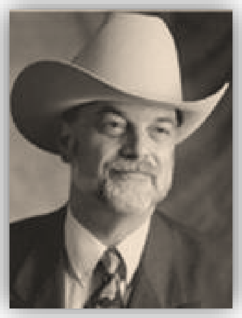

jeff@tpwc.com

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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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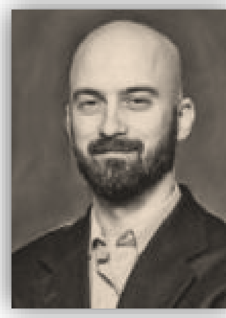

jake@tpwc.com

January 19, 2024

TPWC Market and Economic Update

The Markets

The venerable Standard and Poor's 500 Stock Index (SPX) finally shook off its superstitious fear of flying and soared nearly 1% above its previous record close of 4796.56 set back in January 2022, to end the week at 4839.81, up 1.17%. It is now 21.83% higher than it was a year ago, and up about 26% over the last three years. For those who may have been tempted to bail out during the dog days of October 2022, the SPX has risen over 35% since then. Our other followed market indicator, the CRSP US Mid Cap Value Index, which suggests what the stock market did without the seven high-flying tech companies dominating the SPX, ended the week at 2457.90, down 0.91%. That leaves it 7.1% below its record high of 2645.68 back in January 2022. The takeaway from the action so far this year is that the major market indicators are still primarily reflecting a few large-cap growth stocks. That will bear watching as the year progresses. Unfortunately, it reminds us of the last years of the 1990s when a few dot-com stocks did much the same thing.

The yield on the benchmark U.S. Treasury 10-year note inched up about a fifth of a point from last week's 3.96%, to 4.15%, reflecting increased optimism about potential economic growth this year. Longer-term rates also inched up, as we have been anticipating, while short-term rates maturing in one year or less remained around the 5.5% they have been. West Texas Intermediate crude oil (WTI) joined in anticipation of strong economic demand this year by rising to $73.71 per barrel from last week's $72.68. Interestingly, at least to us, has been the relative lack of movement in oil prices in the face of the many headlines about the supposed disruption in the oil supply caused by the Houthi attacks on Red Sea shipping.

The Economy

The economy of the United States is getting back to "normal" after four years of first a pandemic-related recession and then a series of reactions to the economic events associated with it. Over the last five months, inflation has come down to an annualized average of just under 2%, or about where the Federal Reserve wants it to be. Unemployment has remained at the same level as it was in 2019, just before the pandemic, at about 3.7%. It is widely expected that when the Commerce Department makes its gross domestic product (GDP) estimate next Thursday, it will show that the American economy grew 2.8% above inflation last year, a figure that is very close to what economists think is the maximum growth rate the U.S. can accommodate. Then, on Friday will come the Federal Reserve's preferred inflation measure, the PCE Index and that is also expected to show that the inflation monster is finally under control, running very near to the Fed's 2% target.

At the same time, some elements are anything but normal. Short-term interest rates remain between 5.25% and 5.50%, abnormally high for a 2% inflation economy. Federal Reserve Board voting members have consistently warned that they have no plans to cut short-term rates soon and have warned that cuts may not come until late in the year. Additionally, housing prices and mortgage rates are both higher than would be expected in an economy like we are seeing, and that is having an effect.

There are at least two major problems in the housing part of the economy. First, the abnormally low interest rates we saw until 2022 resulted in many homeowners locking in mortgage rates that have been well below the inflation rates we have seen. Low-interest mortgages make homeowners with mortgages very reluctant to sell their homes and that has created a shortage of homes to buy. That supply and demand imbalance has resulted in higher-than-normal home prices. In previous decades, high house prices resulted in a frenzy of home building. The reason we have not seen an avalanche of new homes being built is partly that abnormally low unemployment rate, partly the caution exhibited by both the housing industry and lenders resulting from the housing collapse of 2008-2009, and partly because the skilled labor needed to build houses is in short supply. The result is that the average single-family, previously owned home was priced at $277,000 in 2019 but is now $382,600, a 40% increase during a period when general prices rose 20%.

The other different thing is our ranking in the world economy. Before the pandemic, China and Germany seemed to have a corner on economic growth. Both economies were thriving and growing at high rates based on their massive exports of manufactured goods. Today, China has just experienced the lowest GDP growth in 25 years and Germany's economy likely shrank by 0.3% in 2023. China also just reported that for the second year in a row, there were more deaths than births there.

The bottom line in this, the third week of the new year, remains much the same. The U.S. economy is churning along quite well in the face of abundant pessimism while the export-driven economies of Europe and China are in various degrees of distress. It looks to be an interesting year ahead.

Until next week, we remain here to serve you and only you, with the best fiduciary advice, portfolio management, and sincere care we can muster. We welcome your thoughts, comments, and suggestions, so don't hesitate to give us a call, email, or even a pen-and-paper missive. We value them all!

Your sincere and obedient servants,

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

Jacob A. McClure, CIMA®