THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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TPWC Market and Economic Update

The Markets

The good old S&P 500 Stock Index (SPX) fell 1.43% this week to close at 2,441.32. It remains up 9.04% year-to-date and is up 11.78 from a year ago. The fall was credited to President Trump's somewhat bellicose verbal exchange with North Korea's dictator. Meanwhile, the dollar fell about half a percent against the Euro and a basket of other developed nation currencies for what was reported as the same reason. Year-to-date, the Euro has risen 12.40% against the dollar. For exporters that is a good thing, for tourists maybe not so much.

Ironically, the ten-year U.S. Treasury yield dropped to 2.19%, down from about 2.27% last week. That drop in interest rates signals that there is a lot of money pouring into those Treasury notes, looking for a safe place to hide. Gold jumped upward 2.54% for the week to close at $1,296.40, trimming its one-year loss to about 5%. Oil was largely unfazed by the saber-rattling and closed at $48.80.

The Economy

Inflation

The news this week on the economic front was, as is common recently, what *wasn't* there rather than what was. What was missing, and has been missing for several months, was a rise in prices across the economy. The Federal Reserve's preferred inflation indicator, the Personal Consumption Expenditures Price Index (PCE) has risen at an annual rate of about 1.7% since this time last year, but both the Consumer Price Index (CPI) and the PCE have been rising at an anemic 0.1% or less for each month for the past five months. As we have explained in the past, rising prices generally mean that the consumption of things is growing faster than the creation of things, and that tends to spur new investment. Low inflation is traditionally an indicator of bad things to come. Perhaps that is not the case this time around. Instead, innovation is creating a more efficient economy and simply making more things available than we have had before. Early this year it looked like inflation was going to get up to the healthy 2% the Fed would like to see. For the past five months though, it has been declining.

Each month there is something that unexpectedly drops in price and throws the rest of the not very fast growing inflation index down to near zero. Each month the Federal Reserve's comments have been something like "Oh, but this is just a temporary blip because of ______." After five months of "somethings", we are beginning to suspect that the economy is like the Gilda Radner book, "It's Always Something." For July, the "something" was an unexpected drop in the price of hotel/motel rooms. Last month it was an unexpected price cut in service plans by cell phone companies, before that it was an unexplained drop in food prices. We think we may be seeing a pattern here.

According to the Bureau of Economic Analysis (BEA), the July specific item that slammed inflation was the "Cost to consumers of lodging away from home." That category fell 4.2% in one month and has fallen 2.4% from a year ago. Reportedly, economists were unable to come up with a reason for the sudden decline, but we, here at the Personal Wealth Coach® have what we think is a pretty good explanation: Air B&B (and its assorted competitors). We recently attended two different conferences in San Diego, California where hotel prices were astronomical. Instead of staying at the sponsored hotel there, we used an online residential rental service and paid a lot less than hotel rates. Yes, the hotel would have had better service (maybe), but the price difference was dramatic. During the conferences, which were about the economy, we wondered aloud how the Hotels were going to react to the competition. It appears that in July they did, and prices came down.

What happened to cause that? The answer is in a single word, the "internet." Hotels, motels and the like have historically had to advertise via signage, telephone directories, or travel agencies. All of those means of making it known that a room or suite is available for rent are expensive and generally require that a business have a lot of rooms to pay for the cost of advertising. Air B&B, Hotels.com, and other web-based enterprises changed that. They are in the business of linking up vacant apartments, condos, and homes with people who want a place to stay and don't care if the sheets get changed every night. Then, smaller investors started buying up apartments and condos in higher-priced areas and posting them on those web sites. Because the condo buyer/investor did not have to build a hotel, he or she could offer the suite of rooms (condo) for a lot less than it cost the hotel to provide the same space, yet still make a profit. Again, the key new item in this equation was the internet.

Last month it was cell phone service packages that fell unexpectedly. What was the cause of that? Once more, the internet. A growing quantity of phone and data services are now coming over the internet. Our office, for example, now has not only internet based telephone service but more and more uses a web-based communication app that runs on our computers. The cell phone companies were in danger of being forced out of business, so they dropped their prices.

Food prices took a hit earlier in the year and we believe it is not a coincidence that happened just as Amazon.com purchased Whole Foods. Each month it seems an internet-based business forces prices down for some physical-presence company. Relatively high-end department stores are cost-cutting and struggling to exist. In cities around the world where car-hailing services like Uber and Lyft are becoming a major transportation provider, car sales are more depressed than in places where car-hailing has not established itself. Again, an internet-based set of providers is forcing price cuts in other areas.

This trend is not over. It may just be beginning. When we were out of town and wanted to buy some Chinese food, and have it delivered, there were food apps available on our phones that gave us both ratings and prices for the local Chinese food delivery restaurants. That must result in price competition and better quality. Where it will go next is anyone's guess. The major automobile manufacturers anticipated self-driving cars and invested hundreds of millions of dollars in being prepared, but as far as we can tell did not anticipate the effect that car-hailing services would have on car sales.

For whatever it is worth, this has happened before. The advent of the steam engine, and later the railroads had a similar effect. Then, in the early 20th century, the tractor, automobile, and motorized truck upended more than a few previously stable industries and the towns dependent on them. Those have been, like this one, difficult times, but at the same time, periods of great opportunity.

How Long Until the Next Downturn?

Reuters conducted a poll of economists and found that the consensus is that this expansion will last at least another two years, albeit with more of the slow growth that it has demonstrated so far. If their prediction is correct, this expansion will hold the record as the longest in 150 years. As we mentioned, they also concluded that the 3% growth promised during the political campaign is just not going to happen. Goldman Sachs added some fuel to the fire by announcing that its economists were predicting that unemployment would fall as low as 3% at some point in 2018 as corporate earnings continued to grow.

Of course, those predictions assume that a couple of things do happen and a couple of other things don't. If Congress does not provide us with a federal budget or a debt ceiling increase before the end of September, all bets are off. The same caveat applies to a war springing up between the U.S. and North Korea. So, if we do, at least minimally, get our fiscal house in line and avoid a second Korean war, things look pretty good going forward for the next two years or possibly three.

Other Economic News

U.S. job openings rose to a record 6.2 million last month. The federal government deficit for the ten months of the fiscal year so far hit $566 billion and is likely to be near ¾ of a trillion dollars by the end of the fiscal year. Productivity in the second quarter was up at an annual rate of nearly 1%. That is not much, but it beats the drop in productivity we saw earlier this year.

Until next week, we remain your faithful servants,

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

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