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TPWC Market and Economic Update

The Markets

The bad news is that the S&P 500 Stock Index (SPX) sagged 1.61% this week to end at 2736.27. The good news is that it was down to 2674 on Thursday and has risen 2.32% since then! The week's close leaves the SPX down about 6.6% from its high in late September and only up about 2% from the beginning of the year. It does remain up over 6% since this time last year but that single-digit number is certainly not what investors are used to seeing.

In one of the ironies we commonly see in the market, the big-big box retailers uniformly reported earnings growth above expectations and boosted profit projections but then saw their stock prices decline by 5% to 15% for the week. Analysts were reported as saying that a big factor was the looming end of year threat of 25% tariffs on much of what the retailers import and sell to the public.

U.S. crude oil joined in the slump, declining 5.08% for the week to $56.83 and is now down almost 26% from its high point in early October. Like stocks, the concern appears to be that the global economic growth rate is slowing and demand for oil will decline next year. Once again, the specter of a major trade war with 25% tariffs has got investors and companies becoming more defensive. Since declines were in style for the week, the U.S. 10-year Treasury note followed suit closing the week yielding 3.067%, a rate 3.7% lower than last week and about 5.3% lower than it was on November 8 but very notably almost 30% higher than it was a year ago.

Gold put in a nearly 1% rise in value but remains down about 8% from the beginning of the year at $1,222. In the midst of this, the dollar remains up almost 5% this year against a basket of world currencies and up almost 7% against the Chinese Yuan.

The Economy

The broad economic news remains the same. The current economic situation is amazingly good with near-record unemployment percentages and job creation at an all-time record. While from a common-sense point of view that might seem good, from the perspective of economics it is a bit scary. The Census Bureau reported this week that year-over-year, inflation (CPI) was 2.5%. Wages are up about 3.5% from a year ago, so workers are pulling ahead, but higher prices for the same things is the definition of inflation. As a result, the Federal Reserve is almost certainly going to raise short-term interest rates in December and likely to continue to do so once a quarter well into 2019 to head off rising inflation.

By itself, that too would not necessarily be a bad thing but there is another factor that weighs heavily on longer-term investors. The U.S. Treasury announced that the federal deficit for October, the first month of the federal fiscal year, exceeded $100 billion. If that is the standard, then the deficit for the full fiscal year will be not the $1 trillion forecast earlier, but a whopping $1.2 trillion! Borrowing a trillion dollars a few years ago when interest rates were effectively zero was one thing but borrowing $1.2 trillion when interest rates are higher and still rising is another.

There is a double-edged sword in those figures. The Federal Reserve controls very short-term interest rates but the longer-term rates are a function of supply and demand. The more money we borrow the higher interest rates are likely to go. The 10-year rate has risen about 30% from a year ago and as the surge of Treasury borrowing continues to rise in volume with both rolled-over and new debt coming due, the cost of the federal debt may finally come home to roost. The CEOs of two major Wall Street investment banks expressed alarm this week at the quantity of the money supply that is and will need to be redirected toward funding that debt and stated their concern about the potential negative consequences. Both suggested that for the next year or so things were likely to continue to look quite good but that the time was approaching when the bill for the good times would come due.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
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