THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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Greetings from The Personal Wealth Coach!

The third quarter of 2015 and the month of September are now behind us. As we enter October, I am fully aware that traditionally, this is the month with the most historic market volatility, so bumps may be in front of us, but at the same time, my reading of the economic data suggests that this month may see the end of much of the uncertainty and unhappiness that has plagued the markets these last two months.

The Markets

The securities markets around the world clearly behaved according to script in the third quarter of 2015. Back in the 20th century, before we experienced the roughly 50% value declines in the S&P 500 Stock Index (S&P 500), Dow Jones Industrial Average (the Dow), and other broadly representative U.S. Market indices, we were in a long-term bull market that lasted from about 1982 until 2000, 18 years. In that 18 years, the broad stock indices took a dip in about 80% of the years during the third quarter. It was such a reliable event that an old euphemism took root, "Sell in May and go away." Then the "secular" bull run ended and we entered into about 13 years of a secular bear market. Over the past 15 years, the rhythm of an annual pattern has been largely swamped by the dramatic declines and recoveries that centered around the market decline from 2000-2002 and again from 2007-2009.

This collapse and recovery cycle in the secular bear we have recently experienced technically ended in early 2013 as the S&P 500 reached the 1,500 level as that was where it was at the top in the year 2000. In essence, the market was "down" for 13 years. At the end of the quarter, on September 30, the market closed at 1,920, up about 28% since hitting 1,500 in January 2013, but down almost exactly 10% from its all-time high on May 20 of this year. It didn't stay there and today is trading in the vicinity of 1,950. The bottom points in this event have been right at the "down 10%" point, at the technical definition of a "correction," but they have bounced off those points rapidly.

I wrote earlier this year that we were overdue for a "correction" in the markets, as they historically have come far more often than we have seen recently. The last semi-correction we had was in 2011, and before that was only the bear market of 2008-2009. I also wrote that market "corrections" come not because of some underlying weakness in the economy, but just because they do. After or even during the downside of each one, journalists come up with lots of reasons for such declines, but without exception, those reasons are there at other times when the market ignores them. Corrections happen simply because the universe is lumpy. They happen for the same reason you can dependably find waves when you go to the beach. It is the nature of complex, dynamic systems to have variance. This event is no different.

Recognizing that Yogi Berra was quite correct when he famously said something to the effect that "Predictions are hard, particularly when they are about the future," I believe that 2015 will see the markets rise to higher levels and close out the year with a gain. I also believe that 2016 is very likely to be an excellent year for the economy and the markets. Read on to see some evidence as to why.

The Economy

There are five major, large-scale socioeconomic experiments going on in the world today. One is in Europe and more specifically the Euro-zone, another in China, yet another in Japan, and one in the United States. I know that is four, not five, but there is one more happening in Russia. Howeverthat one is just a repeat of an old formula that has been tried over and over without success.

The Euro-zone is making a serious attempt at austerity to generate prosperity. In short, the Germans, who effectively run the show there, are attempting to correct deflation and recession by cutting budgets and forcing debt reduction. It isn't working, and is effectively a repeat of the methods the United States used to deal with what later was called the "Great Depression" of the 1930s. That policy managed to get the United States economy stuck in the mud until massive government borrowing and full wartime mobilization put people back to work and blasted us out of the pit. The Europeans are also enthralled with a highly centralized and controlled economy or economies. It is all so logical and rational that they believe that somehow it *must* eventually work!

The Chinese government also is focused on a high degree of central control, once again in pursuit of order and rationality to combat the inherent chaos that comes if everyone is able to do pretty much as they like. They have not focused on austerity, but rather on high levels of state-financed projects that keep people employed and economic growth at higher levels. In essence, they have put their economy on a war-footing, albeit without actually fighting a war. Their control of the Chinese economy is not at all unlike the controls the United States had in place during World War II. To do that they have racked up a level of debt that is truly staggering. Yes, their supposed government debt is a small fraction of what other nations have, but instead, they have loaded up with debt issuance in state-own industries. When the governmental debt is added to the estimate of the debt owed by the many industries owned by the government, the percentage of their GDP is larger than ours, and similar to that endemic in Europe.

Very notably, the Chinese debt is what we in the U.S. call, "debt owned by the public" and not the controllable "social debt" that dominates our version. The Chinese have no Social Security, Medicare, unemployment insurance, or huge pension liabilities. Their debt is direct debt, payable at maturity. A very large portion of what we Americans call our "national debt" is possible future payments to Social Security recipients, and possible future medical costs, all of which can be altered or modified.

The Japanese experiment is one in which no one fails. No major corporations, and particularly banks, are allowed to fail or even recognize that much of the money they are owed will not and cannot be paid back. They have full employment, social serenity, and no corporate officers are embarrassed. Even when a corporation is clearly responsible for what is arguably the largest nuclear disaster since we triggered nuclear weapons on two cities in Japan, the power generating corporation involved has been left in charge of the issue and the senior officers are still running the show.

The Russians are playing an old game. They have an effective dictator in control, supported by the military and a close circle of semi-state owned corporations and fabulously rich friends of the President (dictator). The economy is sinking under the weight of central control, political suppression, state seizure of corporate assets, and general corruption. The citizens are generally kept happy by a steady stream of propaganda, fear of a made-up enemy, and military conquests over that mythical enemy. Meanwhile the government borrows more and more to fund a modernization and build-up of the military at an unsustainable rate. This is very nearly a perfect duplication of the experiment performed by Germany in the 1930s. Vladimir Putin makes the trains run on time, crushes the enemies of Mother Russia, and keeps everyone employed and fed.

The most notable thing about all of these experiments is, with the exception of the United States and possibly the Chinese, they are not working very well. Southern Europe still has about a 30% unemployment rate and is teetering on the brink of slipping back into recession. The European Central Bank is pumping money into the economy even as the Germans insist on debt pay-down that sucks money out of the economy. The Russians are headed into bankruptcy unless they find a way to use their rebounding military to take wealth from other countries. The Japanese are carrying a debt load that is effectively about three times that of the United States, and are now borrowing more to try to stimulate their economy. Notably they are doing that while at the same times having implemented and raised a large sales tax on goods and services. The Chinese are at least trying to get things right by transitioning from an export-driven economy to one like ours where the consumers are the drivers of things. The jury is still out there.

There is one more economy and one more experiment underway and that is here at home in the United States. The "third" estimate of the U.S. GDP, released on September 25, indicated that our national economy was growing at 3.9% per year in the second quarter. Corporate profits were up at a 3.5% annual rate. Auto sales in the U.S. are on track to be the highest since 2000. Consumer confidence, according to the Conference Board report, is high, and construction spending in the U.S. for the trailing 12 months is up 13.7% as of August 2015. Unemployment is stable at about 5.1% of those who want to work, and the Index of Leading Economic Indicators suggests that more good news is on the way.

The long and short of things is that while there is much worry about whether or when the Federal Reserve will raise short-term interest rates to 0.25% and whether or not China will continue to grow at an unreasonable rate (it won't and can't), the largest, by far, economy in the world is cranking along in a very sustainable and accelerating manner. The historic reality is that if we just keep on doing what we are doing in our very chaotic way, with little centralized control, no one in charge, relatively low taxes, and the highest level of freedom and property rights in the world, we will likely drag the rest of the world into growth, whether they like it or not.

We have a peculiar balance between government-run regulation, self-regulation (as with our professions), and what is to the rest of the world an alarming level of uncontrolled elements. We have a socialist aspect in our Social Security and Medicare systems that is far more collective and socialist than the Chinese and yet our socialism is a tiny fraction of what is common in Europe. Finally, we have a strange balance of government support for those who are at the bottom of the economic ladder and at the same time a "sink or swim" approach to success or failure in the economic lives of our residents. Oddly, the Chinese system, nominally communist, has no safety net, and it is literally possible to starve to death there because of the near total absence of a government safety net. That same Chinese government at the same time props up otherwise bankrupt companies if they are party-affiliated. The European governments, many of them nominally "socialist" have such good safety nets that people can often live as well without working as when they are working, yet are forcing individual governments in the southern tier of states to run on such austere budgets that government workers are not being paid. We, here in the United States, have a system that seems to run down the middle with what appears to be a fine balance between government involvement and freedom to succeed or fail. Our system is far from perfect, but it is currently thriving while the others look to be coming apart at the seams.

For whatever it is worth, our chaotic, disorganized, adversarial, and generally messy way of dealing with things drives the central planners in the rest of the world crazy. We are the most disorganized and disjointed economic mess of any developed nation, but at the same time we are the most prosperous, most effective, and most productive of all of them. More, unlike the years leading up to WWII, we have a well-trained, well-disciplined, and most technically advanced military on the planet. My prediction is that despite all the naysayers, the United States of America is just getting started. Good times lie ahead. Yes, I could be wrong (see the Yogi Berra quote above), but it is in the time when all seem to be saying "doom is upon us" that the greatest opportunities and the greatest future success is at hand.

Sincerely yours,

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M.S. Personal Financial Planning

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