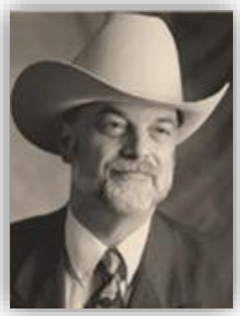

THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The Standard and Poor's 500 Stock Index, aka the S&P 500 (SPX) closed out the week at 2,443.05, up 0.72% for the week, thereby breaking its recent series of weekly declines. That puts it up 9.12% year to date and 12.63% from a year ago. As we coast toward the end of the traditional summer season, the trailing three-month return shows a 1.13% gain, an oddity in market history as the Index commonly declines in the summer months. It is down less than 2% from its high early this month of 2,490.87, but a lot higher than it was as recently as February of last year when it dipped to around 1,864.

Meanwhile, gold climbed to $1,296.5, up 0.48% for the week, on fears of a government shutdown. It remains down 3.32% from this time last year. West Texas Intermediate Oil (WTI) closed at $47.48 and has been remarkably steady in the face of Hurricane Harvey. Notably, the price of gasoline rose as refineries along the Texas coast shut down in preparation for the storm.

The Economy

Oil

The calmness in the oil markets as a hurricane claws its way through the Gulf of Mexico is remarkable unless one understands the economic forces at work. A decade ago, a hurricane in the Gulf would have caused an oil price surge that could have disrupted the economy. Back then, U.S. oil production was concentrated in the Gulf and imports, which made up a much bigger portion of the market, had to mainly come into the Gulf of Mexico to reach us.

Today most U.S. oil comes from far inland as fracking has changed the economic landscape. Yes, refineries will need to shut down, and that may cause a temporary spike in petroleum product prices, and there may need to be some damage repair after the storm passes, but the days of a major wipe-out of U.S. oil production as offshore rigs were wrecked is behind us.

The fact that American ingenuity and investors' money has made us far more secure than we were in the past may not make the evening news, but, at least in our opinion, it should!

Equities (Stocks)

By our reckoning, the SPX is almost perfectly on its trend line established over the past 40 years after subtracting out inflation and reinvesting dividends. It is an open question as to why such a trend line even exists, but over the trailing four decades, the Index has been near or on that line far more often than can easily be accounted for by coincidence. When it gets well above the trend line, as it did in the late 1990s, a fall to below the line has historically followed. From about 1995 until 2002 it was stubbornly above its traditional trend line, but then returned to "normal" from 2002 until early 2008. Following the market drop associated with the "great recession" of 2008-2009, until now, the Index has remained below trend as it gradually climbed back up to its long-term mean. From July 1977 to July 2017, the long-term trend of the Index equates to an after-inflation, average annual rate of return of about 7.7% per year.

Of course, there are some caveats needed here. If we start our calculations in mid-2000, it would take over ten years for the after-inflation value to recover to its starting point. Even today, if we use July of 2000 as our starting point, the average annual real (after inflation) rate of return has only been 0.39%. We have not included taxation in this calculation, nor the real and unavoidable issue of trading costs. Those can be managed and minimized, but they remain part of the equation.

Those two long-term return numbers, 7.7% per year and 0.39% per year, can tell us a lot. First, there is a nearly complete consensus among academics who have studied investing and market returns that over the long-term, equities traded on a major

U.S. stock exchange have historically outperformed any other investment class. The second thing we can deduce is that investing blindly in an index because of that first point can be very disappointing. Just ask anyone who invested at or near the market top in 2000.

One of the first principles of investing is that to minimize risk, one should *diversify*. I am not aware of anyone's portfolio that has matched the after-inflation return of the S&P 500 over the past 40 years, nor am I aware of anyone who really would like to have done so! Yes, we like the idea of getting a long-term return of 7.7% per year, even after adjusting for four decades of inflation, but who would willingly pay the price of watching that portfolio decline and then not recover for a decade, and even then. going 17 years with less than a half a percent per year in real gains?

There have been more than a few who have concluded that the secret of great riches in the market is to ride the good times to the top, then get out and reinvest when the market hits bottom; a practice known as "market-timing." There are only two reasons we don't do that. First, knowing when the top and bottom will be in advance seems like an impossible task. Second, and perhaps most critically, to the best of our knowledge, *absolutely no one has ever been able to do it!* Yes, you read that right. In fact, there have been many surveys of investment strategies and their degree of success, and, as a group, sophisticated market-timers have consistently had the worst long-term returns.

So, how does one dodge the bullet of getting into the market at a bad time and suffering longer term losses than can be tolerated by any mortal? There are a couple of remedies that, when taken together, historically provide the best returns with the least disruptions. Those two remedies are, stick with equities (stocks) that are trading at a price at or below the company's intrinsic net worth; a method known as "value investing." The second remedy can be stated in three words, "*diversify, diversify, and diversify*." To diversify, one purchases investments in other investment classes that probably will not have stellar long-term returns, but have a historical record of not taking the profound dips associated with the stock market as well as different types of equity investments. A well-diversified portfolio may well contain hundreds of individual stocks, bonds, and similar investments.

The result of a long-term dedication to those principles, coupled with using good investment managers, and seeking low investment admin costs, takes some serious discipline to see. During down markets, it means not bailing out of that diversified portfolio. An even more difficult task is to not jump on faddishly popular growth "go-go" investments that promise great riches in the short term. That second temptation crushed many an investor's portfolios at the beginning of the 21st century as they saw the market value of their investments plunge.

During major bull markets, the stocks driving the S&P 500 tend to become overpriced, large-capitalization, growth stocks, whose collective value reaches astronomical levels when compared with the intrinsic value of the company they represent. Alan Greenspan coined a very accurate term when he called that overvaluation, "*irrational exuberance*." Why do we bring this up at this moment in history? When the market is out of favor, as it has been for the past ten years, it is hard to stay invested, but when it rises to and then above its long-term trend line, often people get excited and forget those bad times of the past. Worse, they sometimes think, "It's different this time." or "This could go on forever!"

Particularly since the oil panic last year, the stock market has been turning in some astonishingly good returns. In fact, presuming you have a reasonably well-balanced portfolio, we are confident that the S&P 500 returns have left you in the dust. It is hard to accept, but that is as it should be. We are in a long-term bull market, marked by a barrage of "worry" that something bad is about to happen. At some point we expect that sentiment to change to "this could go on forever" and "it's different this time" as caution is thrown to the wind.

The secret of success may well be, as Rudyard Kipling wrote, "If you can keep your head when those all about you are losing theirs…" Good times will come, as will bad, but they are all the same for one who has carefully planned a course in advance and then holds to it.

Economic News

With nearly all the companies in the S&P 500 now having reported second quarter earnings, it appears that those companies' profits are up about 12% from last year. Significantly, much, if not most, of that very pleasant gain in earnings, has come from the overseas subsidiaries of U.S. corporations. That rise reflects the ongoing recovery in the European Union and developing market countries around the world.

A very significant corner has finally been turned in the recovery from the "great recession." It appears that for the first time since 2007, all 45 countries tracked by the Organization for Economic Cooperation and Development (OCED) have turned in a good growth rate for the last twelve months. More, 33 of them appear to be accelerating and are likely to produce an even better rate a year from now.

The International Monetary Fund (IMF) is now estimating that global economic output will grow this year at 3.5% and notch up to 3.6% for 2018. It appears that we may finally be moving into a coordinated recovery on a global scale. At the same time, outside the U.S. most major economies have a long way to go before they come close to fulfilling their potential for growth. Unemployment in the EU, for example, still is running in the double digits. The good news is that American corporations own a big piece of that new growth and U.S. investors are well positioned to continue to see good portfolio gains even if the U.S. economy is reaching capacity.

If you enjoy worrying about things, there are some things that could legitimately concern you, but maybe not.

Housing sales fell 1.2% last month after falling in June. The problem appears to be that there are just not enough houses available for sale. Again, the reason appears to be that we need more workers than we have available and not enough houses are being built. U.S. durable orders to manufacturers in the U.S. fell 6.8% from last month, but if you look beyond the bottom line, the purchasing managers' index was up, and once we exclude aircraft from the numbers, orders were up half a percent from last month.

There does continue to be a concern that either Congress or the President will trigger a government shutdown and a failure to pay all the bills due at the end of this month. Fitch has warned that "if the debt limit is not raised in a timely manner, Fitch would review the U.S sovereign rating, with potentially negative implications." That would not a good thing for the U.S. or for the world, which depends on the reliability of America's debt payments as the financial foundation for many of the world's currencies. The Secretary of the Treasury and leaders in both Houses of Congress have issued assurances that the debt ceiling would be raised, but there is a serious question as to why it was not done months ago and why the President threatened this week to shut the government down if he did not get his priorities passed in the budget that will need to accompany the debt ceiling increase.

Until next week, we remain your faithful servants,

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

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