THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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TPWC Market and Economic Update

The Markets

Stocks

The S&P 500 closed this afternoon at 2,141,16, up a whopping 0.38% for the week. The 52-week (one year) return looked a bit better at 3.81% while year-to-date the Index is up 4.76%. We, as usual, like to measure from the recent tops and bottoms. From this February's low, the Index is up a bit over 17%, but only 0.49% from its high in May of 2015. Once again, all indications are that the stock market is on hold until after the elections.

BlackRock reported that a survey they conducted indicated that many investors have exited the stock market partially or fully this year and will not consider reinvesting until after the results of the election are clear. 59% of the surveyed investors suggested they will be adjusting their investment plans after evaluating the results. Still, 52% of the investors surveyed by BlackRock believed the long-term prospects for the American economy are good. 63% though believe that the Presidential election will have a great deal of impact on the U.S. economy. Perhaps the most significant finding is that a significant percentage of investors do plan to up their equity investments once whoever is elected is in place and policy is set.

In fact, the President whoever he (or she) may be, has very little power to influence the economy other than in one area. That area though may be critical. If the public perceives that a President is competent and consistent, the markets tend to respond positively. If the President appears to be inconsistent and uncertain, the market tends to fall, all other things being equal. While there is no consensus as to why it happened that way, over the past century or more the stock market has tended to do better when there is a Democrat in the White House and not so well when a Republican lives there. Only time will tell if that element of market lore is about to be validated.

One factoid of some interest, at least to us, is that shares of Microsoft Corp, (MSFT). hit an all-time high today at $59.99, 17 years after its last record-breaking price (adjusted for a 2003 stock split). The difference is that in 2000, MSFT was selling at about 45 times earnings versus about 18 times annual earnings today. Considering that MSFT has a 2.5% dividend yield, that makes today's price as reasonable as it was unreasonable back in the year 2000. Maybe, just maybe, the stock market recession that began in the year 2000 is marking its end.

Bonds

The benchmark ten-year U.S. Treasury note yield dropped from last week's 1.8% to 1.74%, or not much at all. The only interesting thing continues to be that as Federal Reserve Board members continue to indicate they *will* raise rates this year, the Treasury note does not respond. That indicates that there is still a lot of money buying U.S. Treasury instruments. Much of that money must be coming from outside the U.S. as surveys indicate that U.S. investors appear to be moving to cash rather than bonds.

Goldman Sachs issued a warning this week that longer term bond holders were at risk of significant losses in the event of a resurgence in economic data. There is nothing new there either, but when the big guys agree with us it does feel good.

The Economy

There is a LOT of economic news this week, but fear not good reader, we will not turn that fire hose in your direction. Rather, we want to fire off some relatively short blurbs. If you have questions about the details, please feel free to ask for more.

Inflation:

Year over year, inflation appears to be running at about a 1.7% rate. If we pull out energy costs it is lower, but that is at least partly offset by our buying more gasoline. The Federal Reserve has stated repeatedly that we need inflation to run at about 2%, and we agree. As long as there is a consensus that things will be cheaper if we wait to spend our money, we will likely continue to defer buying things. Since about 70% of the U.S. economy is composed of our spending money to buy goods and services, our spending deferral is a drag on the whole economy. There is a consensus among economists that 2% inflation is sufficient to get us back into a more normal spending mode. More, a bit of a rise in inflation will likely trigger a bit of a rise in interest rates. Interest rates are so low that much of what we consider to be a normal economy is not happening. Oddly, a perception of rising rates will likely trigger an economic acceleration across the board according to history.

Immigration:

The United States is one of only four nations in the world that is experiencing a net inflow of qualified workers. The others are the United Kingdom, Australia, and Canada. According to Mark Zandi at Moody's Analytics, If we were to significantly reduce the inflow of immigrants, we would almost certainly experience long-term economic decline. It is good to remember here that Mr. Zandi, has been amazingly accurate in his economic forecasts over the last couple of decades. The native-born population in the United States is having fewer children and getting older.

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That translates into more and more retirees drawing Social Security and Medicare and a decreasing work force to pay for those benefits. Both of those programs are facing longer-term threats, but those threats are easily remedied. That statement though is dependent on our not reducing the flow of immigrants into the United States. There are currently 43 million non-citizens in the United States, almost all of whom are either working and paying taxes, or the immediate family of someone doing so. That number grows each year, but if we were to curtail immigration it would create an unsustainable cash flow deficit for our government and dramatically reduce economic growth.

Japan, for example, has tight immigration rules and has been in a recession for the past 15 years. Despite the reports of high immigration levels into Europe, the demographics there look bleak. Simply put, there are not enough immigrants or births in Europe to offset the deaths. In Russia, the situation is even worse. Historically, developed nations experience reduced birth rates. If those are not offset by immigration, then a level or declining population inevitably leads to an economic decline and collapse.

Government Debt:

J.P. Morgan published a report from mid-September that had several major points about the "national debt," which is to say the total of all debt owed by the federal government to persons or entities other than itself.

1. The federal debt owed to others (about $13 trillion) equated to about 10% of a conservative estimate of federally owned assets. Any corporation that owed that small of a net debt would be considered "underleveraged." The current federal debt can be compared to a couple with assets of one million dollars owing $100,000 on a mortgage.
2. The debt to GDP level is not the highest it has ever been and is manageable. Currently it equates to about 77% of GDP, but it was well over 100% in the 1940s. The Congressional Budget Office (CBO) is predicting that it will rise to 86% of GDP by 2026. Even that level is lower than any other developed country in the world. It is important to note that as of the end of 2008, the deficit was 9.8% of GDP, but has declined to 3.2% and is projected to continue to fall over the next several years. That is assuming that current spending and tax laws remain in place. Those assumptions are, by the way, based on immigration continuing at present levels.
3. Rising interest rates will not cause a federal debt crisis. On the contrary, this period of extremely low interest rates has created a federal portfolio of borrowings (bonds) that are at an interest rate probably well below future inflation. If we have historical inflation levels in the future, much of the federal debt currently outstanding will effectively shrink with time.
4. The U.S. budget is "fixable." Actually, some relatively minor tweaks to Social Security and Medicare taxes would effectively balance the long-term budget. An increase from 2.9% to 3.6% in the Medicare payroll tax, and a combination of limiting Social Security benefits to those who have less-than six figure incomes per-person and a phased in three-year delay to reach the full retirement age would fix both programs. Again, those estimates are based on continued immigration at current levels.

The Rest of the Economy

Existing home sales staged a comeback last month rising 3.2% despite a shortage of homes for sale, with first time home buyers accounting for 34% of sales. At the same time as residential sales, and building, is accelerating, apartment construction is slowing. That strongly suggests that the rush from houses to apartments we saw in and following the great recession is reversing. New home construction is up 13.3% so far this year. Only 4% of home purchases were in the "distressed" category, another indicator that the housing crisis may be behind us.

The Federal Reserve reported that the net worth (total assets minus total debt) of the United States, including its residents, as of the end of the second quarter was $81 *trillion.* We hear a lot of large numbers about the national debt, but those cannot be understood without at the same time looking at national assets. Note here again, that the figure we just quoted was what would be left if every American, and every governmental entity paid off 100% of what they owed anyone, anywhere.

In short, we, the United States of America, by whatever way you want to define it, are in excellent financial condition. Fear gets people's attention far more than good news but that does not change reality. You are living in the healthiest, largest, and most productive economic entity in the world, or for that matter, in the history of the world.

Until next week, we remain your faithful servants,

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