THE PERSONAL WEALTH COACH®

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February 10, 2017

TPWC Market and Economic Update

The Markets

The S&P 500, Dow Jones Industrial Average, and Nasdaq Composite all closed out the week at record highs. The S&P 500 ended the week at 2,316.10, up about 0.81% for the week. That put it up 3.45% year to date and up 24.20% from this time a year ago. As we have mentioned before, last year at this time the market was headed into a slump over collapsing oil prices, so that one-year rise should not be assumed for the future.

Interest rates, gold, and the dollar/Euro exchange rates all were little changed from last week.

Longer-term, the S&P 500 has risen at an average annual compound rate of 8.38% over the last three years. Even better is the 9.96% average annual rate of return over the last ten years. That is a particularly important number as ten years ago we were approaching the high point of the market prior to the 2008-2009 financial crisis.

Most of this week's market gains came today with President Trump's announced agreement to adhere to a "one-China" policy and not upset the international trade apple cart. That, combined with his announcement that tax reforms were proceeding ahead of schedule and loud discussion about actions that may roll back expensive regulations took the stock market indexes from a slightly negative position to the 0.81% gain we saw at the end of the market week.

An interesting phenomenon (at least to us) is that the MSCI Emerging Markets Index is up 7% so far this year. The consensus wisdom after the elections was that the Trump trade policies would devastate those markets, but instead they have risen at an accelerated rate. Even the MSCI China Index is up 4% since the election and recently the Mexican Peso, which initially fell double digits against the dollar, is rallying. For what we think is the probable reasoning, see below.

The Economy

Corporate earnings for the fourth quarter of 2016 are mostly in and it appears that we are going to see something like an 8% increase in profitability year over year. As we have said before, the stock market is driven by profits, which the investment community calls "earnings."

The University of Michigan consumer sentiment index fell from last month's 98.5, the highest it had been since 2007, to 95.7 as consumers became more pessimistic about the future. There are some indications that the implications of a trade disruption with Mexico and China are beginning to be taken into account by those surveyed.

One of the reported reasons we are not only seeing a market gain, but more importantly, seeing markets hang on to the gains achieved since the election is a slowly growing consensus that the President's trade tariffs are less and less likely to come to pass while his promises of regulatory relief and tax reform are more and more likely to happen. As we have mentioned in past weeks, any form of tariff imposed on imported goods would potentially have a very large and very negative effect on the U.S. economy. Some of the biggest negative impacts would hit in the farm states in the middle of our country where President Trump had some of his most enthusiastic supporters.

America is, by far, the biggest food exporter in the world. As it happens, China and Mexico are two of our biggest customers. A series of analysis have been published in the past month on the potential economic impact a trade war

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would have on farmers, and they all look glum. Senators and Members of Congress have reportedly been swamped with letters, emails, and calls expressing opposition to any form of trade war with either Mexico or China. Today's announcement that the administration had backed down from a potential confrontation with China over the status of Taiwan was welcomed as an indication that we just might not start a trade war after all.

At first glance, it would seem that raising the cost of imports from Mexico, for example, would be good for American businesses. The difficulty with that reasoning is that a great deal of what is made in the United States goes through several steps and those steps, in many cases, involved products going to and from Mexico several times. In the United States, we simply do not have either the physical or labor capacity to make what we need to manufacture, for example, an automobile. If a tariff was imposed on the parts for that automobile each time it crossed back into the United States, the cost of the car would no longer be competitive. That would tend to put American automobile manufacturers out of business and benefit Asian manufacturers (who already pay a 25% tariff on most automobiles imported into the U.S.).

If tariffs were imposed by us, then our trading partners would likely impose tariffs in response. That would hurt out export business, and the U.S. is the second largest exporting nation in the world and the number one food exporter. In general, prices of most of what we buy in the United States would rise to offset the cost of the tariffs. The higher prices would, in effect, be a tax paid by us all.

As this becomes more and more apparent to members of Congress, the chances of an economically destructive trade war become less and less. That makes investors happy and more willing to buy shares of American companies.

There are still a lot of moving parts in Washington and only time will tell how things will turn out. Most of what we see is positive, but there is still the possibility of policies or laws that will be economically damaging going into effect. Hold on to your hats and pray that the good policies happen and the damaging ones don't!

Until next week, we remain your faithful servants,

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