



jeff@tpwc.com

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Jeffrey W McClure CFP®



Jacob A McClure CIMA®

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

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

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www.tpwc.com



jake@tpwc.com

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TPWC Market and Economic Update

The Markets

The old tried and sometimes true S&P 500 Stock Index closed out the week at a new record high of 4185.47 leaving it up 1.37% for the week and 11.43% year-to-date. The one-year return was misleading but worth mentioning because of its absurdity, 45.60%. We are indeed in the grip of a massive bull market but measuring from the depths of a year ago distorts the image. Over the last ten years dating from April 2011, the SPX has turned in an average annual rate of return of about 12% but even a lot of that has been recent. The return over the past twenty years is probably a better guide as it averaged 6.77% per year. After it peaked in the year 2000 at about 1500, it took twelve long years to break that record. Periods of unusually high market returns are commonly followed by years of less impressive results. 2021 has indeed provided an ideal mix of low interest rates, abundant cash, rising earnings, and a rebounding economy. The CRSP Mid-Cap Value Index came along for the ride and rose 1.23% setting it up about 17% year-to-date. To paraphrase the legendary beer commercial, "It just don't get much better than this!"

One of the reasons for this week's stock rise was that the ten-year U.S. Treasury note yield declined about 4 1/2 % to 1.584% as fears of a core inflation increase continued to fade. West Texas Intermediate crude oil (WTI) jumped over 6% to \$63.08 as logistics and processing backlogs collided with dramatically increased demand. As another example of how distorted one-year comparisons are right now, WTI is up 248% since last April!

The Economy

There was an abundance of good economic news for the week, but all of it needed careful filtering. It was a year ago that the economic impact of the coronavirus pandemic hit. As a result, literally every economic data point that is based on a one-year measure is misleading. For example, the Labor Department announced that previously somnolent inflation soared in March, year over year, to 2.6% as measured by the Consumer Price Index (CPI). Digging deeper revealed that the big driver in that number was the 22% jump in gasoline prices combined with the fact that prices a year ago were declining as the lockdowns hit. If we exclude food and fuel from the equation, the annual rise was only 1.4% and if we adjust for the price decline a year ago, inflation drops to a mere 1%. Inflation may actually be declining. Interest rates fell on the announcement as traders did the math.

In yet another misleading report, the Chinese GDP was reported to have grown more than 18% in the last year. Again, the reality is that the Chinese economy was virtually stopped in March of 2020. An 18% rebound in one year is impressive, but the longer-term estimate is closer to 6% growth for 2021, similar to that of the United States.

The Federal Reserve announced that industrial production in the U.S. increased 1.4% in March alone after only rising 1% in the previous twelve months. That solid but uninspiring industrial number was small change compared with the Commerce Department's announcement that domestic retail sales and food services were up an astonishing 9.8% in March and a more realistic 14.1% in the first quarter. The heart of the surge was, as you might guess, food services. Automobile sales were a bit of a drag on the number as computer chip shortages slowed production and it appears to be filtering down to the sales lot. Again, the number is distorted, but retail sales are now up about 28% from a year ago.

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In an interesting pattern, the price of imports rose 1.2% in March while the average price of our exports rose 2.1%. Apparently, what we make, and export is growing more valuable to the rest of the world. That did not keep our material trade deficit from climbing to \$1.7 trillion for the first half of the federal fiscal year. In absolute terms, our economy is now the fastest growing in the world, and at the same time the largest. We literally have a lot more demand and money to fulfill that demand than anyone else. The thing about the trade deficit is that we really don't have one. We export a product that is not counted but is manufactured in the U.S. only, has intrinsic value, and is greatly desired by people all over the globe, the U.S. dollar. Thirty years ago, in 1991, the U.S. Dollar Index (DXY) stood at 89.21, today it is at 91.54. Along the way it has been as high as 117 and as low as 72 but it has remained remarkably stable despite all the trade deficits. The reality is that the world runs mostly on a product we uniquely manufacture and control. As the world economy grows it needs more dollars, and we supply them by exchanging them for what others make. As long as we maintain an independent Federal Reserve and it carefully controls the money supply, it works. Will it ever break? No one knows. The Romans made a similar system function for about a thousand years.

The bottom line is that our economy is growing and appears to be rapidly recovering to where it was pre-pandemic with every indicator suggesting that there is a lot more room to grow.

Until next week we remain diligently at work from here or there in an endless task of searching for greater value and the means to provide better service.



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