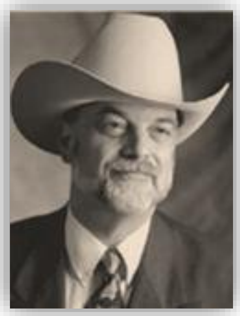

THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

Jeffrey W McClure CFP® *Jacob A McClure* CIMA®

PO Box 1029 / 918 N. Main Street
Salado, TX 76571

(254) 947-1111
(800) 914-7526

Serving Investors Since 1982

www.tpwc.com

jeff@tpwc.com jake@tpwc.com

January 27, 2017

TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index closed out the week at 2,294.69, up 1.03% for the week, 2.50% year-to-date, and 18.27% higher than it was a year ago. It is up about 25% from its bottom last February and about 7.69% from where it was in May of 2015. The ten-year Treasury note fell slightly as the yield rose to 2.48%. Gold fell about $15 per ounce to $1,192.90, down about 13% from last July and down about 25% from its high of 1,831 a few years ago.

The rather obvious big market news this week was that the Dow Jones Industrial Average ("the Dow") rose and closed above 20,000 for the first time. Just as importantly, it stayed above that number for the following sessions, closing today at 20,093.78. We will discuss what that means in detail below, but for now we are enjoying the idea that we saw the Dow cross 2,000 thirty years ago, and now we are seeing 20,000. By the way, back in 2012 when a guy named Seth Masters predicted that the Dow would hit 20,000 by 2020, he took a lot of flak. At the time the Dow Jones Industrial Average had risen to about 12,500 and pundits were proclaiming it to be overpriced. Five years later, and we are there.

While the significance of nice round figures like 20,000 are largely ignored as being of no significance by many market analysts and economists, we believe them to be important. Markets rise and fall on what investors think, and thinking about 20,000 is a lot easier than, for example, 19,987. We, collectively, think round numbers are important, so that makes them important.

So, what was the cause? The Dow had been trending slightly downward for most of the year to date, and seemed without direction. Two new bits of information appeared on Wednesday, the day the Dow suddenly jumped above that milestone. First, existing home sales were reported as down by 2.8% in December, but 2016 was the highest since the housing boom a decade ago. Mortgage rates rose to an average of 4.32%, and the average home price was up 4% from last year at $232,200 all based on data from Freddy Mac. That did not move the market. What apparently did move the market was a series of pronouncements and actions by members of Congress and the President that strongly indicated regulatory and tax burdens for business would indeed be reduced and a lot of money was going to be spent on things from which corporations can profit.

The fair warning here is that the Dow, and for that matter the whole market, is up on rhetoric, not fact. If the reality of those deregulatory and tax-cut actions comes to pass then the market will likely rise more. Unfortunately, while there has been much said about what Congress and the President are going to cut and spend, the details on how all of that will be financed is missing. In short, the market is up about 10% on what we in the investment business call "blue sky." The hard reality is that we will either see higher taxes, cuts in popular programs like defense and Social Security, or a massive increase in the deficit to pay for the other cuts. If either Congress or the President fall short of the ideal, be prepared for a market correction.

We do think the regulatory pull back will be real and will be good for the economy. We also think the "Better Way" tax plan circulating in the House of Representatives has the potential to be a real boost to the economy.

Where Congress and the President will find the money for a trillion dollar improvement in infrastructure and another twenty-five billion or so dollars for a full border wall, including monitoring and guarding is where the rubber meets the road. The administration's press secretary stated yesterday that the wall would be paid for by a 20% tax on imports. That equates to a 20% rise in consumer prices for a much of what Americans buy from day to day, including much of our fresh produce and most of our electronic and mechanical implements. If the press secretary was correct, then the wall will be paid for by a roughly 10% to 15% average rise in the cost of what you and we buy to live or live well. It will be a delicate balancing act to come up with over a trillion dollars without raising taxes or dramatically cutting defense, Social Security, or Medicare. The only viable alternative we can see is to borrow the money. That level of borrowing is likely to raise interest rates significantly, and that increase in rates has its own problems.

We are watching and hoping that someone comes up with some magic to get all this done without wrecking something else. Only time will tell.

The Economy

The GDP

The big economic news this week was the first estimate (there will be at least two more) of annualized fourth quarter U.S. gross domestic product, which came in at 1.9%. That is significantly lower than the previous two quarters, but well in line with what we have seen annually since 2009. 1.9% growth seems pretty anemic, and if that was the real, nominal growth rate of the economy, it would be depressing. Leaving out the seasonal adjustments, which while they make sense, may be distorting the number, there is another figure that, we think, better reflects the reality of America's balance sheet. That annualized, adjusted GDP rate of growth was reduced, as it always is, by the official estimate of our trade deficit. Today's estimate was the result of what we really produced minus 1.7% for our trade deficit. In other words, if we ignore imports and exports, our annualized GDP in the 4th quarter of 2016 was actually 3.6%. A 3.6% growth rate would more than double the size of our economy in twenty years!

A fair argument can be made that since we are sending more money out of the country to buy foreign made goods than we are taking in for selling U.S. made goods and services to foreigners, it is completely rational that we should subtract the difference from our economic growth. We believe there are a couple of very good reasons that is not so. First, the major contributors to our economy are almost all multinational corporations. They are also our biggest importers and exporters. The way they calculate what is an import and what is an export, which they then report to the Commerce Department, is arcane, to say the least. The focus is not on the reality, whatever that may be, of actual imports and exports, but on how to structure the deals so that the least tax is paid. More, a lot of the money those corporations make overseas never comes home to America because we have some of the highest corporate tax rates in the world. How all of that is accounted for is a puzzle that takes armies of accountants to figure and then still doesn't make much sense.

The biggest miscalculation is based on the fact that the U.S. dollar is not just a way of paying for things that we use in the United States. Unlike, for example, China, we do not work at forcing our currency to stay here. The Chinese Yuan (or Renminbi) our currency is the world reserve currency. In fact, the Chinese generally use American dollars to buy what they import into their economy. Without the dollar as a means to purchase raw materials, the Chinese economy would be in dire straits!

To illustrate what we mean, let's say Goldman Sachs, America's largest "bank," came up with and created a new monetary product, which for this purpose we call the "Gold Sack," or just "GS" for short. If Goldman then started marketing those GSs as a unit of international exchange value and at the same time a means to store value against future need, every GS exported for overseas use would show up as a "U.S. export" and be calculated into our balance of trade figures.

Now, for the sake of this argument, recognize that there would be no difference between Goldman Sachs, a bank, manufacturing and exporting GSs and the combined banks of the Federal Reserve System manufacturing and exporting dollars. It is still a bit surprising to some people to discover that the U.S. Treasury does ***not*** manufacture money. Rather it is the Federal Reserve bank and by extension the entire U.S. banking system that creates dollars. The dollar has risen in value over the past several months very simply because there are a lot of institutions and persons who are ***buying dollars***. Despite the fact that the dollar is clearly a product manufactured in the United States by U.S. corporations (banks) and we are exporting a lot of them, that is not figured into the GDP. Rather, our net dollar exports are ***subtracted*** from the GDP.

In 2016, for example, the United States exported about 500 billion more dollars than we imported. Yes, the exports were in trade for goods and services produced outside the United States, but through the year, the dollar appreciated in value against virtually all the other currencies in the world. If we were really draining our dollars into foreign accounts, the dollar would fall in value. There simply would be more of them each year sloshing around in bank accounts, and when there is more of something than people want to buy, then the price falls. Not only are we manufacturing and exporting a valuable product, that product is rising in value all over the globe!

The reality, at least in our view, is that the dollar has largely replaced gold as the world's reserve commodity. If our dollars were, in fact, considered a commodity like gold or oil, the problem of how we keep having the world's largest negative balance of trade and yet are arguably the world's healthiest economy would be solved.

As a last piece of evidence of what has shaped our opinion on this; for decades Japan maintained the largest positive balance of trade of any nation on the planet and except for the time following the recent earthquake and tsunami has continued to export far more than it imports. Despite this supposedly wonderful position of selling far more than it was buying, the Japanese national debt is about 229% of its GDP while ours is about 76% of our GDP, and its economy has been in or near recession for the past fifteen years. Compared with fifteen years ago, the U.S. stock market has risen to ten times that of the Japanese Nikkei. As recently as 1989, the Nikkei 225 stock Index was around 38,000 and consistently ten times that of the Dow Jones Industrial Average. Today the two indexes are approximately equal with the Nikkei at 19,467, or about half the value it held nearly 30 years ago. Over almost all of that time, the Japanese exported hundreds of billions of dollars more than they imported, while we in the U.S. imported more goods and services than we exported, but exported dollars in exchange. If trade balances had the effect that most economists put on them, Japan would be awash with money and our market and currency would have tumbled.

The Wall

We have largely stayed away from the implications of the recent Presidential proclamations, but there is an interesting economic reality in President Trump's executive order this week to the Secretary of Homeland Security. President Trump ordered the Secretary to find money and start building the Wall along the whole southern U.S. border with Mexico. Stanford C. Bernstein & Co. reportedly has estimated the Wall will require seven million cubic meters of concrete made with 2.4 million tons of cement. The problem arises when one looks at the U.S. cement and concrete production capacity. The U.S. cement industry is running at about 80% of capacity already. Throw in the highway construction plans that are already on track in Congress and promised by the President, and the U.S. largely runs out of capacity. Remember that when any manufacturing industry gets to about 85% of capacity, it tends to be unable to go further as the capacity is unlikely to be where the need has arisen. Cement and concrete generally must be produced near where they are used as they both have a relatively short shelf life.

The largest producer of cement and concrete materials in North America, and the only one with the capacity to fill the order for the Wall, is CEMEX, a Mexican based company. Yes, CEMEX has cement plants in the United States, but the profits flow to Mexico where it is largely owned. President Trump could try to exclude foreign owned companies from supplying the materials, but that would simply mean that CEMEX would supply the cement for roads and bridges that would otherwise be filled by American-owned companies. Once again economic reality gets in the way of the ideal. We, apparently, are not the only ones to figure this out as CX, the CEMEX stock symbol on the New York Stock Exchange has risen over 18% in the last two weeks. Incidentally, CEMEX has about 500 manufacturing facilities and over 10,000 employees in the United States.

Until next week, we remain your faithful servants,

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

Jacob A. McClure, CIMA®