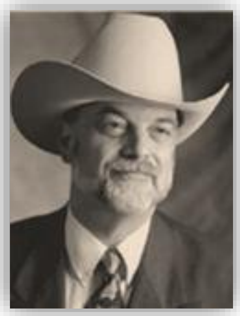

THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index ended this week at 2,472.54, up 0.49% for the week and on Thursday hit its 27th record-breaking high for the year. It is now up 10.44% so far this year, and 13.68% for a full 52-week year. The 10-Year U.S. Treasury rose 0.05% in yield to 2.238% while gold turned in a 2.63% gain for the week closing at $1,260.50, but is still down about 8% from this time last year. The market was up more as recently as Thursday, but worries about the inability of the Republicans in Congress to pass financial legislation has begun to dim the good earnings news. More on that below. On those same worries, the dollar fell 0.9% to its lowest level against other currencies since last September and is now down about 12% against the Euro this year.

The Economy

ECB Holds the Line

The European Central Bank announced this week that there would be no change in its monetary policy, which is to say that they will continue buying bonds to keep interest rates low and inject more Euros into their economy. That decision cited the declining inflation rates seen there and in the U.S. as an indication that stimulus was still needed. Economists who watch the ECB and European economy closely seem to think that with Brexit coming up and the southern members of the Eurozone still weak, the ECB stimulus could continue well into 2018. If that is so, then abnormally low interest rates may be here longer than many have thought.

Server Wars

Microsoft reported a one-year rise in revenue of 13% this week, but it is morphing into a new company, hotly pursuing Amazon in cloud services. The change in the makeup of several of the tech giants is one that could be easily overlooked. Microsoft started off as a nearly pure software company, quite content to let others do the hardware, then entered the hardware business with the Surface line of tablets and computers.

At first glance an observer would notice very little that would cause Amazon and Microsoft to be in a tight competitive race, but that is where Microsoft sees its future. The competition is not in online sales but rather in cloud storage. Amazon charged into the field, establishing distributed server farms that would allow businesses and individuals to coordinate and communicate information without regard to location or even which type of computer they owned. The ability to store big-data without either the expense or risk of having it in a single, fixed location had a lot of appeal, and caught on quickly. Today Microsoft and Amazon are the leaders, with Amazon still in the lead, but with Microsoft closing the gap.

Again, a casual observer would assume that a company like IBM would be the leader in this race, but IBM missed the move, just as they did when they thought that the personal computer or its operating software was a waste of time. The lesson is that whatever we consider to be an unassailable technological niche probably isn't.

A Growing Threat: The Debt Ceiling

At some point in the next ten weeks or so, the U.S. Treasury will run out of ways to shuffle money from one account to another to keep paying current obligations. The culprit is the debt ceiling law imposed by Congress. While the House of Representatives, where such bills are mandated to originate, continues to pass spending bills requiring the Treasury to spend, it, rather consistently, has failed to pass tax bills to pay for that spending. The result is that the Treasury must borrow money to spend the funds the laws require. In addition to all those spending requirements, the Congress passed a bill in 1917 requiring the passage of a new bill for the Treasury to borrow more money. Historically, until the 2010 elections, the Congress passed bills raising the debt ceiling as a matter of course. If Congress had required spending more than taxes could pay for, of course the money must be borrowed. In 2011, that attitude changed. conservative members of Congress appear to have discovered "buyer's remorse" and determined the best way to reduce debt was to refuse to pay the bills. The result was a downgrade of long-term U.S. credit ratings, and some real problems for government employees who did not get paid. The key is that if no bill passes, then the Treasury is legally forbidden to pay its obligations. Blocking legislation from passing has apparently become a favorite sport of the more idealistic members of Congress.

For better or worse, the Treasury reached the debt ceiling limit contained in current law back in March. Since then, using "extraordinary measures" such as not making payments into the Social Security and other trust funds, the Treasury has been pulling money away from long-term obligations and using it to fund the federal payroll and interest payments on Treasury securities, among other such expenses. The problem is that sometime in late September or early October, even those methods will no longer cover the day-to-day obligations. The Secretary of the Treasury has warned that unless an increase to the debt ceiling is passed soon, the United States of America will begin defaulting on its obligations. Meanwhile, the Congressional leadership appears to be focused on a new health care reform bill, and after that on a new budget, and then a tax reform bill. At least for the present, the Congressional leadership has not moved to schedule the debt ceiling to be considered. Reports from vote-counting observers suggest that there may be a growing move by deficit hawks to force a government shut-down as leverage to reduce spending as they did in 2011.

The reason this is important economically is that it is beginning to influence the value of the dollar, as we mentioned above, down 12% against the Euro this year, and general investment attitudes. The stock market is still being driven by very healthy earnings and earnings forecasts by corporate leaders. Those forecasts, though, are based on many assumptions. The U.S. federal government is the largest single entity in our economy, and a significant part of those earnings forecasts assumes that bills owed by the federal government will be paid. Some of our largest industrial producers, such as aircraft manufacturers, construction companies, medical companies, and even banks that hold Treasuries in their accounts, have a part of their income from the government. If the Congress threatens to cause the Treasury to default on payments as it did in 2011, expect to see a very negative reaction in the stock market.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
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