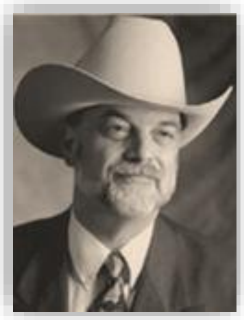

THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

A week has come in which the S&P 500 Stock Index (SPX) finally *didn't* rise. It closed out the week at 2,372.60, down 0.44% from last Friday. This week was a major mark for those of us who follow such things. The low point in the bear market of 2007-2009 was on March 9, 2009, so this makes the bull market now eight years old. Admittedly it has had some decent corrections along the way, but bull markets are longer-term rises, and this has certainly been one. Mid-day on March 9, 2009 the SPX dropped to the ominous sounding level of 666 before closing out the day at 676. Not counting dividends, the stock index has seen a rise to 3.56 times its value on that dark and stormy day eight years ago. That equates to a gain of 256%, which, according to the Wall Street Journal, is the second largest rise in a bull market since World War II.

A very valid question at this point would be, "Is the market too high?" or, the real meaning of that question, "Are we about to see a market crash?" There are no definitive answers to that question, but we do have some strong indicators. Interest rates on the 10-Year Treasury note rose to 2.57% this week, but are still historically very low as they are across the board while the forward price to earnings (P/E) estimate on the SPX is 18.39, and that is *down* from the 23.08 it was a year ago. The lower the PE ratio, the cheaper the price of stocks in real terms, while a higher P/E ratio indicates stocks are expensive. Those numbers put the "earnings yield" of the S&P 500 at 5.44% and even the dividend yield of the Index is 1.98%. One of the prime measures of market levels is to note whether the earnings yield of the stock market is higher or lower than the interest yield of a ten-year Treasury. The theory is that when the Treasury is higher than the market, expect the market to fall but if the SPX is yielding more than the Treasury, then we have room to run. Another indicator is investor bullishness as measured by the American Association of Individual Investors. That level is just 38%, making it relatively low.

What we see is evidence that the market may have finally completed the recovery from the Great Recession and its accompanying bear market and is now entering the expansion phase of this bull run. Expansions typically see rising optimism and culminate in a mania where pessimism disappears. We aren't there yet and don't appear to be even close. There is certainly a clear and present danger of a major correction in this bull market though. Our last major downturn was one year ago, and the present attitude of at least professional investors is cautious optimism. That optimism, so far unsupported by much data, is probably worth about 15% to 20% of the current market value. Remove the optimism and a drop of that amount is highly likely.

As we have written before, most of that optimism is based on political promises. Those promises include a corporate and individual tax reduction, large-scale deregulation, and dramatically increased federal spending. If any or all of them fail to manifest, some or all of that optimism could vanish in short order. The key is to be well diversified by asset class, have a plan for *when* (not if) a market correction hits, and a degree of faith and confidence that our economic system really does work.

The Economy

There were several economic reports released this week that are strong indicators of where the U.S. economy is pointed. Worker output increased at an annualized rate of 2.4% in the third quarter, but more impressively, we only had a 1.0% increase in hours worked. The difference between those two numbers is what we call "productivity." In this case, it is not the rise in productivity alone that we consider such good news, rather is was that our rate of productivity growth was up about 30% from a recent 1% per year to 1.3% per year.

Another sort of perverse piece of good news came out in the same Bureau of Labor Statistics (BLS) report. Wages grew at a 3% annualized rate in the fourth quarter. Rising wages equals rising income to spend on things. More consumer spending on goods and services is the engine that is the most likely to pull us out of the doldrums. As a side note, it also means that the Federal Reserve is very likely to raise short term interest rates this month to head off inflation before it gets started.

In yet more good news, Automatic Data Processing (ADP) reported that private sector employers added 106,000 goods-producing jobs and 193,000 service jobs last month for a total of 298,000 new hires in February. That number is near a record high, but is made even more significant by the lowest lay-off numbers recorded since 1973!

There is a correlation between CEO optimism and hiring, and we have a lot of CEO optimism right now. Consumers were confident too, with the Conference Board's *Consumer Confidence Index®* rising to 114.8, the highest number in 15 years. Again, a note of warning though, the confidence survey revealed that consumers are seeing that the current economy is largely unchanged. It is the future they are confident about. Much of that future confidence is based on hope for substantial positive changes that must originate from Congress. CEO confidence too seems to be based on the promises of tax cuts, higher spending, and lower regulation. Once again we are faced with an economy revving up on promises that if unfulfilled could result in some very real disappointment. Stay tuned.

<u>Household Net Worth</u>

All that hope and promise is a little unsettling and will be until we see actual results, but there was one report this week that was quite solidly fact. The Federal Reserve Board released its *Financial Accounts of the United States* report for the 4th quarter of 2016. In that report the net worth of U.S. households totaled *92.805 trillion dollars*! To put that in a little perspective, ten years ago, in the go-go boom of 2007, household net worth was about $66.5 trillion. Any way you come at it, we are approaching a 50% increase in net worth in ten years. That is impressive!

So, the big picture looks like more hiring, higher wages, higher household net worth and a lot of hope for the future. Just as good is the fact that the majority of news reports we have read on all this good news seem obliged to include a hefty dose of pessimism in the story. Bull markets climb a wall of worry and the wall seems to still be firmly in place.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
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