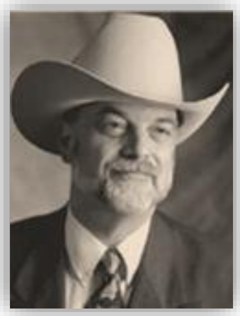

THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index ("SPX"), our preferred proxy for the U.S. stock market, closed out the week at 2691.25, down 2.4% for the week, and down about 6.4% from its recent high mark near the end of last month. It had shown signs of creeping back to a full recovery before the President's announcement that he intended to impose large import tariffs on steel and aluminum. The good news is that the SPX remains up 0.66% year-to-date and 12.93% for one year. More on that below.

The yield on the benchmark 10-year U.S. Treasury note was up to nearly 3% earlier in the week but declined to close at 2.86% following the President's announcement, suggesting that economic growth may not accelerate as fast as it previously indicated. Oil prices declined from $64 early in the week to $61 on Friday, again reportedly in reaction to the threat of a trade war and resulting slowdown in economic growth.

The Economy

The Commerce Department reported that personal, after tax, income rose 0.9% in January as the federal government saw about a $115 billion decline in tax receipts, but in an unusual reaction, consumer spending, adjusted for inflation, fell 0.1% in January. That change was mirrored by a rise in the personal savings rate from 2.5% in December to 3.2% in January. The Personal Consumer Expenditures Index (PCE), the Federal Reserve's preferred inflation indicator, rose 1.7% from last year but appeared to be accelerating toward the end of the year. Housing pending sales were down in reaction to increased mortgage rates and a shortage of houses for sale. Jobless claims continued to fall and hit the lowest level since 1969.

Federal Reserve Chairman Jerome Powell testified before Congress again during the week and once again expressed his observation that the economy appears to be stronger now than last year. That, of course, suggested that the Fed might raise interest rates faster than had been expected. The consensus estimate moved closer to four, 0.25% interest rate increases in 2018 from the previous three. Those increases would put short-term interest rates at about 2.5% by this time next year. If that happens, longer-term interest rates are likely to rise apace. If the "spreads" remain as they are, it would be reasonable to then see the 10-year Treasury approaching 4% and longer-term interest rates rise accordingly.

Higher interest rates slow economic growth as loans needed to fund business expansions or buy big-ticket items, like cars and houses, become more expensive. They are, though, an indicator that loan demand is high, and that itself is an indicator of a faster-growing economy. All of that is a normal process as our economy accelerates into a full-fledged expansion. It also suggests though that the forecast we earlier reported calling for 2019 to be at or near the high mark in this cyclical expansion is more and more likely to be correct.

The surprise was the President's announcement of an impending 25% tariff on steel imports and 10% on aluminum. A very significant portion of the things we manufacture and sell in America and export are at least in part made of steel and aluminum. If U.S. plants raise their product prices to match the newly increased import prices, that rise would filter through into significantly higher prices for domestically produced automobiles, airplanes, homes, commercial buildings, tools, beer cans, and a host of other products. Higher prices for the same products is the definition of "inflation." Higher inflation would force the Fed to raise interest rates higher, slowing our economy. More, it would increase the price to make goods for export, reducing either profits or sales. Additionally, since Canada and Mexico are among our biggest sources of imported steel and are our biggest export customers, the threatened counter-tariffs could create a lot of pain. Canada and the European Union have already announced they will impose defensive tariffs if we follow through with our tariffs on Steel and Aluminum. One thing that could prematurely terminate this economic expansion (and bull market) would be a global trade war.

The stock market reflected that view. Since early 2017, corporate earnings have risen about 15%, but after considering the implications of the tax cut and the tariff announcement, the SPX is now only up about 13% for one year. That differential suggests that the market sees those actions as reducing earnings into the future and is a reaction to that perception. This issue is worth watching.

Until next week, we remain your faithful servants,

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

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