THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index (SPX) ended the week at 2,476.83, up 0.19% from last week, up 10.63% year-to-date, and up 13.47% from this time last year. While we don't usually pay much attention to the Dow Jones Industrial Average (the Dow), it did hit a memorable high this week, breaking through the 22,000 level to close at 22,092.81. For those of us who well remember the Dow at 1,000 and being amazed when it doubled to 2,000 that is an impressive testimony to the strength of the American economy and the corporations that create so much of its wealth.

West Texas Intermediate Crude Oil closed at $49.52, holding amazingly steady despite an abundance of news warning it would be higher or lower. One of the things that are noteworthy here is that oil is now about 1/3 the price it was a few years ago and, contrary to the predictions when it fell in 2015, the global economy has not collapsed. Markets often panic when there is really nothing to fear. Knowing what is really dangerous is a bit of an art.

The U.S. ten-year Treasury Note closed out the week yielding 2.263%, yielding less than last week, but more than it did at mid-week. That unusually low-interest rate continues to confound many economists, but likely is still coming from an abundance of money pouring into the U.S. as a haven from global instability. The rates rose at the end of the week after the Bank of England warned of potentially negative effects as the United Kingdom's negotiations for exiting the European Union stalled.

Gold finished the week with a whimper at $1,264.90 down 0.85% for the week with most of that loss coming on Friday. It remains down 7.42% for one year.

The Economy

Jobs Report

Most headline economic news is about change, and when there is little change, that little change is often magnified to make it sound more interesting. Today's headlines were no exception. "Strong Employment Data Add to Rosy View of Economy" is how the *Wall Street Journal* led off. A more rational headline would have been, "Unemployment Rate and Hiring Little Changed in 24 months."

Yes, the unemployment rate dropped to 4.3% from 4.4% after rising from 4.3% to 4.4% a couple of months ago. Yes, the United States economy did fill a net 209,000 new jobs in July from the month before, but the gain in net new jobs has averaged about 187,000 for the past two years, and this month's numbers are pretty much the same with hiring up a bit in one month and down a bit in another.

The real news in the "Employment Situation Report" published by the Bureau of Labor Statistics today is that despite all the noise and fury in the news, hiring and wage growth has been extremely consistent for the past two years. More, the businesses in our economy continue to hire about twice as many people each month as are entering the job market for the first time. That means that people who were out of the job market, most since the 2008-2009 recession, are steadily returning to work.

Backing that assertion is a statement in the report that the number of "marginally attached" workers is shrinking at an impressive rate. Marginally attached workers are people who would like to have a job, but for some reason are not actively looking for work. They include people who are out of the market because of health issues, family, education, or lack of job skills. The economy is still suffering from worker shortages in both the unskilled, manual labor and highly skilled areas. Employers continue to complain

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that the reduction in high-skill visas combined with general immigration restrictions is limiting their ability to grow their businesses.

Wages were up, year-over-year, by 2.5% for hourly workers. The question about why wage growth is so low if there is a shortage of workers continues to stump most economists. There is no shortage of hypotheses though. It looks to us as if the numbers tell the story. We are creating, on average, about 100,000 jobs per month more than there are new entries into the workforce. That extra 1.2 million new hires each year is coming from somewhere. That somewhere appears to us to be a multimillion person pool of people who are not necessarily looking for work, but who, if a job opening presents itself, will take it. Unfortunately, many of those workers are older and relatively picky about what work they will take. Where we are short workers typically either equates to hard, outside work or high tech skills and a willingness to work long hours at specific locations.

Wages are the prices demanded for the sale of a person's time and expertise. The price will rise when there is a shortage of potential employees and an abundance of job openings. At present the demand is only slightly higher than the supply other than in areas where prices are restricted, so prices (wages) are only rising about 1% more than inflation each year.

Stocks Still Reasonably Priced With Upside Potential

Stocks are driven, long-term, by earnings. Short-term, political and economic events will influence the market, but in the end, profitability drives the train. The *Wall Street Journal* reported today that their relatively conservative forward Price to Earnings (P/E) ratio for the S&P 500 was 18.94. To put that number in perspective, last year at this time the SPX forward P/E was *25* and the long-term average is around 20. That change in P/E ratio makes the Index effectively 25% cheaper today than it was last August despite the record index levels hit this week. At the same time the SPX dividend last year was 2.11% and today has only dropped to 1.97%.

Those increased earnings, based on the numbers so far this month for the second quarter, still are trending upward at something approaching 10% per year. The environment in which we find ourselves is one of slow growth, low inflation, and rising corporate earnings. There is no indication that combination will change in the near future.

A strange positive for earnings is the falling value of the dollar. As the dollar declines against major overseas currencies, it makes the overseas holdings by U.S. corporations rise in value, and their earnings in, for example, Euros, buy more dollars. It also makes U.S. exports more competitive in international markets.

That economic principle is reflected in today's news from the Commerce Department that U.S. exports rose 1.2% in June while imports fell 0.2%. Exports of goods reached the highest level on record in June, after accounting for inflation. Petroleum exports also hit an all-time high.

Last but certainly not least among the reasons to think we can look forward to good stock returns in the near future are the numerous articles we see every week warning that the stock market has peaked and with record high Index marks, can a market crash be far behind? The reality is that market "crashes" come when those warnings disappear. What we are not seeing is rosy forecasts that say something like, "This could go on forever." Yes, the day will come when this bull market runs out of steam, but the pessimism and worries are sufficient that this does appear to still be a bull market climbing a wall of worry.

Worries on the Horizon

Speaking of worries, there are some out there. Not the least of them is the simple fact that when Congress returns from recess it will have twelve working days left to cobble together a budget and pass a debt ceiling increase. More and more it is looking like some Republicans will demand a significant tax-cut, without regard for what the deficit will look like, else they will balk at the ceiling increase. Others are warning that unless the Affordable Care Act (Obamacare) is repealed, they will not support a ceiling increase and will be willing to see a government shutdown and obligations not paid instead.

Experienced political observers are reportedly suggesting that the Republican leadership will have to get Democrat support to have enough votes to pass a budget resolution and raise the debt ceiling. As we have mentioned before, the prospect of the United States government defaulting on its legal obligations is not a pretty picture and we would not be surprised to see an unpleasant (if probably short) reaction from the market.

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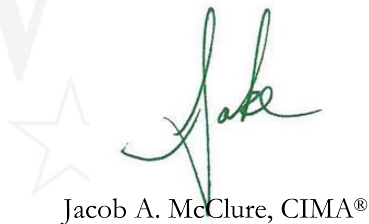
Tensions between the U.S. and Russia and separately between the U.S. and North Korea/China are escalating. Both Russia and China are making tactical moves that suggest they might take advantage of perceived confusion in the White House to make military moves. There is nothing greatly obvious now, but with every week tensions rise. As South Korea agreed to allow the U.S. to expand its anti-ballistic missile capacity there and we moved to do so, China fired 20 intermediate-range ballistic missiles at targets inside China, announcing it as a warning to the U.S. to stop. Russia, at the same time, has moved troops to near the Baltic NATO border, triggering a verbal response from the U.S. and announced an expulsion of over 700 embassy workers from the U.S. embassy in Moscow.

The issue is not that we are on the brink of war, but diplomatic and military relationships with our two largest potential enemies are deteriorating and military posturing is at its highest since the Cold War. It is good to be aware that in the absence of focused, experienced leadership, the potential exists for an incident to be blown out of proportion, resulting in a crisis.

Like the debt ceiling, a military crisis is not an event that will end a bull market, but it could cause a short-term panic. Be aware and be warned, don't panic if something like that happens.

One worry that is unlikely to shake the markets is already priced in. Venezuela is on the edge of a default on about $6 billion in debt that comes due this month. The country's total reserves are currently holding at around $3 billion and the U.S. is threatening economic sanctions. If a default occurs, we will quickly find who is holding that debt. Whatever happens down there, it will not be pretty.

Until next week, we remain your faithful servants,



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