THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The S&P 500 closed out last week at 2046.61 and today closed at 2052.32. That five-point rise is a very insignificant number (0.28%). What is significant is that the barrage of unpleasant news, mostly amounting to something like, "The sky is falling! We're all going to die!" was as thick this week as any in recent memory, but the stock market did not fall.

The Ten-Year U.S. Treasury Note ended the week yielding 1.84%, up from about 1.70% at the beginning of the week. In this upside down world of negative interest rates around the world, that is good.

The Economy

We need to see higher rates, but there are strong economic forces working against that happening. Around the world, sophisticated institutional investors seeking a place where their money will be secure have been buying U.S. Treasury securities. Think about that. They are not snatching up gold or silver, but dollars. In the event of a serious world-wide economic crisis even worse than we saw in 2008-2009, gold would not do a person much good. On the other hand, dollars in hand would buy food, fuel, and whatever else one might need. That is true not only in the United States, but quite literally, all across the world. That reality makes a statement about how the world sees our economy and our nation.

That heavy buying pressure coming from all across the globe causes the price of Treasuries to rise, and interest rates to fall. Conversely, higher borrowing rates cause interest rates to rise and bond prices to fall. Thus, rising interest rates suggest that borrowing in the United States is up.

You may well wonder why more borrowing is a good thing. In a time like we are in at the present, when banks are quite picky about to whom and for what they loan money because of both intense regulatory scrutiny and a painful memory of all the banks that existed in 2007 that simply vanished beneath the waves, borrowing means solid investment. Two of the biggest drivers in our economy are new home construction and purchases, and new vehicle purchases. In the vast majority of cases, those actions require lending and borrowing of money. The same is true when a factory purchases new equipment or wants to build a new facility. Ultra-low interest rates suggest that business and consumer activity are low. The recent GDP numbers confirm that observation.

In today's economic environment the heavy purchase pressure for bonds, notes, and bank certificates of deposit drives interest rates down. That, in turn, causes banks to be reluctant to loan money because there is so little interest they can charge. Their unwillingness to make loans depresses business and consumer activity, which further depresses interest rates. It is a vicious cycle, and one of the reasons economists so fear deflation.

Roughly a year ago, the Ten-Year Treasury Note was yielding about 2.5% per year. The implosion in oil prices created a deep fear that financial institutions had overexposed themselves to that industry as they did eleven years ago in mortgages. That fear hit its maximum level on February 11 of this year. It is not a coincidence that the yield on the Ten-Year Treasury hit its low point on the same day as the stock market did the same.

So, what happened to cause this small, but significant rise in rates?

Existing housing sales rose 1.7% in April, and are up 6% from a year ago. The national median price for an existing home sale rose to $232,500, up 6.3% from a year ago. Existing home sales have a ripple effect as new buyers of existing homes tend to spend a fair amount of money on furnishing their new purchases. As the prices and demand for existing homes rise, the incentive to build new homes rises apace.

The Commerce Board's Index of Leading Economic Indicators rose by 0.6% in April with all sectors except consumer expectations showing growth. That may not sound like much, but the fact that quite literally every sector of the United States economy is expecting solid growth over the next six months to a year is critical. The Federal Reserve is very likely to raise short term rates at least two times this year, bringing the overnight interbank rate up to about 0.75% from its current 0.25%. That is normally a negative for business, but in this environment appears to be a plus.

The total credit card credit balance in the U.S. hit about $961 billion. Note that most of that is short term and a result of people using their cards to purchase items and then paying the card off at the end of the month, but it is a strong indication that American consumers are emerging from a fear-induced funk. The surveys of consumer expectations remain negative, but it appears that those same consumers are voting for a better economic future with their plastic. Again this is an economic indicator that suggests greater economic health rather than unsustainable indebtedness. That nearly one trillion dollar debt may sound like a lot, but it amounts to about $3 per U.S. resident. The high point in credit card debt was just over one trillion dollars, back in 2007. This is another indicator that we are still in the later stages of economic recovery and transitioning to expansion.

Total new car sales for April rose to 1.51 million units according to Kelly Blue Book. That increase equates to a 4% year over year growth in new car sales and while the final figures are not in, could be an all time record. At the same time weekly jobless claims came in at 278,000, a figure suggesting substantial growth in the job market. Any number below 300,000 is an indicator of expanding hiring.

All these factors together in combination with the data from previous weeks on which we have already commented create a picture of a solid growth rate in the U.S. economy. Inflation is holding at or below 2%, manufacturing is expanding, retail sales are growing, and the services sector of the economy is on a tear. So what is the problem that is causing the markets to be less than exuberant?

First, the Presidential election cycle remains a big uncertainty for businesses. As we have mentioned before, Bernie Sanders and Donald Trump have both stated they would do things if they were elected that could be devastating to the business community.

Greece is once again on the edge of default even as Britain approaches a referendum on leaving the European Union. Both are global economic unknowns that could possibly be damaging. In a development that cushioned out some negatives, Congress in a rare display of bipartisan common sense, appears to be ready to pass a bill next week that would allow Puerto Rico to effectively declare bankruptcy in an orderly fashion rather than allowing the Commonwealth's finances to collapse into a morass of individual lawsuits with unknown but potentially catastrophic effects.

Venezuela is teetering on the edge of an implosion. The government is broke and the people previously fed and housed by said broke government are unhappy. Their President has declared what is in effect martial law, but even with dictatorial powers he cannot order food, electricity, and fuel into existence. No one knows exactly what would happen if Venezuela degenerates into chaos, but whatever it is, it is unlikely to be good.

The Euro-zone countries reported a first quarter annualized growth rate of 0.5%. Once again a small number has a big significance. Previous quarters were effectively zero to negative numbers. If Greece can work out a deal with the International Monetary Fund and the United Kingdom does not secede in June, recovery may be in the offing, but there are too many "ifs" in that equation to cause much excitement. Southern Europe remains in what in the United States would be characterized as a depression. Negative interest rates still dominate the economy. There is still a lot more that looks like it could blow up than things that look like good news.

Japan appears to be slipping back into deflation and recession. There is a whole volume on why that is happening, but we will leave it for another week.

The bottom line here is that the U.S. economy is approaching full employment, is on solid footing, and is growing. The rest of the world is dragging along but there is little or no sign of an impending recession and glimmers of hope for improvement in the next year or so. Frankly, the pessimism will probably continue to drag things down until we have finished the agonizing process of choosing a new President and Congress. At some point we believe that the market will realize that the real economy is doing quite well and hanging on every word of doomsayers running for President is an unhealthy practice.

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