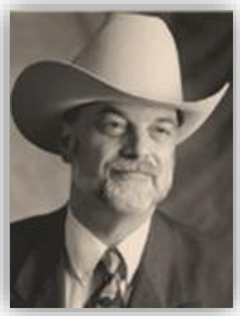

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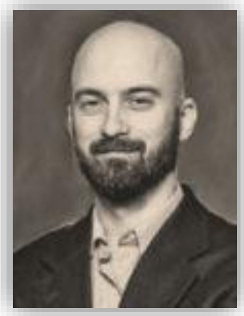

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October 14, 2016

TPWC Market and Economic Update

The Markets

The S&P 500 closed out the week at 2,132.98, down 0.96% for the week. That puts it down 0.29% for one month but up 4.91% for 52 weeks (one year). Using tops and bottoms as the starting points, it is up 16.61% from its low in February of this year, and up a whopping 0.10% from May of 2015. Ten years ago it was at 1,364, so the average annual rate of return over the last 10 years has been 4.57%, pretty close to what we have seen in the last year.

For better or worse, that is the economic world we live in. With Treasury bonds at 1.8% and inflation running at about 1.7%, most people look at a 4.57% return with glee. The 10-year Treasury is well up from last week's 1.723%. That means that generally speaking, the value of bonds declined just as stocks did.

As we have written before, barring some kind of unexpected and very large event, the markets are on hold until after the elections. There are consistent reports that traders and investors are critically uncomfortable with the idea of Donald Trump as President but still less than happy with Secretary Clinton. Once the election rhetoric is over and we see how the Congress and the White House shake out, traders and investors will react.

The Economy

Even as the U.S. economy is doing better than anywhere else in the world, corporate earnings (profits) have fallen for the past five quarters. This is, as far as I can find, the longest earnings recession we have ever had without an actual economic recession in the economy. This past year and a quarter has had a good reason for that anomaly though. Corporate earnings encompass all elements of our producing economy, and a big part of that is oil-related. The price of oil has declined over 50% in that time period, and, as a result, investment in oil-related everything ground to a halt. A large part of our transportation, manufacturing, and even service sectors in the United States was tied to a greater or lesser degree to the oil boom. The surprise here is that the collapse of oil prices did not cause a true recession.

Why did it not? The answer is in those same ultra-low interest rates that kill the concept of using CDs to finance retirement and make insurance and now pension portfolios look both underfunded and highly risky. Corporations borrowed a LOT of money to finance the oil exploration and exploitation that preceded the bust. If interest rates were at historically normal levels, those loans would have been disastrous. Because interest rates are so close to zero, loans were consolidated, and refinanced in such a way that $50 per barrel oil would support them. The back side is that while the companies did not fold, they also did not turn much, if any, profits.

Now for the good news. Following six consecutive quarters of year over year declines, corporate revenues for the third quarter of 2016 are estimated to rise 2.4% from last year. Given the consistency with which Wall Street analysts underestimate revenues, the final number is more likely to be around 3%. But wait! There's more! If we exclude just the energy companies from the calculations, earnings never fell. Minus energy, year over year revenues are expected to rise at 4.1%, which probably means something like a 5% growth.

O.K., so revenues are likely to rise. What about earnings (profits)? The news there is that margins are shrinking this year, so the actual earnings are likely to rise about 1% to 2% for the S&P 500. That does not sound like much until, once again, we remove energy. The underlying earnings for the rest of the market look like about a 3% to 4% rise is likely. We will watch this, but it does appear that the threat of sliding into an actual recession is receding.

In our opinion the Federal Reserve Board will likely raise the interbank interest rate from 0.25% to 0.50% in December. We see that as a good thing and it is a reflection that the U.S. economy is on the mend. The same cannot be said for Europe or Japan. China has its problems, but the odds seem to be in favor of no crisis there.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
M.S. Personal Financial Planning

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