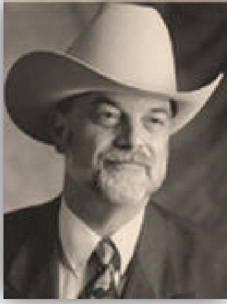


THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

Jeffrey W McClure CFP® *Jacob A McClure* CIMA®

PO Box 1029 / 918 N. Main Street
Salado, TX 76571

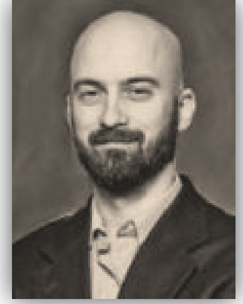
(254) 947-1111
(800) 914-7526

Serving Investors Since 1982

www.tpwc.com

jeff@tpwc.com

jake@tpwc.com



January 24, 2020

TPWC Market and Economic Update

The Markets

A drop in the price of crude oil and the perceived threat of a global viral pandemic got the attention of traders in the week ending January 24. The S&P 500 Stock Index (SPX) fell 1.03% to close at 3295.47 despite breaking intraday records on Wednesday. The Dow retreated below the 29,000 mark to close at 28,989.73.

The yield on the 10-year U.S. Treasury note fell 13.4 basis points to end the week at 1.687% while West Texas Intermediate crude oil joined in the pessimistic party by falling 7.62% to close the week at $54.34. The decline was credited by traders to fear that the corona virus will reduce travel plans and thereby use of petroleum.

The Economy

The Conference Board's Index of Leading Economic Indicators (LEI) was released on January 23. The LEI decreased 0.3% for December. Over the trailing six months the Index declined at an annualized -0.7% rate. The conflict with the good news on employment and consumer spending can be explained by the Coincident Index which rose at about a 1.5% annualized rate. The LEI is calling for an economic slowdown in 2020 even though the Coincident Index is singing "Happy Days are Here Again." All the economic indicators except manufacturing look great for the present, but the auguries for the future remain less than ideal.

A clear consensus has developed among economists, pundits, and market prognosticators that there will be no recession in 2020, and perhaps nevermore. While there is some faint concern about the fact that the stock market has reached a higher price-to-earnings ratio than at any time since the year 2000, that corporate debt as a percentage of GDP or corporate net worth is at an all-time high and the federal deficit is above $1 trillion per year, no cries of alarm are to be heard or read anywhere.

For us here at The Personal Wealth Coach® that last paragraph is alarming. There is an ongoing assumption prevalent in the financial media that interest rates and inflation are forever to be low and unchanging. That same assumption appears to have take hold in both political parties. If the borrowing interest rate is at or below that of general inflation, then borrowing is, in essence, free money on which the real interest rate is effectively zero. That concept, advanced on the left as "Modern Monetary Theory" and on the right simply as "deficits don't matter" has an underlying flaw. There is no doubt that inflation and general interest rates have persistently been at a very low level since the "great recession" but no good explanation has come forth as to why that is. Interest rates and inflation were also quite low in the 1950s and into the '60s, but around 1966, five years before the U.S. abandoned the gold standard, inflation and rates started rising at an accelerating rate. The fact is that there is little real understanding of what causes inflation and interest rates to rise or fall. Making a financial commitment based on the assumption that things will always be as they are today has proven again and again in history to be foolish.

We can say that one of the reasons that interest rates are so depressed is that there is more money available to be borrowed than there is demand for borrowing. Since 2015 there has been a significant shift in cash flows from equity funds and ETFs into bond funds and ETFs. Even as corporations and municipalities have borrowed record amounts

Information contained herein has been obtained from sources believed to be reliable but is not warranted as to accuracy or completeness. Past performance is no guarantee of future returns. For tax or legal issues consult with a qualified tax advisor or attorney. Investments when sold may be at a higher or lower price than when purchased. Refer to your custodial account statements for securities holdings and values.

of money by issuing bonds, investors have funneled even greater record amounts of money into the funds and ETFs that buy those bonds.

The rush to buy bonds, and bond funds, has kept bond prices high and rising and as interest rates move inversely from bond prices, long and intermediate interest rates low. According to *Morningstar* the average price of investment grade bonds traded in the United States is currently 7.46% above their *par* or maturity value. A rise in interest rates to where they were just one year ago would likely erase as much as 10% from the value of bonds. A further rise could easily lead to a bond market panic. In short, the current low interest rate environment is dependent on an ever-increasing flow of money into bonds, bond funds, and bond ETFs. When that ever-increasing flow will stop, or reverse is anyone's guess but like all such things it is unlikely to go on forever. When it does happen, financial markets will likely return to reality and that will be interesting, to say the least.

Until next week, we remain at our posts, vigilantly watching the tea leaves of the economic data for signs of the future.

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

Jacob A. McClure, CIMA®

Information contained herein has been obtained from sources believed to be reliable but is not warranted as to accuracy or completeness. Past performance is no guarantee of future returns. For tax or legal issues consult with a qualified tax advisor or attorney. Investments when sold may be at a higher or lower price than when purchased. Refer to your custodial account statements for securities holdings and values.