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THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The S&P 500 (SPX) closed this week at 2,173.60, down 0.07% from last week. On the surface that effectively amounts to "no change," but that "no change" masks some very significant underlying events. The SPX is still up almost 19% since mid February and is about 2% higher than last year's record high.

Even that sounds quite unimpressive until we consider that this week West Texas Intermediate oil (WTI) traded as low as $40.57, almost 20% below June's high of $51.33, which is nearly in bear market territory for the WTI price. The stock market malaise in the first and second quarters this year marked a period when the SPX almost perfectly tracked oil prices. Today oil is close to being in a bear market and the SPX is close to its record high, rising 3.6% in July.

Another frightening number is the quarterly estimate from the Commerce Department on the growth (or loss) in America's Gross Domestic Product (GDP). That estimate, released this week, set the first estimate of the second quarter GDP growth at 1.2%, well below the 2.6% economists had predicted. At any time in the past few years, a GDP estimate that was less than half that expected would have triggered a stock market plunge, but on Friday, as the estimate was published, the market only lost 0.1%. More on the GDP numbers below.

Meanwhile the ten-year Treasury bond declined to an annual yield of 1.4527%, down 7% from where it was a week ago. As you may remember, another widely proclaimed reason the market declined late last year and earlier this year was falling interest rates. Over the Month of July, as U.S. Treasury rates have fallen to record lows, the S&P 500 rose.

The Economy

The big economic news this week was the first published estimate of the U.S. GDP. The 1.2% annualized rate was less than half the 2.6% rate anticipated by the *Wall Street Journal* survey of economists. Contributing to the bad news was further negative revisions of the GDP growth rates in the 4th quarter of 2015 and this year's 1st quarter to 0.9% and 0.8% respectively. So why didn't the market react negatively?

The details of the Commerce Department's report revealed a silver lining though. Through the last three quarters consumer spending, wages, and jobs have been rising as has household formation. What that means is that the record number of adults living with their parents last year are collectively engaged in a mass migration into apartments. That set of newly formed households are both spending more as they furnish their apartments and earning more as they are fairly easily finding jobs that pay a living wage.

The other side of that coin can be seen in in the Census Bureau report this week that the percentage of households that live in homes they own, at 62.9%, is the lowest it has been since 1965. That decline in home ownership is most pronounced among households where the members are 35 or younger. Home ownership in that group is running at about 35%, or less than half the rate of those over 65 where 77.9% 0f households own the home in which they live.

The good news in those numbers is that the vast majority of the current all-time record number of renters report they are saving toward accumulating a down payment to buy their first home. That trend is one that promises a housing boom that will likely occur sometime in the next decade or so. The low percentage of home ownership amount younger couples is far more a result of a surge in new apartment renters than a shrinkage in numbers of home owners.

Consumer spending in the second quarter rose at a 4.2% annualized rate, so what was the drag? Business investment and business inventories were the culprits. Businesses continue to hoard cash and not invest in new buildings and equipment.

When asked why, the owners and managers cite the risk of an international trade war if the United States chooses to raise tariffs and abandon trade agreements. For very much the same reasons, businesses have been shrinking inventories of goods to sell in anticipation of an economic recession if we elect to cut off trade with China and Mexico. If businesses had just bought sufficient products to replenish their sales in the second quarter, the GDP would have grown at an annualized rate of 2.4%.

The silver lining to that economic negative is that if we do not cut off trade and start an economic war with some of our bigger trading partners, thereby starting a recession, businesses will have a lot of cash on hand and a lot of buying to do to catch up with that rising consumer demand. In short, if in the November elections the United States chooses to remain open for business with the rest of the world, we are likely to see a substantial jump in economic growth. The backside is that if we choose to become isolationist and protectionist, we are likely to see an economic downturn, but businesses will generally have enough cash to weather the storm.

In the longer term that inventory and business investment catch-up spending will give a short term boost to the economy, which will then, in turn, likely set off a home-buying surge that will give us a sustainable high GDP growth rate for at least the next decade or so.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
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