployment has been considered by many economists to be the "natural" unemployment percentage. Yes, the number has been lower, but only for relatively short periods of time when we had exceptional, and generally unsustainable, economic growth. The good news is that new hires are sufficient each month to accommodate newly educated workers leaving school and reentry workers who were out of the workforce temporarily for other reasons.

So who are all those unemployed people, including about two million who have been out of work for 27 weeks or more? They are what economists call, "economically displaced persons." In some cases, employment following the "great recession" collapse of 2008-2009 moved from one geographic area to another. For example, Texas has seen a dramatic gain in new jobs, and despite an impressive number of people moving from the rest of the country (and world) to Texas, our local unemployment rate, which includes the area from San Marcos to the Temple-Killeen-Fort Hood area, is at 3.5% according to the Bureau of Labor Statistics. At the same time, the Detroit area has an unemployment rate of 6.9%, despite an outflow of workers over the past five years.

An obvious question arises as to why the unemployed workers in the Detroit area haven't moved to a state where labor is in high demand and workers are relatively few. One of those answers is to be found in house prices. According to Trulia, the median home sale price in the Detroit metropolitan area is around $40,000 while the median sales price of a home in the Temple area is $161,000.

The second element driving the persistent core unemployment we see in the United States is a combination of skills and education. While the last compiled data from the BLS on this subject is for the year 2015, with today's unemployment rate about where it was last year it probably is still relevant. Unemployment for those without a high school diploma was at 8%, while those with a bachelor's degree in *anything* had a 2.8% unemployment rate. There is anecdotal data that suggests even the automobile assembly line workers who lost their jobs to automation have done reasonably well if they have at least some higher education.

As in previous times of rapid technological change, older workers with less formal education are the ones hit the hardest. If we had to tie the unemployment rate down to a single element, it would be found in the word "flexibility." The greater a person's formal education level, the more likely that person is to be able to learn new skills. As you may guess, language skills are a lead item in that equation.

The other big news this week was that worker productivity increased at a 3.1% annualized rate in the third quarter according to the BLS. Worker output increased 3.4%, but hours worked was only up 0.3%. the backside to that data is that the increase brought us back to where we were a year ago before businesses went on a hiring spree. Our analysis is that as newly hired workers come up to speed, it tends to return productivity back to normal. Now the thing to watch is whether those newly hired and now more productive workers continue to improve the bottom line. Our instinct is that they will, but we, like Warren Buffett, are optimists about the longer term potential for the U.S. economy.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
M.S. Personal Financial Planning

Jacob A. McClure, CIMA®

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