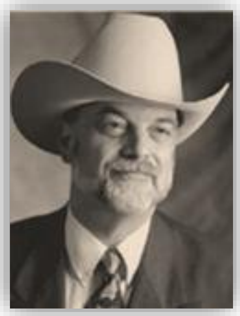

THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The markets were anything but boring as the week began. The S&P 500 (SPX) opened Monday at about 5136, around 4% lower than last Friday's close, and ended the day in very much the same condition. Rumors of "1987" abounded as reports were published that Japan's Nikkei 250 dropped the most in a single day since Black Monday in 1987. Few would have guessed that by the end of the week, the Index would close at 5344.16, down a mere 0.04%. That leaves the venerable SPX just over 12% higher than when the year began and nearly 20% higher than a year ago, about the same total gain it has achieved over the last three years. Our other market indicator, the CRSP US Mid Cap Value Index, closed at 2680.50, down 0.32% for the week, up 6.93% this year, and 10.22% higher than at this time last year.

The 10-year US Treasury note yielded 3.94%, up 3.68% from last week. The 1-month T-bill paid an annualized rate of 5.54%, and the 30-year bond 4.23%. West Texas Intermediate crude oil (WTI) rose 4.57% to $76.95.

We normally focus on the economy because the markets tend to reflect the economy in the long run. This week, we will focus on markets, and more specifically, the stock market, because there are relatively short periods of time when the stock market moves in opposition to the economy in which it resides, and Monday of this week was one of those times.

It started in Japan. Tokyo time is 13 hours ahead of New York, which is critical in this scenario. On Monday morning, Tokyo time, the Bank of Japan (BoJ) floated the idea that it might raise interest rates from the 0% they have been for over a decade. Using something called the "carry-trade," U.S. speculators have long borrowed money (in Japanese Yen) at 0% interest from the Tokyo exchange, then, through a complex chain of transactions, used that borrowed money to purchase stocks and crypto in the U.S. Because the much higher interest rates in the U.S. had caused the dollar to rise against the yen those carry-trade loans have been profitable for the borrowers. Compounding the issue was the tradition that senior traders take their vacations in August, leaving the junior traders with instructions to avoid losing money while the big boys were away.

The Monday morning announcement by the BoJ immediately triggered a rush to sell stocks on the Tokyo Exchange as purchasing Japanese stocks "on margin" is the first step in getting the carry trade loans to the U.S. markets. The immediate result was a 12.5% single-day drop in the Nikkei 225, following a 5.8% fall on Friday. The Nikkei decline was headlined worldwide before the U.S. markets opened as "The biggest decline in the Nikkei since Black Monday of 1987." As the second-string traders arrived at their desks on Monday morning, they saw that an increased interest rate in Japan would tend to reverse the dollar's rise, hitting carry trade loans with a double whammy. The dollar, in which their highly leveraged assets were held, would fall against the Yen, and, at the same time, they would begin owing interest on those loans.

As the junior carry traders started selling, the other second-string traders assumed the sellers knew something the rest of Wall Street had missed and joined in the rout. That was followed by even more selling as members of the public saw the fall and, like the traders, figured someone knew something they didn't and panicked. On Tuesday, a "deputy governor" at the BoJ announced the BoJ would not hike interest rates when the financial and capital markets were unstable, and the markets began to recover. As with all such panics, there were a series of aftershocks as some investors reacted with a lag. There was a parallel with Black Monday, though. Funds and strategies that promised to dampen volatility generally failed, just as they did in 1987.

The Economy

Meanwhile, in the real world of the economy, nonfarm business sector labor productivity increased by 2.3% in the second quarter, according to the Labor Department, as output increased by 3.3% and hours worked increased by 1.0%. Notably, despite reports that manufacturing slowed, manufacturing productivity increased by 1.8% as output increased by 3.4% and hours worked increased by 1.6%. This is an example of how contradictory some economic data has become. If, as the PMI surveys suggest, manufacturing is producing less, how does output increase 3.4%? We suspect the PMI data, with its large sentiment component, is being distorted by political rhetoric.

Once more, despite Chicken Little's pronouncement that "The sky is falling!" we are forced to report that the U.S. economy is in fine shape and the stock market shows little sign of being in a "bubble." We remain confident it will eventually arrive at the euphoric state of irrational exuberance at some point, but not today.

Until next week, the TPWC Team stands ready to serve you as your faithful fiduciaries and loyal servants!

Your obedient servants,

Jeffrey W. McClure, CFP®
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