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TPWC Market and Economic Update

The Markets

The Standard and Poor's 500 Stock Index (SPX), our preferred total market index, declined 1.01% for the week ending on 9/27, and the last end-of-week measure for the third quarter, to close at 2961.79. The Index topped out just above 3000 on Tuesday but see-sawed downhill for the rest of the week. The culprit, as usual, was tariffs. This time it was not so much the threat as it was indications that the economic damage to the U.S. economy is becoming a reality. The week's decline puts the Index down about 2.2% from its highs in July and only up 1.64% from one year ago.

The yield on the ten-year U.S. Treasury note declined 21.4 basis points (hundredths of a percent) to 1.682% and continues to be lower than the 90-day Treasury bill keeping the yield curve decidedly inverted and continuing to forecast a recession. It is good to remember that the 10-year note yielded over 3% a year ago in a positively sloped yield curve that predicted economic health for the year 2019 but has dramatically changed its tune since then. As we have written before, the Treasury yield curve has proven historically to be an uncannily accurate predictor of economic health, good or bad. Meanwhile, the U.S. oil price (WTI) slipped downward 3.79% for the week to close at \$55.91. Once again, the price of oil basically ignored a simmering war in the Persian Gulf and focused on supply and forecast demand as it has fallen over 24% in the last year.

The Economy

Late Friday the Commerce Department's Bureau of Economic Analysis (BEA), our favorite government bureaucracy, announced some economic news that set off alarm bells in our economic brains. First, remember that about 70% of the U.S. economy is consumer expenditures. Some purists don't like that and would rather we be more oriented on exports of manufactured goods as we were in the first half of the 20th century, but there are some tremendous advantages in being a consumer-oriented economy, not the least of which is that we are not dependent on others as our customers.

Now to the announcement: consumers increased their purchases by a mere 0.1% in August. That 0.1% increase follows a pattern that was running at 0.5% per month in the first seven months of the year then began a steady decline. If we annualize those numbers, consumers were increasing their spending at a 6% rate through July but have decreased their increase to an annualized rate of about 1% in August. Business investment, already a negative, dropped a further 0.2% last month and was down 1.7% from a year ago. Nonresidential fixed investment, spending on structures, equipment, and software, fell at a 1.0% rate compared with an annualized rise of 4.4% in the first quarter. Net exports declined for the month, increasing our trade deficit.

Our GDP, and thereby our economy is composed of several major components. The biggest is personal consumption, followed by fixed investment, change in inventories, government spending, and finally net exports. With fixed investment and exports in the negative zone and sliding downhill, something has to take up the slack. Inventories have been rising fast in anticipation of higher prices from tariffs but that will soon come to an end as businesses must at some point sell off the excess inventory. Government spending appears to have topped out as the deficit begins to

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cramp the financial markets. As we approach 2020, the burden is on the consumer to keep us growing but now the consumer is showing strong signs of wanting to hunker down, pay off some debt, and not spend so much.

Consumers are indeed hunkering down and paying off debt. American households are now "saving," on average, 8.1% of disposable income but only some of that is going into traditional savings. Northwestern Mutual released its 2019 Planning and Progress Study that showed Americans reduced their non-mortgage debt by a whopping 22% in just one year. That sounds good until we dig deeper into the data. We are, as a society in the third quarter, expending, on average, one-third of our expendable income on making debt payments and 45% of Americans feel anxiety about their debt levels. Those numbers are important because historically when we hit the one-third level, Americans have traditionally started to pull back on spending.

In another ongoing development, the cash shortage at the money center banks has continued and the Federal Reserve has needed to pump \$50 to \$60 billion into the system daily. At the end of the week, it announced that it was offering another \$110 billion to the banks in exchange for short-term treasuries. While this is not a crisis, it does confirm that the bond liquidity crunch we wrote about several months ago is a real thing. In our opinion, this is another symptom of the economy reaching its limits and thereby at or near the top of a cycle.

In short, the stage is set for a classic inventory and consumer-debt generated recession to start sometime in the next 12 months. No one can foresee the future and recessions are commonly triggered by an unexpected shock. Even though there have been plenty of warnings, the price increases as the tariffs filter through to the consumer price tag may just be that shock. The good news is that this kind of recession and accompanying market downturn historically have been generally mild and relatively short. Only time will tell, so keep watching.



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