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THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The stock market, as represented by the S&P 500 Stock Index (SPX), nosed down to 2885.57 closing the first week of the fourth quarter down 0.97%. It has struggled to rise to the record it set in mid-September or to do much better than where it was in late January but seems to hit a wall each time. To provide some context, the record high SPX close on January 26 was 2872.87, meaning that last week the SPX was only 0.44% higher than it was in the first month of the year. It is easy to read or hear the news that the market is at or near a record high level and miss the fact that it hasn't risen much at all this year. The Index remains up a very respectable 13% from this time last year.

There is a factor in the market rise over the last year that may merit some serious attention. Fundamentally, stocks fall into categories measured by two characteristics. The first is size. There are large companies, mid-sized companies, and small companies represented in the U.S. stock markets, otherwise known as, "large-cap", "mid-cap", and "small-cap". The second characteristic is based on whether the price of the stock of a company is based on the underlying value of its assets or alternatively, based on the anticipated future growth of the company's profits or "earnings." Over the long-term, value stocks have outperformed growth stocks, and small-cap value stocks have done the best of all.

Historically, at the tail end of a bull market, growth stocks tend to take off and value stocks get left behind. That appears to be happening now. Unfortunately, those "growth" stocks have a historic tendency to come crashing back to reality with little or no notice while the value stocks tend to better hold on to their gains. To illustrate how upside down this market is, so far this year, the Dow Jones large-cap growth index is up 13.5% while the historically best performing domestic stock index, the Dow Small Cap Value Index, is down 0.9%.

The last time this size and value inversion was this severe was in the late 1990s, described famously by Fed Chairman Greenspan as a time of "irrational exuberance." Two years later the bear market of 2000-2002 was in full swing as growth stocks gave up their gains, declining as much as 80% in two years. Is this a repeat of that? Only time will tell, but the similarities are worth watching.

The 10-year U.S. Treasury note closed on Friday yielding 3.230%, a dramatic rise in the past few weeks. Gold rose 0.88% to $1,206.70 but is still down about 9% this year. Oil rose 0.99% to $74.29 and is now up 42% from a year ago.

The Economy

The U.S. economy is on a tear, and from the market reaction this week, one that may be a bit over the top. The Labor Department announced on Friday that the U.S. unemployment rate fell to 3.7% in September, the lowest rate since December of 1969. Wages are up 2.8% from last September and net employment has grown now for 96 months, the longest period since records have been kept. Ironically, it was the unemployment and labor reports that were given credit for the market declines.

Federal Reserve Chairman Jerome Powell in a speech noted that we are seeing a "Remarkably positive set of economic circumstances." When asked how long this economic good news could continue, he replied, "…effectively indefinitely." Upon reading that quote, our alarm flags went up. One of the more reliable hallmarks of the late stages of an economic expansion or a bull market is when one hears or reads "this could go on forever" or words to that effect.

In a bit of news that illustrates to us why the trade balance is really a non-issue, the Chinese government announced it would be selling $3 billion worth of dollar-denominated Chinese bonds. Note that this is not a sale of U.S. Treasury bonds, but new bonds (borrowing) by the Chinese government on which they are asking investors to purchase Chinese bonds using U.S. dollars and promises to pay the interest in dollars and then return the principal in dollars at maturity. The backing for the Chinese currency is primarily its dollar holdings.

Until next week, we remain your faithful servants,

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