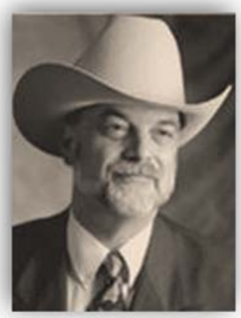

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An SEC Registered Investment Adviser

Jeffrey W McClure CFP® *Jacob A McClure* CIMA®

PO Box 1029 / 918 N. Main Street
Salado, TX 76571

(254) 947-1111
(800) 914-7526

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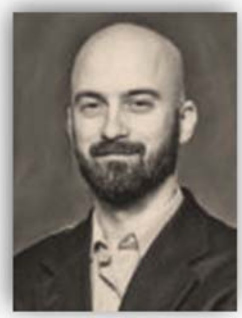

jeff@tpwc.com

jake@tpwc.com

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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index (SPX), our preferred indicator of the U.S. stock market, weaved up and down during the week, at first appearing to break out to the upside, then retreating on news that both China and the U.S. may make good on their threats of a trade war. It ended the week at 2779.66 up a mere 0.01%. It remains up 3.96% for the nearly half-over year so far and 14.23% for twelve months.

West Texas Intermediate (WTI) crude oil fell by 1.83% to close at $64.30 while North Sea Brent closed at $73.07 down 4.43% for the week. Both remain between 40% and 46% higher than at this time last year. The 10-year Treasury Note slid to 2.918% at the end of the week after rising to 3% mid-day on Wednesday, again reflecting fears that the threatened trade wars may damage economic growth over the next decade. Gold, too, slumped at the end of the week, dropping 1.63% to $1,282.20.

The Economy

What started out the year as synchronized growth in the world economy more and more looks like it may come apart as the various trading blocks and nations around the world work themselves into what looks like a very damaging exchange of high tariffs. The White House announced a 25% tariff on $50 billion worth of Chinese goods Friday followed shortly by an announcement of Chinese counter-tariffs on about the same dollar amount of goods as the White House list.

Meanwhile, the Bureau of Economic Analysis (BEA) at the Commerce Department reported the U.S. trade deficit dropped for May on a $2.9 billion increase in exports. That acceleration in exports appears to be threatened if tariffs and counter-tariffs become reality. Thanks in part to the reduced trade deficit, the second quarter GDP growth appears to be on the way to a 4% annualized rate as the tax cuts and increased government spending get traction in the economy.

In what may be the first indication of our economy's limits, industrial production dropped 0.1% in May, reportedly because of a lack of capacity in trucking. Truck production was slowed as well by a fire in a key parts supplier. Some of that impact was offset by an increase in consumer sentiment and spending. We do appear to be getting near limits on our ability to grow.

Oddly, just as our economy is heating up, the Euro-zone GDP appears to be slowing. Here in the U.S. most of our economic activity is selling to ourselves (consumers) while much of the growth in Europe comes from exports. Despite the weakening numbers, the European Central Bank, the equivalent of our Federal Reserve, announced it would be ending bond purchases this year and planned to begin increasing interest rates late in 2019.

Speaking of interest rates rising, our own Federal Reserve raised short-term rates a quarter percent to 2% for interbank lending and indicated it will do so two more times this year. That will bring short-term rates to at least 2.5% by the end of the year, very close to what the 10-year Treasury is yielding now. The Fed further warned that they expected to raise rates three times in 2019. That would result in a short-term rate of 3.25%, well above the current 10-year rate. If the rate increases do come to pass, either longer-term rates need to rise or we will find ourselves perilously close to the dreaded inverted yield curve where short-term rates are higher than longer-term rates. Such inversions have historically predicted a recession about 18 months later.

The Fed's announcements came as the Labor Department released the news that prices are up 2.8% from this time a year ago, and appear to be accelerating as job shortages begin to produce a bidding war for workers. The economy is running hot and the Fed's job is to slow it down before it overheats. The backside to that is if the economy is running really hot, the rate rises usually triggers a recession to cool things down. The good news is that we appear to have a year or two before the slowdown is likely to come.

Until next week, we remain your faithful servants,

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

Jacob A. McClure, CIMA®