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

TPWC

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

Serving Investors Since 1982

www.tpwc.com

jeff@tpwc.com

jake@tpwc.com

May 12, 2020

TPWC Market and Economic Update – Special Edition

The Markets

The S&P 500 Stock Index (SPX) retreated 2.04% in the first two days of the week but remained up 0.06% for five days as it closed at 2870.12. The *Wall Street Journal* reported that there was no consensus among traders suggesting there was some underlying reason for the decline, but the announcement that the Consumer Price Index (minus food and energy) fell 0.5% in April combined with the news that China's economy appears to be experiencing a bout of industrial deflation may have contributed. The Index is now down 11.16% year-to-date and 15.24% from its top in February but is also up a healthy 28.28% from its bottom in March and is 1.26% higher than it was a year ago.

The 10-year U.S. Treasury note yield continued its slow, uneven slog upward to close at 0.673% despite a record breaking $32 billion Treasury auction of 10-year notes. Historically, a T-note auction of that magnitude would have caused a major spike in yields, but the buyers once again are legion, with the world lined up to loan dollars to the Treasury at astonishingly low rates. With the 90-day T-Bill yielding an annualized 0.108%, the Treasury yield curve remains comfortably positive. West Texas Intermediate crude oil (WTI) also continued its rise, closing at $25.33 per barrel as innovators managed to come up with novel and interesting places to store the surplus in anticipation of an increase in demand a few months from now. WTI is still down nearly 60% from the beginning of the year but the fall in price now better captures the actual decrease in demand as the Saudi's pledged a further reduction in oil production.

The Economy

The Labor Department announced that the Consumer Price Index (CPI) for the United States declined 0.8% in the month of April. Even after discounting the volatile energy and food prices, the core CPI fell 0.5%, the largest one-month decline since detailed records started being kept in 1957. Some cold comfort may be had from noting that the core index is still 1.4% higher than it was a year ago but economic data from before the coronavirus crisis is looking more and more like information from a different universe. The open question is whether prices will continue to fall in coming months. Some experts are predicting a surge of buying and spending as the economy opens up but evidence from China and South Korea suggests that consumer demand may not surge back as rapidly as they think.

It is also becoming apparent that many businesses and factories are now closed permanently, and their former employees are going to be some time in finding new sources of income. Add to that the reality that as long as there is no effective vaccinated immunity, a significant portion of our population will remain at least partially isolated and the stage could be set for lower demand to spark deflation. Deflation is a real threat to any economy because if prices are perceived as falling, buyers will delay purchases, resulting in falling sales and further layoffs, which then tends to spiral into a self-reinforcing cycle.

Still, there is the high potential that there is a silver lining to this dark cloud. Bad news for local communities and for workers at what were marginally profitable factories and businesses is potentially longer-term good news for the economy. It is an unfortunate fact that there are sectors of our economy as well as individual businesses that were slowly dying and might have hung on for years as the proverbial "dead wood" in the U.S. economic system. Counterintuitively, it is not the lockdown orders that are being credited with the business closures as much as it is the fall off in demand.

The lesson here is that this has happened over and over again in the history of our economy. Perhaps the greater danger would be to artificially keep struggling, inefficient businesses open to avoid the job and capital losses associated with their closing. Japan tried that a couple of decades ago and has remained mired in a nearly constant recession as a result. It is sad to see domestic porcelain serving ware and hardwood butcher-block manufacturing firms vanish, not to mention that Boeing is forecasting that at least one major airline will fold, but the reality is that creative destruction is a necessity for an economy to remain vibrant and growing.

In the shorter-term, to keep us from sliding into deflation and a potential depression, the Federal Reserve has already taken note of falling prices and closing businesses and is starting to purchase commercial exchange traded bond funds on the open markets and is preparing to purchase regular commercial bonds. Those purchases exchange illiquid bonds for cash, enabling the bond holders to have money to spend and hopefully increasing the purchases that will head off deflation. Another factor that will tend to block deflation is the massive fiscal stimulus passed by congress that effectively has flushed trillions of dollars into the economy. Some pundits have warned that such an avalanche of money pouring into the system will generate runaway inflation, but all indications currently suggest that the coronavirus crisis has removed far more money from the economy than the government replaced.

We won't know how this all plays out until it does, but we continue to be optimistic that this strange thing called the American economic system will not only avoid collapse but emerge far stronger and better because of this experience.

Until Friday, we remain alert and on watch to inform, serve, and manage on your behalf.

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

Jake
Jacob A. McClure, CIMA®