THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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TPWC Market and Economic Update

The Markets

Stocks

This week, the S&P 500 Stock Index (SPX) rose a meager 0.43% to close out at 2,182.87. That figure is 19.34% higher than it was in mid-February when the consensus seemed to be that the economic world was going to collapse because of the low price of oil, and 2.44% higher than last year's record high. Once again, U.S. stocks edged ahead, acting more like the tortoise than the hare, and did so in the face of a week when oil futures dropped below $40. It appears that the movers and shakers in the stock market have come to the conclusion that the price of oil on futures exchanges is not a good barometer for the whole economy.

The big stock market "news" is actually rather misleading. The NASDAQ 100 Index (QQQ) hit and all-time record high this week. One could legitimately become alarmed when the most volatile stock exchange breaks upside records. Way back in 2000, the almost daily record-breaking high prices of that exchange marked the top of the irrational bull market of the 1990s, and the greatest of the stock valuations excesses. It is good to note that the record breaking high this summer is just a tiny bit higher than the NASDAQ Index was sixteen years ago. In fact, even given the relatively low inflation rates we have enjoyed since then, that Index has a long, long, way to go to match the inflation-adjusted value it held in 2000. Back then, the NASDAQ 100 had a price-to-earnings ratio, based on then current reported earnings, of over 90. That means that if an investor received all the profits of the Index companies as dividends, it would take about 90 years to earn back the purchase price. That also means that the earnings yield on a share of the Index was about 1% and inflation was about 5% per year. In short, it meant that the chances of actually winding up with a gain in a QQQ purchase were pretty much non-extant no matter how long you held the shares. Today, QQQ has an earnings yield of about 4% at a price-to-earnings ratio of about 23. Given that inflation is around 2%, that suggests that a long-term buyer has a fairly good chance of showing a gain for his or her purchase, eventually.

Note here that we are not recommending a purchase of QQQ. The mere fact that a purchase of that particular security would still put an investor in a very real loss position after 16 years is a strong indicator that a prudent investor should feel the same about QQQ as they might about a flood-plain property purchase on the gulf coast! It may look appealing, but the odds are that it is just a matter of when, not if, a major loss is in the cards. QQQ has had two, full-fledged bear market drops in the last 12 months.

Quite significantly, European stocks, at least as represented by the FTSE 100 Index (UKX) rose 1.03% this week. That puts UKX up a whopping 0.61% for one year. Unfortunately, it also means that the premier European Index is trading at about 33 times its annual reported earnings, suggesting that there is more than a bit of speculation going on there. Contrast that with the SPX here in the United States where the Index is riding along at about 22.7 times earnings, or a bit below its long-term average, and is up 3.95% over the last year. It may have only risen 0.43% this week, but it still is in sanity range, whereas UKX appears to be in fantasy land.

If you want to note a reported truly weird bit of reported information, much of the gain that put European stocks into positive territory for year-to-date and one-year was credited today to the U.S. Labor Department report that U.S. employers hired a lot more new employees recently than anyone expected, combined with a quarter point drop in the Bank of England's short-term rates. That an index of purely European stocks should turn in a big gain on a purely U.S. economic number and an announcement by the Bank of England that a Brexit-related economic slowdown is in the works, is a statement on just how much the rest of the world is depending on the United States of America to be the leader in bringing the world out of the Sough of Despair into which it has fallen (with appropriate credits to John Bunyan's, "A Pilgrim's Progress.")

Bonds

The Ten-Year U.S. Treasury Note Rate rose to 1.59% this week. While that is far below the 2.26% rate with which we started the year, it still constitutes a rise of about 9.26% from last week's close. Every time this happens we wonder if this is the turning point that will herald the bear market in bonds we believe is inevitable. We have given up on the fruitless attempt to forecast when and how that will come. What we can know is that with the SPX yielding 2.73%, combined with a potential to rise over the next ten years, the current Ten-Year U.S. Treasury security yielding about 1.6% and with a nearly guaranteed loss over the next decade is, in our opinion, overpriced.

Gold

People ask us from time to time about whether they should own some gold in their portfolio. The good-news about gold is that is is up about 25% so far this year. The bad news is that back in 1980, 36 years ago, gold was trading at an average of $615 per ounce during the year. By 2001 the price had dropped to around $251 per ounce, again the average for the year. In 2011 it peaked again at a yearly average of $1,571.52 per ounce. By November of 2015 it had fallen to about $1,000 per ounce, but today is back up to $1,350. After inflation (and before taxes and sales commissions) a person who bought an ounce of gold in 1980 would need to see the sales price rise to about $1,783.81 just to break even. Worse, after making no profit, the investor would owe taxes on about $1,168.81 in phantom gain, at regular income tax rates. Perhaps the strongest argument against owning gold is that the longer one holds the metal the more likely there will be a loss after inflation, and a worse loss after taxes and inflation.

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There are certainly times in the past when buying and then selling gold would have been profitable. For example, had you bought in 2007 and sold in 2011, the gross (before inflation and taxes) return would have about tripled your money. After taxes, and inflation you still would have had about a 75% gain. On the other hand, had you bought gold at the beginning of September 2011, you would have had to pay about $1,900 for an ounce of gold. That would make this year's 25% rise to around $1,336 look pretty meek.

The S&P 500 Stock Index was at 110.9 on January 1, 1980. It closed out this week at 2,182.87. Not that there were readily available index funds in 1980 for you to use, but the index value has multiplied by a factor of 18.68 since then. Another factor is that because the stocks that compose that Index pay dividends, they effectively have offset inflation. Yes, there would be taxes if you sold today, but the tax on the sale of long-term stocks is lower than regular income. Again, we are not recommending you purchase an S&P 500 Index fund. At least historically, there have been better, less volatile ways to capitalize on the ownership of publicly traded companies.

No matter how you approach it, the gold has been far more volatile and over the long term has turned in a significantly lower gain over the long term than owning a diversified portfolio of shares in mostly American companies, so where is the great appeal reflected in the television ads for gold sales?

As far as we can tell the only reasonable way to make a gain in gold over the long term is to sell it commercially. As it has no earnings and generates commissions to the dealer on sale or purchase, it is a simple market-based transaction. Because average public buyers of gold have experienced far, far, more losses than gains over the years, it makes sense that sellers of gold have reaped much of those gains, making gold selling a very profitable enterprise. Better yet, many commercial gold investment sales organizations do not actually own the gold they sell. Rather, if they are legitimate, they simply purchase options to buy gold to cover the sales they make to the public. Of course, from time to time scams are reported in which the gold sellers either sold bars that were not actually pure gold (tungsten weighs almost precisely the same as gold, and can be coated with a plating of gold) or sold certificates for gold held in storage that was not there. That last group usually does own some gold, but effectively sells the same bars to many, many different people.

That high profit from gold sales incidentally is why there are so many advertisements on conservative talk-show cable channels proclaiming the virtues of the metal. Because it is not a regulated security, gold promoters are largely unlimited in what they can say about the future price of gold. As far as we can tell, anything that is highly promoted on television will make a very substantial profit for the advertiser. Television ads are expensive.

The Economy

The big U.S. economic news this week was that in the month of July employers hired about 255,000 more people than they fired or laid off. More, the Labor Department adjusted their reports for May and June by adding another 25,000 to the initial estimates. That means that employers have averaged about 190,000 net new monthly hires for the last three months. Another bright spot in the July report was that average hourly wages have risen 2.6% so far this year, for an annualized rate of about 5% (after adjusting for estimated inflation). Here in the United States of America we are currently employing about 1,330,000 more hourly workers than we were at the beginning of the year, and have increased the wages of the entire hourly work force by 2.6%. Meanwhile the unemployment rate remained at 4.9%, reflecting that well over a million new or rejuvenated workers have entered the workforce since the beginning of the year.

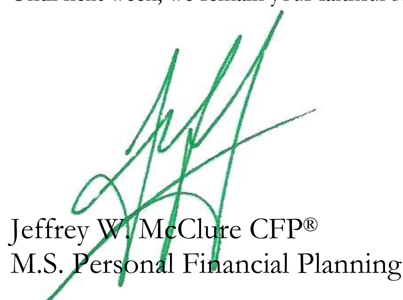
That paragraph of numbers alone goes a long way in explaining why the stock market is up. We now have about 151.5 million people gainfully employed for hourly wages in the United States. Note that the figure does not count self-employed or salaried workers. The combination of hourly wage rises and new hires effectively means that about $5.3 billion in new money is in the consumer's bank accounts since January 1. There is always a lag between an increase in total wages and the purchasing of new consumer goods and services, but on an annualized basis, those numbers mean that something like $9 billion in new consumer income likely to appear for 2016. Since, as we noted in the past, everything that we call our economy is ultimately based on how much money United States consumers spend, those are exciting numbers.

One of the numbers reported should give pause as well. Hourly wages are rising at about 5% per year. Inflation is ultimately a result of more money chasing a fixed number of products and services. The Federal Reserve will need to raise rates again else we will face a build up in spending power that will outstrip our ability to produce goods and service. Barring some horrendous event, I would not be at all surprised to see a rate increase of 0.25% in September. If the Fed is concerned about the political impact, it may wait until December.

While there is growing consensus that the Brexit will have very little or no impact on the U.S. economy (other than making European vacations a lot less expensive), evidence is growing that it will have a negative effect on the United Kingdom and Europe. The Bank of England lowered its benchmark rate by 0.25% this week, the first such move in about a decade. That caused the Pound Sterling to fall, but helped give a boost to U.K. stocks.

U.S. consumer debt grew at an annualized rate of about 6% in July. While that may sound like a lot, it is less than the total wage growth, and as such suggests that no crisis is in the works. Note that the debt includes all money owed by consumers, including mortgages, car loans, student loans, and credit card debt. Home purchases were a significant portion of the increase.

Until next week, we remain your faithful servants,



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