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TPWC Market and Economic Update

The Markets

The venerable S&P 500 Stock Index closed today at 2,191.95, down just under one percent for the week, but still up about five percent for the last month and 7.24% year-to-date. Interestingly enough, at least to us, is the fact that for a full 52 weeks (one year) the Index is up 4.79%, or less than the rise in the last month. To round out the numbers, the Index is up 19.84% from its low in mid-February of this year and up 2.87% from its high in May of 2015. In short, all the hype about a runaway bull market following the recent elections looks a bit overdone from here. The stock market has apparently gone back into a "wait and see" mode following its roughly 5% relief rise as the election bloodbath seemed to be over.

The good news is that we do have a roughly 5% rise in stock values over the last year. We also do not have an overpriced market. There was an abundance of warnings from pessimists that the run up since the election would be overdone and result in a market collapse. From our perspective, a gain of less than three percent over the past year and a half is not irrational exuberance.

Unlike the stock market, bonds did not wait out the week. Today's ten-year U.S. Treasury Note closed at a yield of 2.387%, up from the 1.78% yield it had just prior to the election. That rise in rates equates to a 30% increase in interest rates in less than a month. One of the little reported indexes, the S&P Municipal Bond Index, is down 4.56% so far this quarter a bit more than the 4.55% decline in the S&P U.S. Treasury Bond 5-10 Year Index. Of course, if an investor holds a Treasury bond to maturity, he or she will receive back the face value. The problem is that very few individual investors purchase Treasury obligations directly from a local Federal Reserve Bank. Instead, most purchases are made on the open market where, until recently, high quality debt obligations were trading at a premium to their face value. When we consider that the Treasury Index has now lost more market value year-to-date than the likely interest an investor was paid, the day of reckoning may be drawing near.

Among the largest price moves in the various markets following the election was gold. The NASDAQ COMEX gold quote was just below $1,360 three months ago, and held up quite well until the elections. Following the closing of the polls it started down and today closed at $1,177.80, down about 13.4% for the quarter.

Here is the oddity. The widely-held belief seems to be that gold will rise in the face of potential inflation as bonds fall in value. The bond market is signaling that traders there believe higher inflation is in the works for 2017, and the data seem to support them. Rising inflation, according to that belief, should make gold rise in value. Instead the market value of gold has fallen substantially. Our best guess is that the driver of gold prices is not inflation but purchases and sales in India and China. The Indian government withdrew all larger notes from circulation in November, triggering what appears to be a great deal of social upheaval and economic fear. Traditionally, Indian families have used gold jewelry as their financial reserve. If, as we suspect, panicked gold selling in exchange for dollars is going on in India, that could be a cause of the sudden decline in gold prices. If that guess is correct, then we would also expect to see the international price of the U.S. Dollar rise. Sure enough, the U.S. Dollar Index (DXY) has risen about 5% against a basket of world currencies over the same period.

What that says to us is that gold, rather than a hedge against inflation, may be in a position to fall or rise with the economies of developing economies like those of India and China. If that is true, and we believe the evidence supports that view, then it may have assumed a risk that gold investors in the United States may discover to their dismay.

The Economy

Our beloved Bureau of Labor Statistics released its monthly "Empsit" (Employment Situation) report today. The unemployment rate in these United States fell to 4.6% from nearly 6% two years ago. The unemployment rate for adult men declined to 4.3%. The total of persons employed in non-farm jobs increased by 178,000 in November and has averaged 180,000 for the past year. Even the much hyped under-employed and discouraged worker's numbers declined.

Our other greatly loved federal agency, the Bureau of Economic Analysis released its Third quarter GDP second estimate on Tuesday of this week. It appears that a more thorough look at the nation's economic numbers has revealed that our economy in the third quarter of this year grew at an annualized rate of 3.2% while real Gross Domestic Income grew at a 5.2% rate. Meanwhile, the Personal Consumption Expenditures (PCE) Index, the one the Federal Reserve is rumored to most closely follow) only rose at an annualized rate of 1.4%.

So, what does all that mean? It means that employers are hiring a lot more folks than are being laid off and consumers are buying goods and services at a brisk rate. All that activity is being reflected in a healthy national economic growth rate. From an investor's perspective, this is all good news. Still, the "market" appears to be taking the news with a grain of salt. So much negativity has been spread about that even excellent economic news is not enough to move the stock market by much.

The hope is that a reduced regulatory burden and perhaps a lower corporate tax rate will propel future corporate earnings and prices. The fear is that a trade war with Mexico and China will raise the price of doing business here in the United States. Thus, the market is more focused on the balance between those two elements and paying little attention to the underlying economy. We remain optimistic.

Until next week, we remain your faithful servants,

Jake

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