THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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TPWC Market and Economic Update

The Markets

Our dear old S&P 500 Stock Index (SPX) closed out the week, and the quarter, at 2913.98 having lost 0.54% for the week. It is still up 8.99% year-to-date, and 15.66% for one year but those gains are fading as we draw nearer to the end of 2018. The stock market is up based on hopes for higher than expected earnings reports for the third quarter (which just ended). If those above-expected earnings do not materialize things could get rough.

The U.S. Treasury 10-year note yield climbed to 3.102% Wednesday before slipping back to 3.05% by the end of the day on Friday. With the two-year note at 2.96%, that leaves the yield curve flatter than it has been since 2007. 30-yr mortgage rates are up to an average of 4.74% from 3.38% last year and car loans are up a like amount to around 4%. Gold continued its slump, dropping 0.67% and is now down over 10% year-to-date at $1,195.30. U.S. Oil headed in the opposite direction, up nearly 4% for the week to close at $73.55 as North Sea Brent oil closed over $80 per barrel.

The Economy

The Federal Reserve raised short-term interest rates again, targeting a range between 2% and 2.25%. More importantly, the Fed signaled that it planned to raise rates a quarter percent in December and at least three times next year. The cumulative increases would put the overnight interbank rate at 3.25%, higher than the current yield on the 10-year Treasury note. Unless longer-term rates rise significantly, we would then see the dreaded inverted interest rate curve. If longer-term rates rise, the cost of borrowing will dramatically increase, as will the cost of the national debt.

Year-over-year inflation as measured by the personal-consumption-expenditures price index (PCE) was up 2.2% in August, but wages and consumer expenditures were up 0.3% for an annualized rate of 3.6%. That spending increase was impressive but less than we saw in the second quarter. At the same time, and in its usual correlated fashion, forecasts for the third quarter GDP growth were uniformly below the 4.2% final estimate for the second quarter and ranged from a low of about 2.8% to a high of about 3.6%.

There were reasons for the high GDP number in the second quarter and for lower numbers now. First, there was a surge in exports as farmers in the second quarter rushed to get their crops out before the tariffs kicked in. Second, the tax law change generated a rush of investment in new equipment as it became immediately tax-deductible. Those elements have deteriorated in the third quarter and appear to be still dropping as we enter the fourth. In the second quarter housing building and sales initially surged, but then interest rates rose, tariffs began to raise material costs and the labor shortage began to have an effect. House building and sales are now slowing. With the rise in the dollar, imports are cheaper, and the trade imbalance is getting more severe. Ironically, the tariffs are increasing imports and decreasing exports.

At the same time, it is important to note that expansions do not end without warning. September's Conference Board Index of Leading Economic Indicators increased 0.4% in August. That is not as much as it increased in earlier months, but as long as the index is headed up we have an historically high probability of at least six and likely twelve months ahead without a recession. The Conference Board's Chief Economist is predicting a 3% GDP growth for 2018 but dropping to 2.3% by the end of 2019. 2020 is still an unknown, but a consensus among economists has developed suggesting a recession in 2020 is a strong possibility.

In short, we continue to be in an economic expansion that is running at a higher than sustainable rate and will slow in the future and eventually terminate in a recession. The key is to not get carried away by the good news and be like the ant, setting aside reserves for the downturn in a few years and not like the grasshopper who consumed all he made in the good times.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
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