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August 18, 2017

TPWC Market and Economic Update

The Markets

The venerable Standard and Poor's 500 Stock Index (SPX) ended the week at 2425.55, down 0.65% for the week. It has now declined 1.90% over the past month, but remains up 8.34% year-to-date and is ahead 11.07% from a year ago.

Perhaps the best explanation for both the rise and the fall is the market is up longer-term over economic fundamentals, mainly corporate earnings, but it is down short-term over political issues. The increasing divisions in the Republican party and between the President and his party are reducing the likelihood of a tax reduction, or even a budget and an avoidance of a government shutdown.

Speaking of "longer-term," three years ago, on August 22, 2014, the SPX had risen to what was then considered a landmark high point of 2000. 36 months later it is 21% higher, despite multiple waves of panic and the slowest economic recovery in memory. Most of that market gain only occurred following the oil-price collapse in early 2016 that took the Index back down to about 1880. In fact, the consistent (and wrong) sentiment over the past three years has been that the recovery is finished and the stock market is too high and about to plunge. We have often said that one of the prime indicators of a bull market is a pervading sense of worry and pessimism. The danger will come when everyone agrees that, "this could go on forever."

Gold fell in an apparently counterintuitive move to $1,289.80 while the ten-year U.S. Treasury note declined to 2.196%. As a side note, the mind-bending issue of negative interest rates continues in Europe, with even the German government securities with maturities of less than about 7.5 years still showing a below-zero yield.

The Economy

While there was no blockbuster news about the economy this week, there were many lesser indicators, and they are uniformly making the same statement: the economy continues to plug along at about a 2% annual rate of growth, but with no indications of a downturn ahead.

U.S. Consumer sentiment increased in the first half of August to the highest level since January with the University of Michigan reporting a level of 97.6, up from 93.4 in July. Expectations rose to 89.0, up from 80.5, while the reading on current sentiment fell from 113.4 in July to 111.0 this month.

According to the Commerce Department, sales at U.S. retailers rose 0.6% in July, matching Decembers gains. Wal-Mart, Target, TJX, Ross, and Amazon led the way with significantly increased sales, while pricier retailers saw their downward trend in sales continue. The sales at the larger, discount retailers accelerated sufficiently that the losses at Macy's, Kohl's, J.C. Penney, Foot Locker, and others were more than offset both in absolute volume and in dollar value. In the midst of the retail shift, a clear pattern appears to be emerging. Low price is the winner. That ties in with the fundamental shift in the economy from the assumption of inflation and corresponding wage gains to the new paradigm of low to no inflation and static wages.

Thursday saw the Conference Board's release of their measurement of the Leading Economic Index (LEI) for July. The LEI has been a near-perfect forecaster of good economic times for the following six months for decades. From time to time it will give a false warning of recession risk, but has never consistently risen in the six months before a U.S. recession. This release showed the Index increased at a 4.7% annualized rate, a strong indicator that at least through the end of the year, the economy is set for smooth sailing. That growth rate is not only good news as a single figure, but confirms a slow, steady acceleration in the indicators that now has lasted more than a year.

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Within the LEI though, there were some elements that bear watching. The good news was that manufacturer's new orders for durable and nondurable goods were at a record high and that more than offset a decline in building permits. The decline in building permits and housing starts so far this year is reportedly a result of a critical shortage of willing and able workers.

U.S. industrial output rose 0.2% in July, which may not seem to be much, but that annualized rate of 2.4% still keeps us in a healthy position and is quite consistent with the overall economic growth. The positive elements in the total picture were mining and utility output while automobile manufacturing continues to decline.

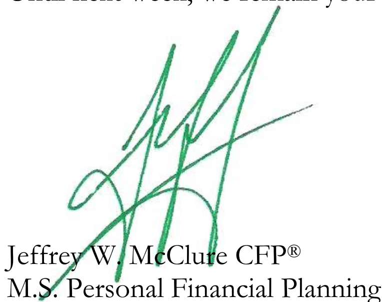
Part of what depressed the market this week is the continued uncertainty generated out of Washington. An example is an announcement this week that the White House will make the monthly payment to health insurance companies which enables them to give discounted policies to low-income customers. That monthly contribution is part of the Affordable Care Act (Obamacare) but has been challenged in court. The failure of Congress to pass an amendment to the ACA formally authorizing the payments combined with repeated threats by the President to not make them leaves a large part of the healthcare industry in a month-to-month funding crisis.

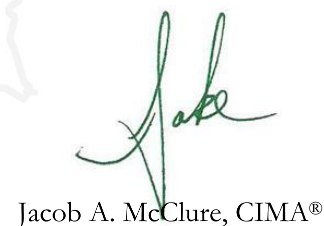
Further confusion and uncertainty are being generated by rumors being floated by members of Congress about where tax deductions might be eliminated to provide the revenue needed to cut tax rates. Add to that the uncertainty about whether the government will be open for business on October 1, and you can see that a certain level of negativity is beginning to affect companies.

Another element that is a bit troublesome about our economy is an arcane figure called “gross private domestic investment.” That number, published by the Federal Reserve Bank of St. Louis “FRED” site, indicates what percentage of our GDP we invest back into the economy to produce more in the future. During the 1980s we collectively reinvested an average of about 18% of what we made back into the economy. During the “Clinton” years and during the George W. Bush administration, we again invested about 18%. During the 2008-2009 recession, as is normal, investment dropped precipitously. Investment started to recover, but in 2015 it peaked at about 17.25%, then began to decline. Recently it seems to have stabilized at about 16.4%. The result is that since the recession, we, as a nation, have dramatically reduced our investment. It may be no coincidence that our growth rate has been slow if the investment we direct toward future growth is well below historical norms.

At least part of that investment deficit has to do with a tax code that tends to tax investment here in the U.S. at a higher rate than in other countries. Let us hope our representatives in Congress can find a way to remedy that problem.

Until next week, we remain your faithful servants,





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