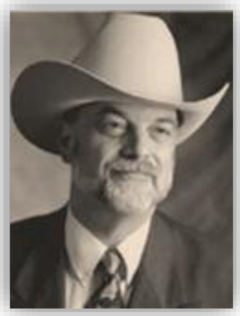

THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The S&P 500 (SPX) closed at 2,472.10, down 0.0178% for the week. The ten-year U.S. Treasury note perversely dropped in value, too, as the yield rose to 2.294% from last week's 2.238%. Gold managed to rise just a bit at the end of the week to $1,275.70. The dollar, after rising to near parity with the Euro earlier this year (0.955), has fallen to 0.85 Euros.

Severe cross winds buffeted the stock and bond markets this week as the Senate failed to pass any form of repeal or replacement of the Affordable Care Act, but the Commerce Department reported a 2.6% annualized GDP growth for the second quarter. The inability of the Republican-controlled Congress to pass any form of healthcare act, which many had considered to be the centerpiece of this year's legislative agenda raises the specter of a potential inability to pass a budget, an increase in the debt limit, and certainly drops the likelihood of tax reform.

The Economy

As we mentioned above, the Commerce Department's Bureau of Economic Analysis (BEA), one of our favorite government agencies, announced its first estimate of the second quarter's gross domestic product (GDP) growth rate today. The GDP is, interestingly, an annualized estimate of the *net* profits made in the U.S. for a quarter. Today's first estimate for the second quarter came in at 2.6%, a major improvement over the first quarter's revised 1.2%. Still, the annualized growth in our GDP for the first half only amounted to 1.9%. Most economists, and probably about everyone else, want more, but this recovery and expansion has been quite consistently hitting an average of around 2% per year, which has its advantages.

We are now in the third longest economic expansion since World War II. The longest, to-date, was the one that ended in the year 2000 with a 50% drop in the stock market after at least six years of "irrational exuberance." That expansion averaged 3.6% per year GDP growth, but ended badly with the economy and the markets out on a limb that broke with a vengeance. Contrast that with this slow and steady growth that, nine years in, just keeps going Back in the expansion of the 1990s, at the nine year point, inflation was running at 5% to 6%, but in this expansion inflation has had to work to average just over 1%.

In both longer expansions preceding this one, one in the 1960s and the other in the '90s, by this point, stocks were, by historical measures, overpriced. Today, the consensus is that the broad stock market is fairly priced given the record earnings reported by S&P 500 member companies. Friday's GDP report indicated that consumer spending, the biggest element in the economy, rose at an annualized rate of 2.8%. Corporate non-residential fixed spending, the investments that corporations make in buildings, rose at an annual rate of 5.2%. Better yet, corporate investment in equipment, which has lagged for several years, rose at an 8.2% pace in the second quarter. The price of oil is down about 2/3 since its peak at $144 per barrel just a few years ago, but the number of oil and gas rigs drilling in the U.S. is up 44% to 958 since the beginning of the year. In yet another piece of good news, U.S. exports grew faster than imports in the second quarter, adding about 0.18% to the GDP.

Meanwhile, on Thursday our good, old BEA announced that orders for durable goods; larger, longer-lasting things like refrigerators, airplanes, and bulldozers, grew 6.5% in June, and jobless claims remained at a four-decade low.

So, what's the bad news? First, despite a rising demand for homes to purchase, residential fixed investment (home building) fell at a 6.8% annualized rate in the second quarter. The culprit appears to be a tight job market with declining numbers of immigrant workers available to build homes. Another issue is that historically, corporations have issued new stock to expand, but in this environment, they are issuing bonds. In other words, not only in the U.S., but around the world, companies are running record levels of debt. American corporations find it cheaper to leave money parked overseas and borrow the same amount of money on the bond market rather than pay an effective 40% tax rate to bring it back to the U.S. Then, there is the looming potential default of the federal government. The Congress has gone home for August, and when they return, will need to pass a budget and raise the debt ceiling or face some very real consequences for the economy and the markets.

In other words, we do have a couple of economic weak spots. One is that we do not have an effective immigration policy. We have plenty of demand for low and unskilled labor, but we just don't have the workers in the economy to fill those jobs. A second problem is that we have a corporate tax rate that is too high, and is thereby distorting the debt markets, among other things. Third, there appears to be a near-consensus among economists that our economy is over-regulated, and finally, the dysfunction or our federal governance bodies has the potential to create some real damage.

If those ills sound familiar it is because they are. The Senate passed a comprehensive immigration bill several years ago, but the House of Representatives killed it, opting instead to keep the current system until the several million unregistered foreign workers in the U.S. are deported or leave. Unfortunately, the worker shortage in the United States would be far worse, and would likely have a negative effect on the economy if those workers did leave. As for tax reform, the last time we got a tax-reform law passed was under President Reagan, and it took three years and bipartisan support. Corporate leaders and economists seem to mostly agree that cooperation and leadership in Washington to create tax reform is unlikely soon. There also seems to be a consensus that regulatory reform is failing to happen because of infighting in the administration.

The bottom line appears to be that we will likely continue to muddle along with about a 2% growth as U.S. companies make more and more of their profits outside the U.S. The economy and the markets are growing despite dysfunction in Washington. In this case, we may have overwhelming evidence that American ingenuity and enterprise are stronger than most people thought. If so, we like it. Expect some short-term turbulence if Congress fails to pass critical bills, but we, as an enterprising nation, are stronger and better than that. It may take some time, but we have faith that we will emerge with solutions and means to get the things done that need to be done.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
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