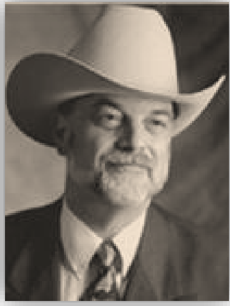

THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index (S&P 500) started this week at 1,900 and ended the week at 1,940. In most weeks that 2.1% gain would not be particularly notable, but this week it is a powerful indicator. On January 20, the Index closed at 1,859, so today it closed about 4.4% higher than it was in the middle of last week. It is still down 194 points from where it was last May, but that 194-point drop is 9.1%, which means that technically we are no longer in a bear market. Just as another point of reference, we started the year with the S&P 500 at 2,063, so today's market close marked about a 6% decline for the month.

Meanwhile, the ten-year U.S. Treasury note, generally considered the benchmark for bonds, had its market yield decline to 1.923%, which is still higher than it was a year ago, meaning that year over year, had you held a ten-year T-note, you would have seen a decline in market value.

The Economy

Stock Effect

So, what apparently caused the turnaround in the stock market? Well, it was certainly not the GDP report! Normally, a low GDP estimate would cause a decline, but the low report we got this week seems to have coincided with a rise in market value. As usual, the price of oil appears to have had an effect, rising to about $33.71 per barrel, a huge rise from the near $25 price it was in the middle of last week. The rumor is apparently out there that OPEC and Russia have come to an agreement to end the price war on oil, and a lot of "short" positions were liquidated. For those unfamiliar with that term, a short sale is when someone sells an interest in something they do not own with the intent of buying it back later at a lower price. In this case, there were a lot of short sales of oil contracts and as the price had started to rise, the people who had sold those contracts had to buy them back. The cumulative buying back of short contracts has had a lot to do with what has amounted to about a 25% increase in the price of oil this week.

The other, and perhaps more significant issue today, was the announcement by the Bank of Japan that it was setting its interbank lending rate at a negative 0.1%. Japan now joins Switzerland, Sweden, and Denmark in the very unusual position of charging banks to deposit money in the central bank, and conversely, paying banks to take loans. In Sweden, the benchmark interest rate, equivalent to our "Fed Rate," is a negative 1.1%. That means that the central bank will actually pay banks 1.1% per year to borrow money!

It is hard to get our minds around that concept, but it effectively means that, for example, an adjustable rate mortgage based on the benchmark rate in Sweden will charge the homeowner no interest. Each month as the mortgage payment is made, the entire amount goes to pay off the principal, and then the bank takes an additional 1/12 of the bank rate off of the balance in addition to the payment. It also means that large depositors not only will receive no interest on their deposits at banks, but will actually be charged a monthly fee to leave their money in the bank. Negative interest rates provide a very strong incentive to depositors to invest their money rather than saving it, and, at least theoretically, encourages spending over saving.

There is no certainty about these things, but last week may have marked the bottom in this correction. Not coincidently, the decline just barely crossed the official "correction" line then leveled off and began to rise, just as it has done in the last two corrections. Historically, that makes this downturn a classic correction and a completely different animal from a bear market. We will be watching, but the wall of worry that a bull market needs to climb appears to be firmly in place. That, believe it or not, is good news.

Fourth Quarter GDP

The 4th quarter U.S. gross domestic product first estimate is out and is reported to have been an anemic 0.7% annualized rate. That follows a 3.9% rate in the second quarter and 2% in the third quarter. The 4th quarter estimate by itself initially looks bad, but year over year, the U.S. economy appears to have grown at a 2.5% rate. Note though that GDP estimates are subject to revisions and some of those revisions have been pretty big in the past.

Cumulatively that 2.5% rate has lifted the U.S. gross domestic product to $18 trillion. We remain, by a long shot, the largest economy in the world. More, in an absolute sense, we are the fastest growing economy in the world. Yes, by manipulating the numbers one can produce numbers that suggest that we are falling behind, but the reality is that we are not only the largest economy and in absolute terms, the fastest growing large economy, we are also growing at a very sustainable rate.

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The big negatives were in oil-related industries (no surprise there), business inventories, and exports. When businesses inventories are a drag, as in this report, it simply means that business were selling goods out of their inventories rather than buying new goods to sell. Another drag was business spending, but that is a bit misleading. A big part of business spending is in the purchase of fuel, and, as we are all well aware, the price of fuel has dropped and is still coming down. Another item in the numbers that is not too obvious is that the rising dollar decreases the cost of imports. Much of what businesses buy as components for finished products is imported, and thus the same amount of purchases can show up as a negative if the price is falling, as it is. Business spending on new equipment in the oil fields and mining sectors dropped like a rock (-35%). Again, no surprises there.

The positives were more interesting, at least to me. Spending on new home construction and remodeling rose 8.1% in the fourth quarter. Consumer spending rose 2.2%, but that masks the fact that a lot of consumer spending is, like businesses, on fuel, so consumers really increased their purchases more than the number indicates. What they bought was just less expensive. That, by the way, is the nature of deflation, and deflation is what we have. Inflation technically rose 0.1%, but at least part of that is "implied value" so, in reality, the cost of living in the fourth quarter actually declined. Another big positive that encourages me is that defense spending rose 3.6% in the quarter, reflecting the bipartisan budget passed last fall as Speaker Ryan took office.

What is the bottom line here? Wages are rising faster than inflation. New homes are being built at a good rate, and that new building is accelerating. New jobs are being created at a rate faster than new workers are coming into the market. There was a time when Walmart was the bellwether for the economy, and before that, it was Sears. Today it is Amazon. Amazon's revenue in the 4th quarter grew 22%. Its total for the year was over $100 billion, a 23% increase in 2015! Earlier we reported record car sales in 2015, and that is another strong indicator of what is really happening in the economy.

As we have written before, go out and look around. What you will see is a lot of people on the roads, a lot of people in the retail stores, and a lot of people in the restaurants. Economists are puzzled by the fact that their numbers indicate consumer spending on other things has not risen as fast as the price of fuel has declined. In our opinion, the issue is simply that the flood of doom and gloom news has influenced American consumers to pay off debt and increase savings. Still, as we visited some big-box stores this week, we saw people buying big-ticket items. When the American consumer will seriously begin to buy things with that extra cash from cheap gasoline is an open question, but I have faith it is not a matter of "if" but "when."

Sells and Buys

We have just finished a thorough investment review. In doing so we have put in more hours and brain-strain than we like to think about, but we are moving on it. You may have already seen notices of funds sold and then other funds purchased. Odds are that if you haven't you soon will. Phillip Caret, the founder of the Pioneer Fund in 1928 is reputed to have said something to the effect of, "You never know who is bathing without a swimming suit until the tide goes out." This decline, like many others before it, exposed some funds as being overexposed in areas where they were reaching for yield or gains rather than sticking with the fundamentals. Once we identify fund managers who are acting that way, we tend to get rid of them as soon as we can. In other cases, our research has just found better funds, or funds that in the past we really wished we could get but which were closed to investors, but now have opened.

The result is that you will be getting notifications of confirmations on fund trades. Those are for real, and it is we who are making those trades. One thing that I can say for sure is that we do not trade funds lightly or without regard for your well-being. We have spent a lot of time on each account determining the most cost effective and long-term efficient way to invest.

We also recently made some changes in how we are taking funds for those who are doing systematic withdrawals. Again, you may notice that in some cases the monthly liquidations in equity positions have halted. In other cases, you will see a rebalancing as we change funds. In the long-term, what we do in a down market makes a far larger difference that what we do in an up market, so we are taking what we believe to be very positive actions.

If you have questions, please do not hesitate to ask. Once again this week we plan to be live and in living sound on KTEM 1400AM or www.ktemnews.com from 10:00 to 12:00 Saturday morning.

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