THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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TPWC Market and Economic Update

The Markets

Our dearly beloved S&P 500 Stock Index ("SPX") ended the week down 1.33% at 2718.37 on trade war fears, although it managed a gain of 2.93% for the second quarter and is up 1.67% year-to-date. Its return from the end of June 2017 is a very respectable 12.17%. The benchmark 10-year U.S. Treasury closed the week yielding 2.858% putting it down about ¼ of 1% from mid-May, for a decline of about 8.4% of the total yield in about six weeks. With the Fed Funds short-term rate now at about 2%, that makes for a relatively flat yield curve and one that is getting flatter each week.

U.S Oil ended the market week trading at $74.31, up 7.26% for the week and over 13% for one month as the Trump administration moved to shut out Iranian oil from the markets. Gold closed at $1,254.50 down 1.31% for the week, 3.34% for the month and 6.02% for the quarter. As short-term interest rates have risen, so has the WSJ Dollar Index, up 0.20% for the week and 5.08% for the quarter. You may remember the recent Bitcoin craze as it traded at about $18,000 per coin at the end of last year. This week it dropped to about $5,800 for a 67% loss (so far).

The Economy

Inflation appears to be finally returning. The Personal Consumption Expenditures Index ("PCE") was up 2.3% from this time a year ago according to the Commerce Department's news release. May's PCE marks the highest inflation in six years and signals that the Federal Reserve is likely to raise short-term rates at least four times this year. In a parallel announcement, the U.S. GDP growth for the first quarter was revised downward to 2% from the previous 2.3% estimate. The combination of more rapid short-term rate increases by the Fed to head off inflation and the recent declines in the 10-year Treasury note yield could bring us into an inverted yield curve situation as soon as next year. The recent declines appear to be related to concerns about what may be a full-fledged trade war taking hold in July and the economic impact that would follow in a year or two.

The recent rise in inflation is being credited to the tax cut at the beginning of this year combined with the economy starting to hit production and delivery limits as capacity limits restrict growth. More money is now chasing after shortages of materials and services available in an economy that is maxed out on transport and short on labor.

At the same time as the economy appears to be hitting the wall in some areas, it appears more and more that the second quarter GDP will be a blockbuster with annualized economic growth at 4% or higher. The driver for the high GDP number seems to be exports. We are seeing a surge in exports from the United States as manufacturers are rushing out orders ahead of the tariffs that are scheduled to take effect in July. They were also able to ship metals-based products that used steel purchased before the U.S. steel tariff raised prices about 50% in the U.S. over current prices in the rest of the world.

Unless something changes, the second and possibly third quarter GDP results look a lot like they may be the highest we will see for some time. Despite favorable tax treatment this year, business investment in new buildings and equipment is down from last year as companies wait to see the effect of the trade war. Some companies, most notably Harley-Davidson, are planning to scale back production in the U.S. and increase production overseas to avoid paying tariff-related expenses that could cumulatively reach 50% of the value of final production. There is typically a lag of 18-24 months between the imposition of new taxes (tariffs) and the shift of production that follows, so the impact looks to become most apparent in the economy in late 2019 or 2020.

In another development that adds to the inflation pressure, the U.S. sanctions on Iranian oil and the Trump administration announcement that companies buying oil there will be banned from U.S. business in short order has already limited the world oil supply and raised the price of oil and gasoline. The net result is a looming global oil shortage. The ability of U.S. producers to meet the increased demand is limited, again, by the fact that we are hitting maximum capacity in transportation assets. We simply don't have the capacity or the infrastructure to cover the shortage, and higher prices are likely to follow.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
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