THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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TPWC Market and Economic Update

The Markets

For anyone who missed the action, the stock market, as measured by the S&P 500 Index (SPX), dropped into a classic correction at the close on Thursday, February 8, as it ended the day down 10.16% from its record high reached at the end of January. So far, it appears to be one of the shortest corrections in recent history as it closed on Friday at 2619.55, up 1.5% for the day, still down 8.8% from the high but out of the -10% range that is informally considered a "correction." That put the index down just over 2% year-to-date but still up over 13% from a year ago.

The benchmark 10-year US Treasury Note bobbed up and down but ended the week at 2.857% with a 2/10 of a percent higher yield than last week. That Note has now seen a rise in yield of about half a percent in three months. That rise in yield amounts to a 22.4% increase in rates in a quarter of a year, translating into a loss in market value for investors holding the notes.

In what to many will be an unexpected move, gold prices declined 2.2% as the stock market sank, although it remains up 5.5% for one year.

The Economy

There has been no small number of ideas floated as to why this correction took or is taking place. Every index of leading economic indicators continues to forecast smooth sailing and an improving economy for the next six months to a year. Earnings by 80% of publicly traded companies reporting so far have come in above expectations, an all-time record. Factory orders and purchasing managers indexes too continue to suggest better times ahead. With all that good news, why would the stock market suddenly take a 10% plunge? It appears to us that there were two elements in this short-lived correction that are warning flags.

The first is that the combination of tax cuts and dramatic spending increases has the potential to create some serious problems down the road. The U.S. federal government is going to need to borrow over $1 trillion just in 2018 and that is just the down payment. The spending bill passed by Congress on Friday morning should add another $200 to $300 billion to that this year. More, the hit will be bigger next year. Over the next seven years the addition to the national debt, earlier advertised as about $1.4 trillion from the tax bill alone, has effectively been increased to around $3 trillion with the passage of the spending bill.

The conclusion reached by many investors appears to be that the combination of the need for the federal government to borrow $3 trillion and the infusion of that much money into the economy through increased government spending will likely trigger some serious inflation and higher interest rates. The higher interest rates will make corporate borrowing much more expensive and cut into future corporate earnings. It just makes sense that if higher borrowing costs are likely to reduce corporate earnings by about 10%, a decline in stock prices may be in order. That is what "corrections" are all about. The reaction appears to have been magnified by large-scale selling of index funds to cover options losses for investors who have bet against high volatility.

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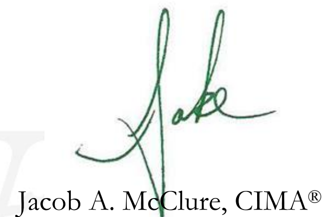
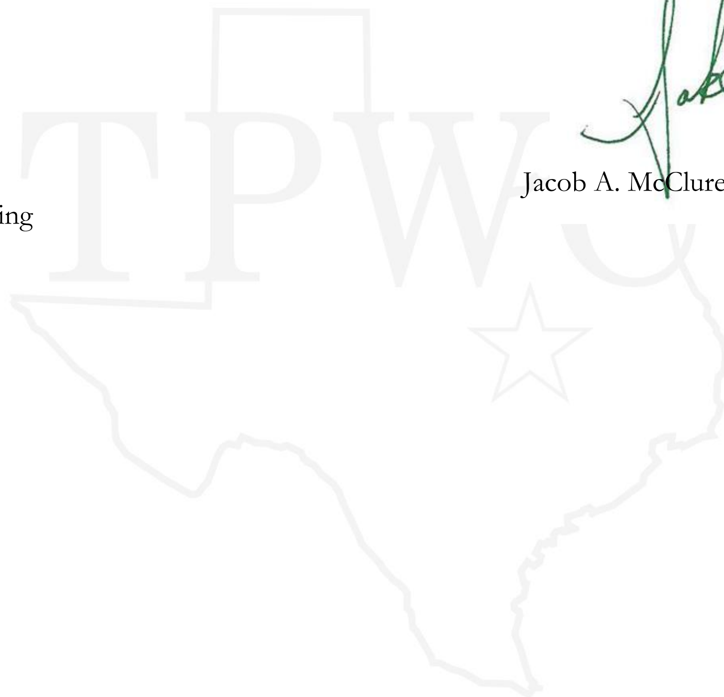
The other red flag issue was that several of the major do-it-yourself advisory services such as the ones at Fidelity, Schwab, Betterment, and others crashed as the market plunged. The concept of robot-advisors maintaining portfolios of exchange-traded index funds was seen by many as a "sure thing" that would limit losses and give higher returns. As with other historical "wealth without risk" schemes, this one failed when it was supposed to provide greater safety. The companies responsible were able to get things up and running again fairly quickly but this market event was only a minor stumble, not a panic. The lesson is that there are many investors who are depending on untested technologies to limit risk. If those technologies failed in a minor correction, they could be a time bomb that might trigger a bigger fall later in the year. For whatever it is worth, the pattern this year looks a lot like what we remember from 1987. Only time will tell.

Meanwhile, the economy remains hale and hearty. Stocks are reasonably priced, and from our perspective, the stage is set for continued growth, not a sustained market decline.

Until next week, we remain your faithful servants,





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