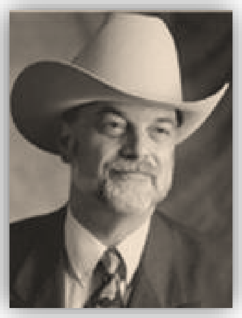

THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

At the close today (Friday) the S&P 500 has finally returned to zero. Zero in this case means that it is now at the same level it began the year and that is quite an accomplishment for this year. It is also, of course, what we predicted would happen about this time. The S&P 500 Stock Index closed today at 2075.15 having started the year at 2058.

The reported reason for the market rise was a reduction in central bank rates in China and in Europe. Note here that the market fell substantially last month supposedly because the Chinese economy might be weak. A lowering of interest rates by the central bank in China signals that the authorities in China agree that things are slowing down, so, of course, the market in the U.S. rose about 1% today. The S&P 500 is now about 11% higher than where it was at its low in August. Worry not though, there are still plenty of doom-sayers claiming that this is just a "relief rally" and soon the Index will swoon to new lows. The turning point, it is worth remembering, was then Bill Gross, the bond guru who left PIMCO in a huff and then went to work for Janus, warned and was widely reported to have said that the equity markets had to fall a lot more before the found bottom Mr. Gross has become my most reliable indicator. He issued the same warning right at the bottom of the market decline in 2002 and again in 2009.

The Economy

The International Monetary Fund (IMF) after carefully examining what is going on in China reported today that the Chinese economy is not in free-fall. Instead it is in a transition from being export driven to being consumer driven. Hmmmm. Seems like someone else recently wrote that.

It appears that the House of Representatives will get a Speaker, however; Paul Ryan, the heir apparent, has a list of requirements which include no poison pills from the Freedom Caucus. If he is elected, the chances of a government shutdown diminish to near zero. This bears watching. The one major risk factor on the horizon at this point, in my opinion, would be a default by the U.S. Government on its obligations. Absent a viable Speaker in the House, that would have been a real possibility. Part of the rise in market values this week may have come from the promise of some degree of compromise in the House. Early next week we will either see solid progress there or not. If the gridlock continues there is a real risk of a short term blow to market values and the credibility of the United States of America. If cooler heads prevail and a compromise is reached, then we will likely see not only a significant boost to the economy and the markets, but an equally substantial rise in tax revenue next year creating a reduced deficit. All of that would be good news.

Mark Zandi, probably the most respected (and accurate) economic forecaster in view, has repeated that 2016 looks like it will be excellent for the U.S. economy. Meanwhile the leading economic indicators seem to be backing him up. This afternoon after the markets closed, the Manufacturing Purchasing Managers' Index rose to a five year high. In September it was at a five year low. The respondents to the survey cited unexpectedly high domestic consumer demand and "pricing power." That last is another good sign. Pricing power is when there is room to raise prices on manufactured goods because there is more demand than supply. That too was unexpected.

In another good news move, it appears that the Obama administration has a plan to rescue Puerto Rico from a financial collapse. If that is so, then once again the peculiar American system will have proven to be more effectively than that of the Eurozone. It will be in the hands of Congress to approve it, but if Paul Ryan is leading the House, I have faith that something will be done. A financial default of any part of the United States, even a commonwealth, is not a good thing.

In short, things are looking good. The August-September minor panic was just that, a panic without cause. It is always possible for things to go wrong, but all the elements seem to indicate some good times ahead barring political meltdown.

Long-Term Planning

I have mentioned this before, but we produced some numbers this week for a client that are illuminating. We are in a near zero inflation environment, and in fact, the consumer price index is negative for the trailing twelve months. Stocks, over the past century, have produced an annual average rate of return of about 7%. Bonds are priced over the long haul to provide about 2%. While this is overly simplistic, a well constructed portfolio consisting of 60% stocks and 40% bonds would then have an expected long-term return of 5% per year. That, of course does not include expenses and cash holdings in a portfolio, but it is a good number to be aware of. Inflation seems to have pretty much disappeared off of the map and may not return in any significant fashion for a long time. Japan, China, and Europe are all suffering various degrees of deflation. As long as that persists, and it may persist for quite a while, portfolio returns of around 5% per year mean that the manager is providing enough extra return to cover expenses and other frictions that are always there.

Sincerely yours,

Jeffrey W. McClure CFP®
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