THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

Jeffrey W McClure CFP®

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

Jacob A McClure CIMA®

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

Serving Investors Since 1982

www.tpwc.com

jeff@tpwc.com

jake@tpwc.com

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Greetings from The Personal Wealth Coach®,

In our last two newsletters, we wrote that the stock market was long overdue for a "correction" i.e. a drop in major index value of 10% or more. Here it is, pretty much right on time! Stock market corrections tend to happen, on average, about every 18 months. Our last correction was about this time of the year in 2011, so we were, based on pure averages, overdue.

Reality versus Mythology

There is a very popular myth, similar to the pot of gold at the end of the rainbow, which claims that somehow there is a way to get out of the market when it is about to go down and then get back in at the bottom, thereby making a great deal of money in a short period of time. For better or worse, to date, there is no evidence that anyone has actually been able to do that wonderful timing trick. In fact, study after study have demonstrated that those who attempt to get out and back in at the right times have the very worst long-term returns of any identifiable group of investors. On the other hand, every great long-term investor in history from Andrew Carnegie to John Templeton, to Warren Buffet have all had exactly the same strategy, "Buy into a well-diversified portfolio and just stay there for a long time, ignoring the ups and downs of the market."

Notably, there have been more than a few hedge funds and mutual funds that have attempted this heroic feat. They are very hard to find today because they lost money so magnificently that they vanished into merger or bankruptcy.

One of the realities of our universe is that when something is growing or moving, the movement will not be completely smooth unless the growth is very, very slow. The faster the movement, the more frequent and severe are the "bumps." It is rather like driving a pickup across a pasture, the faster the pickup goes, the bumpier the ride will be. Over the past five years we have had an unusually slow growth economy and market, and thus have had relatively few and relatively mild "bumps." The last one was in 2011, when Congress threatened to shut down the government, and as a result, the Standard & Poor's company cut the long-term US credit rating from AAA to AA. At the same time the Federal Reserve released notes suggesting that eventually it would need to raise interest rates from zero.

While I have little faith in Congress, I do believe that an action that would cause most of the House of Representatives to lose their Congressional seats is something that they may pretend to do, but in the end will recant and revert to some form of sanity. I also realize that a quarter point of Fed interest rate increase would not be severely damaging to the economy. Still, when the stock market has gone a long time without a good solid correction, anything, no matter how unreasonable, will do as a trigger to create a panic amongst the traders.

We are in the Dog Days of Summer so let's have a Correction!

It is quite notable that irrational corrections tend to almost always occur in the months between the end of June and the end of October. Those are the same months that the major movers and shakers in stock trading companies are out of town on vacation. In other words, the people with the vision and authority to make major purchases in the stock market are off in a cabin somewhere cool while the skeleton crew that is left behind has the authority to sell, but pretty much not to buy. That stay-behind crew normally gets left with a simple mission, "Don't lose money." As a result they (figuratively) sit there during vacation season with their finger held over the "Sell" button waiting for some indication of bad news to give them reason to bolt out of the market.

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Congress's action in the late summer of 2011 that is widely credited with causing the last correction was artificial. It had nothing to do with the economy or the recovery. It did hurt the economy a bit, but the market reaction was totally out of proportion to reality. This panic, here in 2015, is supposedly generated by the precipitous fall in the Chinese stock market following the minor devaluation of the Chinese Yuan currency. Note, however, that the Chinese stock markets (there are several) were, and still are, unreasonably high, and they got that way in the last year, with rises in value that were commonly over 100%!

Such manic market value increases are not unusual when a population is for the first time given the ability to actually buy stock in companies. Quite literally millions of people who could not define the difference between common stock and live stock have invested in stocks of companies that make the dot-com mania of the late 1990s look mild in comparison. Once pretty much everyone who was affluent or of the desire to buy had bought, all that was left were the people who wanted to sell. At that point the stampede started for the exits. Yes, the trigger for the stock selloff was the minor devaluation of the Yuan. Since Chinese stocks are valued in and trade in Yuan (not dollars) and the Chinese government is being very uncommunicative on how far the Yuan will be allowed to fall, any investor in a Chinese stock is, and should be, alarmed.

Is that a cause for the stock markets in the United States to lose value? It might be a cause for our markets to decline one or two percent. Why? Because perhaps one or two percent of the profits earned by American companies is a result of selling to the Chinese. On the other hand, a large part of American corporate profit is a result of buying parts for American products from China. The devaluation will make those parts less expensive. That lowered expense will have a tendency to make American corporations more profitable. Historically, the published triggering event for corrections almost always results in increased profitability and more revenue and earnings. That combination then creates a rise in market values that takes us well beyond where those values were before the correction.

There is nothing that suggests this event is any different from past "corrections." There is nothing in the economy that suggests an economic downturn is imminent. In short this is much ado about nothing!

Don't hesitate to call or write if you have questions or concerns.

Jeffrey W. McClure CFP®
M.S. Personal Financial Planning
Senior Advising Member

Jake McClure, CIMA
Advising Member