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TPWC Market and Economic Update

The Markets

For a change, the good old S&P 500 Stock Index (SPX) closed out the week at something other than a record high. It ended down 0.30% to 2,431.77 after being up to 2,445 earlier in the day, which would have been another record, but then dropped to 2,417 before closing near where it started the day. A drop in some of the larger tech stocks led the way down earlier on no particular news, but the relatively mild instability we saw in the market today was more likely from the unexpected loss of a majority by the Conservatives in the United Kingdom parliament.

The real market news this week was in what the market didn't do. Historically, revelations like the ones that came out in Senate testimony this week or the unexpected surge in the U.K. Labor party, led by an avowed Marxist, would have resulted in far more noticeable market movements. This week's non-events confirm that the stock market is far more driven by underlying corporate earnings than by political theater. For investors that is a good thing.

The SPX remains up over 16% for one year, 8.62% year-to-date and up about 33% from its lows in February 2016. Gold declined almost 1% this week to close at $1.268.80 per Troy ounce. The 10-year U.S. Treasury Note saw an increase in yield of four-100th of one percent to close at 2.2%. European two-year notes continued to trade at negative interest rates, while the German 10-year Bund yielded 0.267%.

The Economy

The Board of Governors of the Federal Reserve System issued its "Financial Accounts of the United States" ("Z.1") Flow of Funds first quarter report yesterday. In it the Fed reported that the total personal net worth, which is total value minus total debt, of U.S. households rose to a record $94.8 trillion as of the end of the first quarter. To put that in perspective, in 2007 at the top of the economy we had a collective net worth of about $66 trillion, while at the bottom of the 2009 recession, household total net worth was about $55 trillion, so we have nearly doubled our collective personal wealth in about eight years. In the first quarter of this year alone, stocks and mutual funds representing personal ownership in the stock market rose $1.3 trillion.

In another measure of how things are going, the Eurozone economy grew 1.9% from last year as of the end of the first quarter of 2017 and for the quarter, grew at an annualized rate of 2.3%. The Eurozone is still lagging well behind the U.S. in its overall growth since the recession, but it is gaining steam and appears to be reaching a self-sustaining rate. This week the European Central Bank hinted that the stimulus it has been injecting into the Euro economy may reach an end at some point in the foreseeable future.

Here in the U.S. we broke an export record with little fanfare. We Americans exported about one million barrels of oil a day so far this year and appear to be on track to continue that average. If so, 2017 will see a doubling of our previous oil export record last year. Interestingly, while not the largest importer of U.S. oil, China is one of the fastest growing customers. China imports about 8.6 million barrels per day and historically has been highly dependent on OPEC but as American oil becomes more available and is, on average, about $2.50 per barrel cheaper than OPEC oil, the Chinese are buying.

On the world oil market, the U.S. has become the big disrupter, which for those of us who remember the formation of OPEC in the 1970s, is truly ironic. Back then the Arab nations in what is now called Southwest Asia and a few other places, wielded the big stick, hitting us with an oil embargo, then setting the world oil price for crude for decades. Part of the irony is that the price increase OPEC created had a lot to do with us creating technological innovation that both reduced the oil used to do things and seek ways to extract oil that literally everyone thought could not be economically pumped out of the ground. Now the OPEC nations are trying to raise the price of oil by cutting production while here in the U.S. we are frustrating their efforts by finding ways to extract oil for less and less per barrel.

There is a lesson here. We do export jobs in a sense, but when we do it is not long before the jobs go away. Whatever we do well, the world tends to copy and then we find a better way to do it. As an example, VCR video recorders and playback machines were invented in the U.S. A couple of decades later none were made here as the "jobs" and manufacturing moved to Asia. A couple of decades went by and the technology (and jobs) vanished. The process of drilling for petroleum and using it for the myriad things it was and is used for was invented in developed in the United States. Over many decades, the dominance for producing crude oil moved to what we then called the "Middle East" and there was much wailing and gnashing of teeth here at home. Now we, once again are in the cat bird seat, but that will eventually change again. The next stage in the energy wars is already under way as natural gas replaces oil and once again we are in the lead. What comes next? The most likely next step will be in renewable energy sources such as solar and wind. Fortunately, U.S. companies are leading, running ahead of the next wave, as they develop batteries, wind turbines, and better solar panel materials.

The world economy is moving, growing, and innovating. There will be times we seem to be at a disadvantage, but we must stay in the game and keep on innovating and exporting. Our stock market is up 16% year over year not just on growth in domestic production, but to a large extent because we Americans own large parts of profitable corporations doing business outside the United States.

In the year 1997, the net total net worth of American households was around $30 trillion. At the end of the first quarter of 2017, twenty years later, we were at nearly $95 trillion. That equates to an average annual growth rate in net worth of about 6% per year. In the seven years since 2009 our household net worth has grown at an average annual rate of over 7% per year. While there are technical differences, if we compare that with average GDP growth there is a huge difference. Looking at all the components, the critical issue is that we Americans own more and more of the rest of the world each year. The rest of the world is well behind us and has a lot more growing to do if they want to catch up. By owning a part of that accelerating growth, we grow our wealth here in the United States of America. Since World War II that has been what we have been best at; profiting greatly by investing in others betterment.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
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