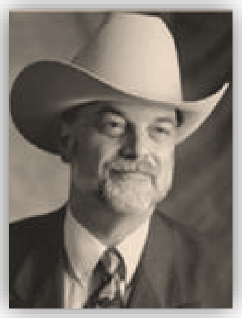

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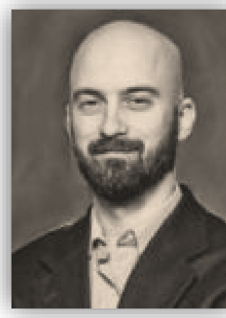

October 30, 2015

TPWC Market and Economic Update

The Markets

It is hard to believe, given the doom and gloom that has been so pervasive, but as October ends, the major U.S. stock indexes have risen for five weeks and this October will record the largest monthly gain in domestic stocks in four years. From a more sensational than statistically significant perspective, the Dow Jones Industrial Average (the Dow) and the Standard and Poor's 500 Stock Index (S&P 500) recorded the largest point gain in market history this month!

For the month, the S&P 500 is up 8.7%. Note here that this single month has seen a rise in the Index greater than the annual average going back a century. October of 2015 is an example of what is wrong with market timing. There are a host of indicators that state when a market timer should get out of the market. They exist because when those indicators hit the "sell" spot, there is a better than even chance a significant decline will follow. Unfortunately for market timers, there simply are no reliable signals that announce when to buy back in.

Several well-known market pundits warned pretty much at the bottom of this most recent downturn that the worst was yet to come, and getting out was a good idea, while getting back in was a horrible idea. From that point to the close today, the market has gained about 11.4%. The pundits are still warning that this is a false rise, but as we get back to gain territory for the twelve month period, they will very probably state that the time to invest is "now." If one carefully plots their advice, it amounted to "Sell when the market is low and buy back in again when it is high." Notably, the loudest proclamations about when one should do what in the stock market came from bond fund managers.

Everything I just wrote about domestic stocks can be said in multiples about foreign and emerging markets stocks. Those same Chinese stocks that were proclaimed as the reason for the recent market correction just had their best month in six years! That does not mean that emerging markets are recovered to anywhere near their highs reached in 2014, but it does mean that they have risen a LOT in the past month.

To bring this back to the nitty-gritty, I must announce that for today, Friday, October 30, 2015, most stock indexes around the world fell with the S&P 500 down 0.22%. They did not fall much, but they were down. So, if a person looked at just one day, things look less than good. For the week, the results are unspectacular, but when one looks at the month, things are really looking up. The same alternating sets of views can be seen as the time frame gets longer until beyond ten years when every view becomes positive. There is a lesson here. The longer the time frame, the better a broadly-diversified set of stocks looks. In the short-term the market exhibits something like a "random walk," but once we get out beyond ten years things just look better and better.

The issue then is to find some way to cushion the short-term declines in stocks, but still remain in stocks to a degree that will support an expectation for long-term growth. That, not surprisingly, is what we work at here.

The Economy

The Commerce Department announced their first estimate of third quarter GDP for the U.S. economy. Note this is just the first estimate, and we really won't have a clue as to what happened for several months. That first more or less educated guess was that annualized growth had slowed to 1.5%. The big drags were a combination of retailers not buying new inventory and a serious slowdown in exports. At the same time, a final consumer spending report for the second quarter rose on an annualized basis by 3.6%. The future is always uncertain, but the anecdotal evidence is that the consumers continued to spend right through the Chinese panic, and those retailers are going to have to do some serious buying in the fourth quarter to cover what they did not buy in the third. That means that fourth quarter GDP should yo-yo back up to a much higher number.

Another major drag on the GDP numbers is the relatively dramatic decrease in government spending. Had the federal government continued spending at the same rate it did in 2010, third quarter GDP would have been at about 3%. For the past five years, federal spending has grown, but it has grown quite a lot less than the economy, so as a percentage of total GDP, it has shrunk. Despite all the sound and fury from both sides of the aisle, it appears that we may be on the right track to gradually pay down the debt we ran up in the recession.

At the same time, annualized inflation for goods and services in the United States appears to have been about 1.3%, somewhat lower than in the second quarter. While we are sort of pre-programed to think of inflation as “bad,” in fact something like 2% inflation is ideal. We are still fighting an uphill battle in the economy. The good news is that we appear to be winning.

Weirdness continued to proliferate in the European Union. This week Italy, one of the most indebted countries in the world, brought a set of two-year sovereign notes to auction and when the dust had settled, the interest rate on those notes was a NEGATIVE 0.023%. Investors will be paying Italy a small interest payment each year to get the ability to lend money to that country. Huh? Just a couple of years ago Italy had to pay over 8% to borrow money! The big-moneyed bond purchasers are effectively announcing that they expect the Euro to drop in value during the next two years, and thereby give them a profit on Italian treasury notes. Meanwhile U.S. two-year Treasuries are yielding +0.73% per year. That is not a high rate, but it effectively states that investors believe our economy will do well and our dollar will be stable to higher over the next two years.

A final piece of good news was announced this year as the Congress passed a two-year budget plan that will avoid the risk of a government shut-down, and the House of Representatives elected Paul Ryan as its speaker. Congressman Ryan is one of the most astute budget analysts in either house, so we are hopeful that a more rational budgetary plan will emerge during the apparent budget truce that should give us two years to look hard at what we are doing.

Predictions

First a caveat: The future is uncertain.

Having said that, the indicators we follow continue to suggest that 2016 will be a good year for the economy and probably for the equity markets. Sometime next year we think there is a good chance that we will see something like a full recovery from the economic meltdown of 2008-2009. There is also, in our opinion, a reasonable chance that market values will rise more in the next year or two than we have seen in the past few years. In short, we are optimistic.

As always we welcome your comments, your thoughts, and your questions. We are planning to be on KTEM 1400 AM tomorrow morning from 10:00 to 12:00. If you cannot get the radio signal, you can listen in at myktem.com. We welcome your calls and emails.

Until next time.

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