THE PERSONAL WEALTH COACH®

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January 26, 2018

TPWC Market and Economic Update

The Markets

For the week ending on 1/26/18, the S&P 500 (SPX) set another record, its 14th this month, closing at 2872.87, up 2.23% for the week. As January draws to a close, the SPX is up 7.45% just for this month! Even that pales with the one-year rise of over 25%. 3M, Caterpillar, Intel, and other manufacturing stalwarts turned in surprisingly high earnings with comments suggesting more to come. In the end, as has been the case throughout this market runup, it was corporate revenue and earnings that drove the market higher.

If a falling dollar is good for America is subject to debate, and there appears to be one between the President and his Treasury Secretary but the dollar dropped 1.7% for the week and is down over 9% in one year against a basket of major currencies compiled by the Wall Street Journal. Against the Euro, its principal competitor, the dollar is down over 16% since this time last year. The US dollar, which bought almost one Euro a year ago, now requires $1.25 to do the same thing. Gold continued to rise in dollar value, almost exactly mirroring the fall in the greenback. Oil climbed to $66.24, delighting the fracking industry and encouraging them to buy more equipment to drill more holes. Meanwhile, interest rates continued their climb, with the ten-year US Treasury note yielding 2.664% at the close. The yield on that benchmark note has now doubled in 18 months.

The Economy

The Commerce Department, now reopened, announced its first estimate of the annualized US GDP growth in the 4th quarter of 2017 at 2.6% while revising the 3d quarter to 3.2% from the earlier estimate of 3.3%. That put the total growth for last year at 2.3%, the most since 2013. Durable goods orders, the ones that drive much else, were up at an annualized rate of 2.9%. So far in the first quarter, all indications are that long-term equipment and other manufactured items are being ordered and selling at an even faster rate. Much of that appears to be generated by the new tax law that allows businesses to write off the full purchase value of long-life equipment immediately rather than stretching it out over the life of the purchase. Durable goods orders look likely to surge in 2018 as the price of oil creates an incentive to buy new equipment for the oil patch and a worker shortage combined with tax breaks encourage the purchase of robotic equipment.

Prices are rising, raising the specter of a return of inflation. There is a verified shortage of long-haul trucks and even if the trucks could be found or built, there is a critical shortage of people to drive, load, and unload them. As a result, the cost of shipping goods is rising. At the same time, the falling dollar is pushing up the cost of imported goods and services. Adding to that pressure is the recently imposed tariffs. LG, one of the largest sellers of washing machines, raised its prices across the board to reflect the new import tariff imposed on washing machines. A falling dollar, encouraged by administration policy this last year, may be good for exports, but means that the many items we buy from abroad will rise in price as the dollar falls. If the administration follows through on its promises of more tariffs, prepare yourself for prices to rise accordingly. A prime economic principle is that tarrifs are ultimately paid by the consumer, not by the exporter.

The International Monetary Fund forecast the world economy to grow 3.9% in 2018. Noting that a very large part of the earnings for U.S. companies comes from overseas operations, that is good news for stock investors. In short, it looks like 2018 is starting off with a bang and is likely to get better for stocks.

With all this good news, the obvious question is, "What could cause it all to come crashing down?" The short answer is "The US pulling out of NAFTA or starting a trade war." The economic good news is almost all to do with international trade and most of our trade is with Mexico and Canada. Shutting down NAFTA would be a serious blow to the markets and the whole economy. Meanwhile, the nations that were part of the Trans-Pacific Partnership (TPP), have regrouped under Japan's leadership and are set to enact the treaty without the U.S., creating another competing trading bloc rather than one we would lead. Ironically, the new tax law encourages the purchase of automation equipment, much of which is made in TPP countries.

Both Goldman Sachs and Moody's Analytics came out with analyses concluding that the tax cut may feel good in the short term, but will have almost no effect on the economy in the intermediate term, then be damaging in the long term. The reasoning was that we, both commercially and individually, will have more money to spend in 2018 but that rising spending combined with labor shortages and a falling dollar will create inflation, causing interest rates to rise. Rising interest rates will take money out of our pockets about as fast as the tax cut puts it in. In the longer term, the increased federal deficit will increase government borrowing, putting even more upward pressure on interest rates. The economics gets more interesting when the restrictions on home-related tax deductions are combined with rising rates. Both organizations predicted a fall in home values would result and that will put pressure on local governments to raise taxes in order to stay solvent.

The net result of the tax cut, according to the two best economic forecasting institutions we have, is that the reduction in federal income taxes will be offset by rising costs making the tax cuts simply a transfer of cost from one place to another. In the longer term, both firms forecast the bill to come due in around seven to ten years as the tax cuts expire, taxes go up, and the national debt is a few trillion dollars higher than it otherwise would have been. The future is always uncertain, but we have been warned. Don't bet on these good times going on forever. Save and invest now so as to have the means to deal with what looks more and more like some unpleasantness coming in seven to ten years.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
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