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THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

Stocks

Before we get started, we are not recommending any investment strategy or investment here, but simply relating what has happened in the past.

The Standard and Poor's 500 Stock Index (S&P 500) closed today 2,154.45, up 3.80% for the week. That sounds great, but we believe it is important to put that rise, like we did for the earlier declines, in perspective. The news headlines are proclaiming nirvana is at hand as the Dow Jones Industrial Average (the Dow) was up 959.38 points or 5.36% this week and is at an all-time high of 18,847.66. Just under a year ago, it hit 18,000, so today, at its record high close, it is about 4.7% higher than it was then. In May of 2015 it closed at 18,298, putting today's record high a whopping 3% higher than it was 17 months ago.

As we have been in the habit of doing, we will also measure today's S&P 500 close against recent highs and lows. Today's 2,164 close puts that Index up 18.34% from mid-February of this year and 1.58% higher than it was in May of last year. Yes, the Dow has done a bit better than the S&P 500 if we measure from last May, and for that matter, so far this year, but the Dow is composed of 30 stocks picked by the editors of the Wall Street Journal while the S&P 500 is generally the 500 stock issues traded in the United States with the highest total market value. If the Dow does better, it is probably because the editors of the Wall Street Journal are better at choosing good stocks than simply choosing the largest 500. We use the S&P 500 for our benchmark in this letter because it probably better reflects the total stock market.

Now for the elephant in the room. The stock index futures markets behavior prior to the election indicated that the stock market would see a selloff if Donald Trump won the election. In fact, the Dow futures index dropped over 600 points Tuesday night and early Wednesday morning. Then, President-elect Trump made his victory speech. In that speech he sounded like a very different person than he did in the campaign. He came across as reasonable, gracious, and mature. His and his staff's statements in the following days sounded quite Presidential as he met with President Obama and called world leaders. Traders and investors seemed to conclude that the firebrand they saw in the campaign was a different person than the one that emerged from the process. What he and his staff proclaimed was not thin-skinned vengeance, but a pledge to roll back federal regulations, cut taxes, and spend a lot of money on domestic programs and defense. More money, lower taxes, and less regulation tend to equal higher earnings for corporations. Higher earnings tend to support higher stock valuations. Higher deficits and more borrowing generally equal higher interest rates. The markets responded.

Bonds

Another point to remember here is that unless you are 100% invested in large-cap blend stocks, your portfolio will not have the same performance as either of those stock indices. Most people have investment portfolios that are composed of a combination of asset classes that usually include a reasonable allocation to debt securities like bonds, notes, and bills. The benchmark ten-year U.S. Treasury note closed out the week with a yield of 2.152%. When compared with last week's yield of 1.776% that is an impressive 21.17% rise in interest rates! To provide some idea of what that means, had you purchased ten-year U.S. Treasury notes worth $100,000 in May of this year, and sold them at the close of bond trading this week, you would have received about $95,000 back, a 5% loss in six months, and the Federal Reserve has not started raising interest rates yet! The bond market was closed Friday for Veteran's Day, and overseas trading suggests that bonds would have fallen further if it had been open.

If the Federal Reserve has not started raising rates, what happened? As we wrote in the Stocks section, a new President and a GOP controlled Congress is what happened. Nowhere in the Republican platform or campaign this year has there been any pledge to reduce deficit spending, but rather there have been pledges to cut taxes and increase spending. That equates to more borrowing, which means that higher rates are probably in order.

That interest rate increase with its attendant bond value loss may well mark the end of a three-decades during which bonds may have fallen for short periods but seemed to always rise in value over the longer term. In the early 1980s, just over 30 years ago, U.S. Treasuries yielded as high as 20% per year. Of course inflation back then was in the double digits and taxes were, for most people, much higher. As newer bonds were issued at lower interest rates, there was a high demand for the older, higher-interest bonds, resulting in a bond typically rising more in market value the longer it was held, up to a point. As it approached maturity though, it would tend to go back to its original issue price as that was all the Treasury was going to pay the holder when it matured. Bill Gross, the famous former bond manager at PIMCO Total Return Fund, captured that value curve extremely well and then borrowed money to increase the return as he timed the top of the bond value curve. That was in the good old days for bond investing. Had you purchased that formerly high-flying bond fund last year about this time, instead of the 5% to 6% or so rise that could have occurred in a diversified stock portfolio, you would have seen about a 4.3% fall in your portfolio value as of today. Both the stocks and the fund numbers are based on your taking the interest and dividends in cash for income.

What that tells us is that things are working as they should. A person who had an evenly balanced portfolio of 50% stocks and 50% over the last year would have seen little in the way of up and down movement, but would have only had a very small gain. A person with a portfolio that was well diversified and invested mostly in stocks would have seen a gain significantly higher than he or she could have gotten in the bank or short term Treasuries, but would have seen more up and down movement. In fact, since the beginning of this year, a well-diversified, moderately conservative portfolio probably would have seen an after-inflation gain quite close to the 100-year average. We still have some catching up to do in order to get back to the long-term mean, but what we have seen this week could be a harbinger that a market recovery just might be at hand.

The Economy

The big news in the economy was the election of Donald Trump as our next President of these United States. His election combined with the Republicans retaining control of both the House of Representatives and the Senate, give one party the power to change things. Although the Democrats still hold sufficient seats in the Senate to block legislation, that power is going to be limited if anything at all is to get done. For example, the Republicans can pass a vital spending bill to fund the government and attach items to that bill that the Democrats don't like. If the Democrats filibuster to stop the bill from passing, it would be they who shut down the government this time and that would be a form of political suicide.

If we assume that what the Republican leadership is currently proclaiming as their plan is accurate, then we should see some significant increases in defense and infrastructure spending, tax cuts, and roll backs in federal regulations or at least the enforcement of those regulations. Frankly, it is our opinion as well as that of many economists, that a significant boost in federal spending combined with less regulatory restriction is exactly what we need to get us out of the slow-growth rut we have been in for several years. Short-term that may be a great thing.

In the longer term we face a demographic challenge that we need to address or we could easily find ourselves with the inflation of higher spending, yet with growth vanishing; in short, "stagflation." During the ten years ending in 2006, the U.S. GDP grew at an average rate of 3.3% per year, but during that decade the number of people 65 or older grew at an average rate of 310,000 per year. In the last decade that changed as we saw our GDP only grow at 1.5% to 2%. The change may have come from demographics as much as increased regulation and a business-unfriendly federal government. Since 2006, the number of people in our nation 65 or older soared by 1.28 million as the additions to the working-age population rose by exactly that same amount.

In short we are seeing people age, leave the work force, and begin drawing Social Security and retirement income. That means our labor force needs to grow faster and have increased productivity. Computers and robots may assist in the productivity gains, but we still need more young people. If Congress and the President use their promise to curb illegal immigration to also enact immigration reform laws that allow more people to enter the country legally, we can overcome that challenge.

In more traditional news, the Bureau of Labor Statistics, one of our favorite government agencies, announced that in September of this year, an all-time record low percentage of the workforce experienced layoffs. Voluntary quits were up and approaching another record, which is a good thing. Voluntary quits indicate that people are finding new jobs that generally pay more. That is good for the economy. Low layoffs indicate that businesses are growing and the wages earned are not likely to shrink. More money in workers' pockets generally leads to more spending, which is again good for earnings and the stock market.

Non-News

We have been bombarded in the last few days with "news" about what President Trump and his administration are "gonna" do. "Gonna" is a dangerous word. The real news is that very little is known about what the Trump administration will or will not do other than general tendencies and policies. Congress is largely controlled by conservative Republicans while our new President is a populist. Those are not at all the same thing. Things will change, but how much and in exactly what manner is an unknown. Presidents tend to do things once elected that are usually quite different than the political rhetoric they used to get elected would seem to indicate.

What we can say is that it will not be "business as usual" in the Federal Government. What that non-usual business will be will gradually reveal itself over the next year or so. Meanwhile sit back and relax. What we can also say is that our Constitution and our political system worked. We have just had a populist revolution without gunfire or bloodshed. We here at The Personal Wealth

Coach are optimistic that the changes we will see will work out to be good for our nation and for the world. Yes, we are optimists, but we have been for over 35 years. The pessimists and alarmists were around when we elected a B-movie actor as our president in 1980, with the Dow Jones Industrial Average dropping to around 800. In 1982, as the Dow finally broke through 1,000 and for the first time stayed there, we were optimistic in the face of determined pessimism. Today with the Dow approaching 19,000 we think we are on the right track.

Until next week, we remain your faithful servants,

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