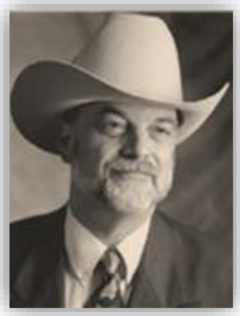

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TPWC Market and Economic Update

The Markets

Stocks

This week, the August "Jobs Report" was released by the Labor Department with hiring lower than expected, and the second quarter GDP was revised downward to a 1.1% (annualized) rate. In reaction, the Standard & Poor's 500 Stock Index (S&P 500 or SPX) roared to a 0.50% weekly rise to 2,179.98, largely offsetting last week's decline of 0.68%. Sure, it bobbed up and down more than that during the week, particularly just before announcements, but the big news is that it remains very nearly at its all-time high, but is only 2.31% higher than it was in May of 2015. Summer is noted for low volumes, and for declines that don't recover until the fall, but this year the stock market took an end of June dip, promptly rose by mid-July, set a new record (just barely) in mid-August, but has idled near that high all summer. If you read last week's commentary, I could almost repeat it this week.

We are enclosing an image from www.bigcharts.com of the movements in the SPX over the last 90 days.

Bonds

Here, we have a different story. The Ten-Year U.S. Treasury Note *yield* has risen, in relative terms, almost 10%. In absolute numerical terms, the interest rate annualized yield has gone from about 1.45% at the end of July to today's 1.597%, a change of 0.145%. That small move seems insignificant, but as a percentage of the already tiny yield a month ago, it is still about 10%. Investors are still flocking to bond funds though, and there is a reason for them doing so. One more or less typical, extremely low cost intermediate-term bond fund is up just over 4% so far this year. Notably its total gain for one year is less than that, and the five-year average, annualized total return is 2.26%. Over that same five-year period, the S&P 500 turned in an average annual return of over 12%.

There was a price to pay for that 12% return, and it can be seen in 2011 when the SPX dropped into a 20%(+) correction and again last year and earlier this year when it dropped almost by that much. The difference between volatility and return in the stock and government bond markets is made clear in those numbers. The U.S. Treasury Note, if held for multiple years, has very little market risk, but as inflation has averaged around 2% over that period, after taxes, a conservative investor using that bond fund would have a net loss while the hypothetical 100% stock index investor would have seen a wild and scary ride, but be in a very profitable position. We, of course, favor a balance between appreciation assets, like stock funds, and preservation assets, like shorter-term bond funds, among others.

The Economy

As we wrote above, the Labor Department released the July Jobs Report today. Domestic U.S. non-farm employers hired 151,000 more people than they laid off in August. Economists generally agree that we need, on average, about 145,000 new hires in a month to accommodate the normal influx of new workers. At the same time the unemployment rate held steady at 4.9%. So far this year, the American economy has generated an average of about 182,000 net new jobs per month. In July, the average hourly worker saw a 2.4% increase in wages from one year ago. Once again, the degree of stability here is remarkable.

Note here that the August employment report has been historically subject to some very large revisions in the following 90 days, and those revisions are consistently to dramatically increase the number of jobs and general employment.

The ho-hum employment report was in some way a relief for investors. The big question that seems to dominate Wall Street short-term thinking concerns when the Federal Reserve is going to start raising the interbank lending rate. The lackluster employment report released today caused the estimates of the "when" for that action to be moved to December.

The "marginal" employment rate, those who are working part-time or at temporary jobs because they cannot find adequate full-time employment, declined to 9.7%, higher than in previous recoveries, but still a long way down from the 17.5% we saw eight years ago.

The breakout of data that comes with the employment report is absolutely fascinating for us economic geeks. The unemployment rate for persons with a four-year college education is about 2.5%, and almost all of that is people "between jobs." For those who finished high school, the rate is about 5%, but for workers without a high school education nearly 7.5% cannot find work.

Another illuminating point in the Labor Department's volumes of data is that about 15.3% of American workers aged 55 or older without a college degree are either seeing or likely to see their occupational categories shrink and eventually disappear over the next decade. A counterintuitive element to that revelation, published by Jed Kolko, in his September 1 blog entry at jedkolko.com, is that those occupations are not low-wage! Instead they are the archetypical, "good, high-paying" jobs where people learn mostly on the job and see higher wages with seniority. Many are "brawn" jobs, but others include bookkeepers, accountants, fast food cooks, and mail carriers. One of the most surprising occupations that the Bureau of Labor Statistics (BLS) includes in the "shrinking" category is "computer programmers."

We expected to see job losses in manufacturing, fishing, and farming. The rest we had suspected but the reality of the degree of forecast job loss is surprising. In the "non-brawn" shrinking occupations, it is computers and computer programs that are replacing people. For example, we are already seeing a shrinkage in the tax preparation and bookkeeping occupations. That can be explained in a single word, "QuickBooks." Computer programing, as opposed to the design and development of software, is more and more being done by other computers. Interestingly, the demand for software developers, database administrators, and network architects is expected to grow, and likely will continue to outpace the number of available qualified workers here in the United States.

All of this has a very practical application. The more years of on-campus education a person has, the more secure their financial future is likely to be. That can be refined by stating that the greater the creativity, education, and the ability to both communicate and apply that education with intelligence, the greater the demand will be for that person. For particularly older, less-educated workers, the anxiety about being able to work until their Social Security retirement age is both high and growing, with good reason. They *are* seeing their jobs threatened and vanishing.

The American economy is healthy and growing, but in order to do so it must evolve to stay competitive. That means that productivity must rise. Rising productivity occurs when more goods and services are produced with fewer hours of work, and with fewer workers. Our economy is about the only one on the planet among developed nations where we are both creating more output per worker-hour and at the same time growing fast enough to need more workers.

Chinese Debt

We have listed this as a separate section because it is both remarkable and has little to directly do with the American economy. It is, in our opinion, a critical element in gaining an understanding of global issues.

According to the International Monetary Fund, China's corporate and government debt equals 225% of their annual gross domestic product (GDP). China's official *government* debt-to-GDP ratio is about 80%, compared with the current U.S. rate of 78% (debt held by the public). The BIG difference is that corporate debt in the United States equates to about 32% of GDP (St. Louis Federal Reserve FRED numbers). The official non-financial corporate debt on the books in China equates to *145% of GDP* (IMF). The combined corporate and federal debt held by the public in the United States is about 110% of GDP, while in China it totals *225% of GDP!*

Why is this important? We have reported before that, among developed nations, when we use the same debt reporting standards that are in place in Europe, our federal debt is among the lowest in the world. Note that the numbers we use do not include the projected future costs of Medicare, Social Security, or federal pensions. The rest of the world does not consider that "debt" but rather a potential future obligation unless it is changed by law. For example, the German government has a significantly greater debt held by the public than does the United States.

So what about China? There have been many claims published over the past several years that warn that China is growing so fast it will soon, or perhaps already has, overtaking the United States as the world's largest economy. China *is* a large, and rapidly growing, *developing* economy, but we are in no danger of being overtaken. Why? Because the largest portion of that corporate debt on the books in China is held by government-owned companies, many of which are losing money at an astonishing rate. If they accounted for debt the way we do, much of that "corporate" debt would be revealed to actually be government debt. The output of those companies is counted as part of the GDP, even if no one buys what they are making, or if they do, it is at a loss.

The most fundamental difference is that in the United States, the vast, vast majority of the money that was borrowed by corporations goes into productive assets that are designed to make a profit. In China the majority of that borrowed money is propping up state industries whose mission is to keep a lot of people working whether it is profitable or not. According to *The Economist*, the five largest banks in the world are in China, and owned by the Chinese government. They collectively have non-performing loans on the books (loans on which the borrower has stopped making payments) of about 19%, higher than the ratio we had at the worst moment of the financial crisis of 2008.

The bottom line here is that neither the Chinese nor the European, nor any other nation or group of nations is even competitive with the United States of America. That you are in this economy at this time is the equivalent of winning the lottery. Give thanks. We are living in the best of times in the most prosperous nation in the world.

Until next week, we remain your faithful servants,

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