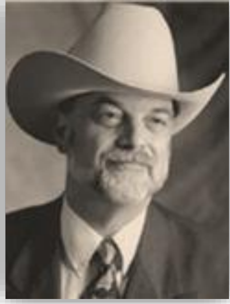

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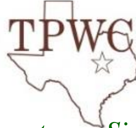

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March 30, 2018

TPWC Market and Economic Update

The Markets

The exchanges were closed for Good Friday, so Thursday, March 29 marked the end of 2018's first quarter for the markets. The S&P 500 Stock Index (SPX) finished the week down 2.82% at 2640.87 after rising 1.38% on the last day of the trading week. That left it down 1.22% for the first quarter but still up 11.53% for the 52-week year. The anecdotal evidence from traders and investors still suggests that the simmering trade-war rhetoric remains the drag on market values.

As potential economic growth tends to raise interest rates and potential slumps lower them, it is no surprise that the ten-year U.S. Treasury note continued to evidence a decline in yield, ending the week at 2.742%. That yield is 7% lower than the peak reached near the end of February. The dollar ended the quarter down about 2.8% from the beginning of the year. Conversely, the Euro is up about 3% against the dollar so far, this year and up over 15% since this time last year. West Texas Intermediate Crude Oil (WTI) has risen 8.56% this year and is up nearly 29% since the quarter end this time last year. Gold is up 1.1% this year and 4.81% for twelve months, closing out the quarter at $1,329.10.

The Economy

The Commerce Department announced that the Personal Consumption Expenditures Price Index (PCE), the inflation gauge preferred by the Federal Reserve, rose 0.20% in February and was up 1.8% for 12 months. The average monthly increase over the last five months suggests we are on track for a 12-month inflation rate of about 2.4%. As the Federal Reserve's target is 2%, the rise in prices could well lead to a more aggressive interest rate increase from the Fed this year. The increase in inflation rates is not surprising. American workers saw a 0.4% increase in disposable personal income in February following the tax cuts this year. Many American workers are taking home more money for doing the same work and the Treasury is borrowing the difference.

There are some counterintuitive results showing up in economic figures. Americans apparently are not spending the extra money from the tax cuts, electing rather to pay down existing debt or save the extra take-home pay. Despite much talk about the trillions of dollars American corporations were going to "repatriate", the dollar continues to decline. If trillions of dollars were being converted from other currencies to dollars to come home to America, the dollar would be rising. Instead, it has been falling. Tax revenues have slumped, again suggesting that corporations have managed to largely avoid much or most of the tax on overseas holdings.

The current market correction started with the tweets announcing steel and aluminum tariffs. While the proclaimed intent was to help the domestic steel and aluminum industries, Nucor (NEU) the largest domestic steel producer is down nearly 9% and US Steel (X) is down nearly 20% since the announcement. Across the board, domestic steel producers appear to be taking the biggest economic hits from the tariffs.

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The tax cut was announced as a big boost for economic growth both from the money predicted to come back to the U.S. and from increased consumer spending as the tax cut would increase take-home pay. Neither appears to have happened. The third economic boost from the tax cut was to have been increased corporate investment. Some of that appears to be occurring, but the sudden increase in steel and aluminum prices may have dampened that effect. Independent private analysts are forecasting that GDP growth in the first quarter of this year will come in at between 1.8% and 2.0%, far lower than last year's 2.6% total and the 2.9% growth rate of the fourth quarter in 2017 announced by the Commerce Department on March 28th.

As we have written before, one of the largest economic experiments in American history continues. The results so far are mixed.

Meanwhile, ignoring the ongoing drama out of Washington, the mainstream U.S. economy is continuing to drive forward with impressive momentum. The American labor force is many, many times larger today than it was in 1973, but last week's jobless claims report showed the lowest number in 45 years. That makes it the lowest percentage of the job force laid off in a week since records have been kept.

Our long-term forecasting skills are certainly not perfect but we anticipate a market recovery and reasonable growth this year. The economy drives the markets, not the other way around. The hangover looks more and more likely to come in late 2019 and hit full-on in 2020. Stay tuned.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
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