THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

Jeffrey W McClure CFP® *Jacob A McClure* CIMA®

PO Box 1029 / 918 N. Main Street
Salado, TX 76571

(254) 947-1111
(800) 914-7526

Serving Investors Since 1982

www.tpwc.com

jeff@tpwc.com

jake@tpwc.com

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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index (SPX) rose a less than impressive 0.23% for the week, closing on Friday at 2581.07 after dipping to 2544 mid-week. The one-month view looks better at 2.45%, but the impressive numbers are year-to-date at 15.29% and one year at 21.38%. Those numbers look exciting, but the other side of the market, bonds, where a much of the new individual investor money has gone this year, is a different story. For one year, the Bloomberg-Barclays U.S. Aggregate Bond Index total return is up 0.28%, with all interest reinvested. A good guide to a benchmark for the average portfolio is to average the returns which gives you about 10% for one year. By any measure that is a great return, but may look disappointing with such a high return for stocks.

Gold continued its slow decline, down about 6/10 of one percent for the week and down about 1.61% for the year. Oil prices rose about 2% and the oil rig count rose a bit as well. As would be expected with good news rampant, the yield on the ten-year U.S. Treasury note rose about 14/100 of one percent to 2.415%, from 1.85% at this point last year causing losses in bond portfolio values.

The greatest danger for investors when the market falls is that they will sell out near the bottom. That is well understood by most investors we have known. The other danger is perhaps less well recognized. It is the tendency to pile into growth-oriented stocks in a bull market. As we report below, consumer confidence is high and part of that is generated by the rising stock market. Greed and fear are the investor's two most dangerous enemies. Holding some "dry powder" as well as a reasonable percentage of defensive positions is, to say the least, prudent. We do have some idea of long-term economic cycles, but sudden, unexpected events can drop the value of the broad stock market by as much as 50% in an amazingly short time.

Here in October, we are 30 years out from just such an event. If anyone reasonably predicted the stock market crash of October 1987, I have been unable to find that warning. Worse, there was no external event in the economy or in politics that can be blamed. It probably happened because of something called "portfolio insurance" which most investors believed would make things more secure but wound up crashing the system instead. That market crash was relatively short-lived and preceded one of the great bull markets in history, but it did happen and it did take the market down about 30% in just a few days. Maintaining a balance in your portfolio remains a crucial part of long-term success.

The Economy

One of our favorite government agencies, the Bureau of Economic Analysis, announced in its Friday press release that their estimate of Gross Domestic Product, which is to say the net profit of all U.S. enterprises and workers in the third quarter of this year, grew at an annualized rate of 3%. There were some surprises and not-surprises in that announcement. Economists surveyed by the Wall Street Journal expected the number to be 2.7%. The good news is that we seem to have just had the best stretch of economic growth in three years. The non-surprise was that the third quarter looked good. We have been on a run of first quarters looking weak and third quarters looking good for several years.

The real surprise was that the impact of several hurricanes hitting the U.S. last quarter depressed the numbers so little. This third quarter first estimate was only 0.1% lower than the growth we saw in the second quarter. Exports grew substantially faster than imports, which slightly declined from last quarter. The biggest growth components were in fixed investments by businesses and consumer spending. Consumer spending is up by about 2.9% from last year, while business investment in long-term equipment and structures is up 4.8%. That bodes well for the near future. Business has been slow to make long-term investments since about 2014, but seem to have broken out of their reluctance.

Of course, this is only the first estimate out of three that will come over the next quarter, but even though third quarters have recently been high, our overcoming of several hurricane hits in the quarter is impressive. The real test will come over the next two quarters. If we can sustain improved growth through the first quarter of 2018, we will truly be out of recovery mode and into a healthy expansion.

In other positive news, U.S. durable goods orders for factory goods that are expected to last for several years rose 2.2% in September from a month earlier. As durable goods orders are one of the major leading economic indicators, this is a big deal. Caterpillar and Boeing reported unexpectedly large earnings gains and both raised their one-year earnings and revenue forecasts.

The positives were reinforced here at the end of October, commonly a dismal economic month, by news from the Commerce Department that new home sales rose 18.7% in September to 667,000, the highest level in 25 years. That, like the GDP numbers, was a surprise to most economists, who collectively believed new home sales would slump in the wake of the hurricanes. Instead, new home sales in the south, where the storm damage was the greatest, rose almost 26%. Nationally, new home sales are up 8.6% from this time last year.

At the same time and quite possibly related is the University of Michigan report that its final October reading of consumer sentiment rose to 100.7 from 95.1 in September. Consumers surveyed were optimistic about job opportunities and economic conditions. At least part of that optimism came from the rising stock market. It appears that a rising value in retirement accounts equates to an optimistic view of the economic future. The University also reported that most respondents believed the economic expansion will continue over the next five years or more.

While the data set we are seeing is relatively short-term, it does seem that we may have turned the corner from looking back at "Great Recession" of 2007-2009 and are looking forward to better times in the years to come. Historically, this turn tends to mark the half-way point to the next downturn. We appear to have left the safe zone of "another recession could happen at any time." The mood is still sufficiently cautious that we do not believe we are in danger yet, but the tide does appear to be turning. Bear markets and major recessions to tend come when most people believe that the good times are here to stay and could go on forever. Bull markets and economic growth is the most likely outcome when people believe that the bad times could go on forever and a stock market is a scary place where people lose money.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
M.S. Personal Financial Planning

Jacob A. McClure, CIMA®