THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index (SPX) did a small standing jump at the end of the day on Friday to just barely keep its now seven-week gain streak going and close at 2707.88, up a tiny 0.05% for the week. That small gain was a relief after the Index surged to 2737 on Tuesday but then fell off a cliff on Thursday when the administration announced that there would be no China-US summit before the March 1 deadline for the U.S. imposed tariffs to rise to 25% on most Chinese imports. The SPX dropped as low as 2684 by Friday morning before starting recovery. Companies in the SPX are now on track to report about a 2% decline in growth from last year's first quarter as they face the multiple threats of an increased trade war and economic weakness in China, a "hard" Brexit that cuts out the UK, a major U.S. trading partner, and recession warnings from the European Union.

Reflecting the general gloomy forecast, the 10-year U.S. Treasury note yield declined 1.31 tenths of a percent to 2.63% on the same bad news after having risen to 2.73% on Tuesday. The Treasury yield-curve continued to exhibit a sag between 2 and 5 years, suggesting that the bond market sees a potential economic slump on the horizon for next year. Following suit, West Texas Crude Oil dropped 4.82% for the week to $52.71. Gold declined 0.32% to $1,317.90.

The Economy

As the Bureau of Economic Research (BEA) plays catch-up following the shutdown, information is trickling out. U.S. factory orders declined 0.6% in November, resulting in a 2.2% growth for 12 months, the weakest since late 2016. Still, Moody's Economics remains optimistic that we will avoid a recession in 2019. In some surprisingly good news, the U.S. nominal trade deficit narrowed in November, dropping to $49.3 billion from $55.7 billion in October. The drop in the trade deficit boosted Moody's estimate for 4th quarter annualized GDP growth to 2.7%. Unfortunately, the BEA still hasn't been able to gather the data necessary to give us an official GDP estimate and does not yet have a date when we can expect the announcement.

Long-term, the U.S. GDP growth is based on just a few simple elements: the number of workers, number of hours worked per worker, and net output per hour, minus the trade deficit. Unfortunately, our birth rate has dropped for the third consecutive year and is now the lowest since 1937. In the past, we have relied on high immigration rates to offset the decline, but immigration rates have fallen and continue to drop. Over the last year, we have seen a 2.1% increase in the average hours per workweek, adding to GDP growth for 2018, but there is a distinct limit to how far that can go. Another unfortunate fact is that the one-year productivity growth in the U.S. through last November was only 0.6%.

If we add up the 2.1% increase in hours worked and the 0.6% net increase in output per hour (productivity), we get a GDP growth rate of 2.7%. That sounds reasonable until we consider that it is extremely unlikely that we will either see significant growth in the workforce in 2019 or another large increase in hours worked. Those data are why economists are suggesting that by the end of 2019, GDP growth will slow to an annualized rate between 1% and 2%.

There are two apparent solutions to the potentially low growth rate we face. One is the traditional one of allowing more immigration, thereby increasing the number of workers and hours worked. Employers across the economy are nearly unanimous in their complaint that they are unable to find enough workers to grow their businesses. The second solution has the potential to take longer but is profound in its implications. In a word, the answer is automation. Automation in the works ranges from self-driving trucks and cars to systems that could build most of a new home.

The drawback to the automation solution to GDP growth is that we are not there yet and probably will not be there for several years. In the interim, we easily could see either an economic slowdown or a recession as we reach economic capacity limits and temporarily hit a bump. That also suggests that when we do see large-scale automated systems taking over manual labor, we may see a jump in productivity that could spur us to economic growth rates we have not seen since the 1920s.

Until next week, we remain steadfastly on duty in our endless search for a better way to manage portfolios and serve our clients.

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