THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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July 13, 2018

TPWC Market and Economic Update

The Markets

It may be Friday the 13th but it was a good day for the stock market as the S&P 500 (SPX) ended this fateful Friday up 1.5% for the week at 2801.01. That puts the venerable Index up 4.78% year-to-date and 13.91% from a year ago. It also puts us back above the 2800 line and only about 72 points below the all-time high of January 26. The driver to the gains was corporate earnings. The first two major banks to report, JPMorgan Chase and Citigroup, posted double-digit profit increases for the quarter, mostly driven by the new tax law. Even so, the stock price gains were muted by continued fears of the economic fallout of a major trade war.

Underscoring those fears of future earnings and economic pain, the U.S. 10-year Treasury note continued its long, slow slide in yield, closing the week at 2.831%, down from 3.11% two months ago. Gold, too, coasted downhill for the week to $1,241.80 down 10% from the $1,379 per ounce it fetched at the end of January. West Texas Intermediate oil declined 4.52% for the week to $70.58 on Wednesday's news that Libyan oil exports were resuming but it is still up over 50% from a year ago, primarily due to the squeeze on Iranian exports. The dollar has remained largely unchanged for the past several weeks.

The Economy

One of our favorite government offices, the Bureau of Labor Statistics ("BLS") reported that the U.S. Consumer Price All-items Index ("CPI") rose 2.9% for the 12 months ending in June. This is the largest one-year rise we have seen in about six years. Two major elements contributing to the jump were the rise in energy costs we cited above, and cost of services, a result of the labor shortage. Economists are predicting that the tariffs currently in place could increase inflation by about another 0.6%. If the nearly 3% inflation we have seen over the past year were to persist, inflation could be running at a 3.5% annual rate a year from now.

The effect of that level of inflation is not just that we would be paying more for the same things but that it would serve as an imperative to the Federal Reserve to raise interest rates. While future interest rates are always uncertain, if the Fed were to raise short-term rates to get ahead of or equal to inflation at that level, short-term rates would be nearly a percent higher than the 10-year rate is today. It is that kind of "inverted" yield curve that has historically preceded recessions by about 18 months.

In a shadowing of things to come, the Import Price Index for June was up 4.3% from a year earlier. While the full effects of tariffs have yet to show in final pricing, the rise in the cost of imported items appears to be largely from the already imposed tariffs and can be expected to filter through to the things we buy as consumers in the not-too-distant future. The good news is that export prices were up in June even more with a rise of 5.3% for one year. The export rise in both volume and pricing appears to have been a rush to get ahead of foreign retaliatory tariffs.

In spite of the longer-term risk of a recession in or about 2020, the near future looks bright as the ECRI Weekly Leading Index remains near its all-time high at 148.5, an indicator that economic growth should remain strong for at

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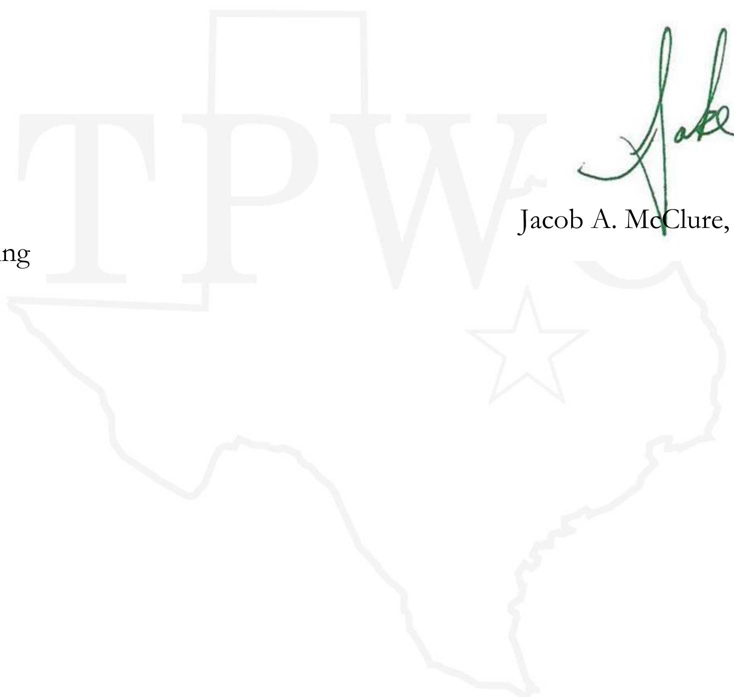
least six months to a year into the future. The University of Michigan Consumer Sentiment Survey dropped to its lowest point in six months with expectations dampened by news of the trade war and rising prices on some consumer goods but is still in positive territory. Consumers, investors, and business owners reported that they have generally gone from thinking that the tariff and trade-war announcements were a negotiating tactic to a growing belief that they are going to take effect and have a negative impact on economic activity.

In another bit of good news, the bank loan default rate continues to decline. That same credit improvement can be seen in the high-yield bond default rate. A year ago, the high-yield default rate was 4% while last month it was down to 3.4% with an even lower default rate of 2.5% predicted for the first quarter of 2019. That forecast reflects a consensus that the U.S. GDP annualized growth will likely come in at or about 4% for the second quarter. Double-digit corporate earnings growth and a 4% growth rate for the GDP would normally generate a stock market boom but investors realize that this is a one-time jolt of stimulus as the tax cuts show up on balance sheets but a combination of supply constraints, tariffs, and higher interest rates are likely to offset the tax cuts within 24 months.

Until next week, we remain your faithful servants,

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

Jacob A. McClure, CIMA®



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