Financial Wanderings

January 2018

A masterful examination of the previous month's financial events, written by Brad Blackburn, CFP ®

(and made even awesomer by Andrea Dickerson)

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Although the commentary in this newsletter has been thoroughly researched, well-reasoned and contains many impressive multi-syllabled words, please enjoy it responsibly. There are many economic minds that are far smarter than mine—and even they can't agree on even the simplest economic questions. In other words, please enjoy this newsletter with the full understanding that it may be entirely wrong.

How long will the economy keep growing?

The combination of the American economy and the global economy hasn't been this strong since well before the 2008 Financial Crisis. Europe and Japan in particular are finally hitting on all cylinders. Over the last 10 years, I must have commented dozens of times that if only Europe and Japan could get their economic act together, it would really help us here in America. That is what is happening now.

The American economy looks good too. The only semi-disappointing recent economic number was the recent jobs report which showed only 148,000 jobs were created in December. But the only reason that's disappointing is because we've been creating 200,000 jobs for so many years. However, at this point, our unemployment rate is at 4.1%. So there really aren't all that many employable people who don't have jobs. It's just not reasonable to expect our economy to add 200,000 a month like we have in recent years.

So, the entire global economy is clicking on all cylinders. However, the stock market has a history of beginning to fall well before any signs of economic trouble. For example, in the year 2000, our GDP was an impressive 4.1%. But, that was the very same year the dotcom bubble burst, which sent us into a recession and a 3-year bear market in stocks. Similarly, in 2006, just before the Financial Crisis, our GDP was 2.7%. So, the stock market doesn't need a bad economy to fall. Of course, none of this means a recession or a bear market are coming anytime soon. I just don't want anyone to get too comfortable.

North Korea got Trumped?

North Korea and South Korea have decided to sit down, have some Soju', and talk out their problems. Reluctantly, I have to give Trump some credit on this one.

I've heard Trump supporters argue that Trump was deliberately faking being irrational and unpredictable in an attempt to scare North Korea (and China) into changing their ways. I wouldn't blame North Korea for being scared. The most powerful country in the world just turned crazy. Imagine a 10-foot-tall, 500-pound giant in your neighborhood suddenly getting a screw loose. I would cuddle up in the fetal position with my former enemies too.

However, I don't believe Trump was faking being irrational and unpredictable. When he called Kim Jong Un "short & fat," "little rocket man," and threatened "fire and fury," he was just being Trump. I don't think he's capable of operating any other way. But I'll be darned if it doesn't somehow keep working for him.

Although things are looking up now, I fear this story might not be over. North Korea doesn't have a reputation for negotiating in good faith. So, it's unlikely that they'll stop pushing towards nuclear weapons capable of hitting American cities. In other words, they are probably just stalling. If Hillary Clinton were president, I'm pretty sure Trump and the Republicans would be loudly pointing this out.

The unemployment rate was never "phony"

In 2016, Donald Trump called the official 4.9% unemployment rate "phony" and claimed the "real" unemployment rate was 35%. However, now that he's President, he's celebrating that same unemployment rate.

Trump should absolutely be celebrating – a 4.1% unemployment rate is a wonderful thing. It was never phony. Hopefully, he's learned his lesson and will show more respect to government number-crunchers in the future.

The instant the numbers look bad, they'll be phony again

But what exactly does a 4.1% unemployment rate mean? It all comes down to how you define "unemployed." We can all agree that a baby who doesn't have a job shouldn't be counted in the official unemployment rate, but an able-bodied adult who can't find a job should absolutely be included. It's where to draw the line in between there is the tricky part.

The official unemployment rate we hear about most in the headlines is called the U3. For the U3 unemployment rate, you're considered unemployed if you've looked for a job at any time over the last 4 weeks. So, when you hear that our current unemployment rate is 4.1%, that means 4.1% of Americans were actively trying to find a job over the last 4 weeks.

The problem is that the U3 rate leaves out a lot of people. What if you've searched diligently for a job, but became so discouraged that you stopped looking?

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(The unemployment rate was never "phony"…….Continued from page 2)

Or what if you have a part-time job, but want a full-time job? Thankfully, there are other official unemployment rates that cover those people. The U5 rate includes "discouraged workers," and the U6 rate includes part-time workers who want to be full-time. The U6 rate is the broadest measurement of unemployment we have. While it was never 35% like Trump said, it has dropped from a high of 17% in 2010, down to 8% now.

So, no matter how you define it, we've made a lot of progress in creating jobs here in America since the Financial Crisis. Trump should absolutely be proud. However, so should Obama.

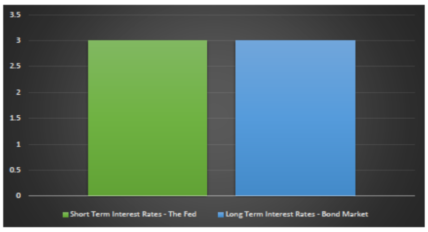
So, no one cares about the Fed anymore?

For years, the Fed was a plentiful source of scary headlines for the financial world. However, now that the Fed is actually raising rates, no one seems to care. Last year, the Fed raised rates 3 times, and they expect to raise rates 3-4 times again this year. I think that's the right decision, but it brings many risks with it – and the markets are ignoring those risks.

The global economy is awash in debt. The IMF (International Monetary Fund) recently reported that global debt is now $226 trillion, which is three times higher than our global GDP. That seems like a problem.

In that same report, the IMF noted that many corporations were already having trouble paying for all that debt. So… what happens when interest rates rise, and all that debt becomes even more expensive?

Another worry is that the Fed is raising rates while inflation is still low. That has caused what economists call a "flat yield curve," which means that short-term interest rates are near the same level as long-term interest rates.



That's happening because the Fed only controls short-term rates. Long-term interest rates are controlled by the bond markets. However, since there isn't much inflation, long-term interest rates have actually fallen over the last year.

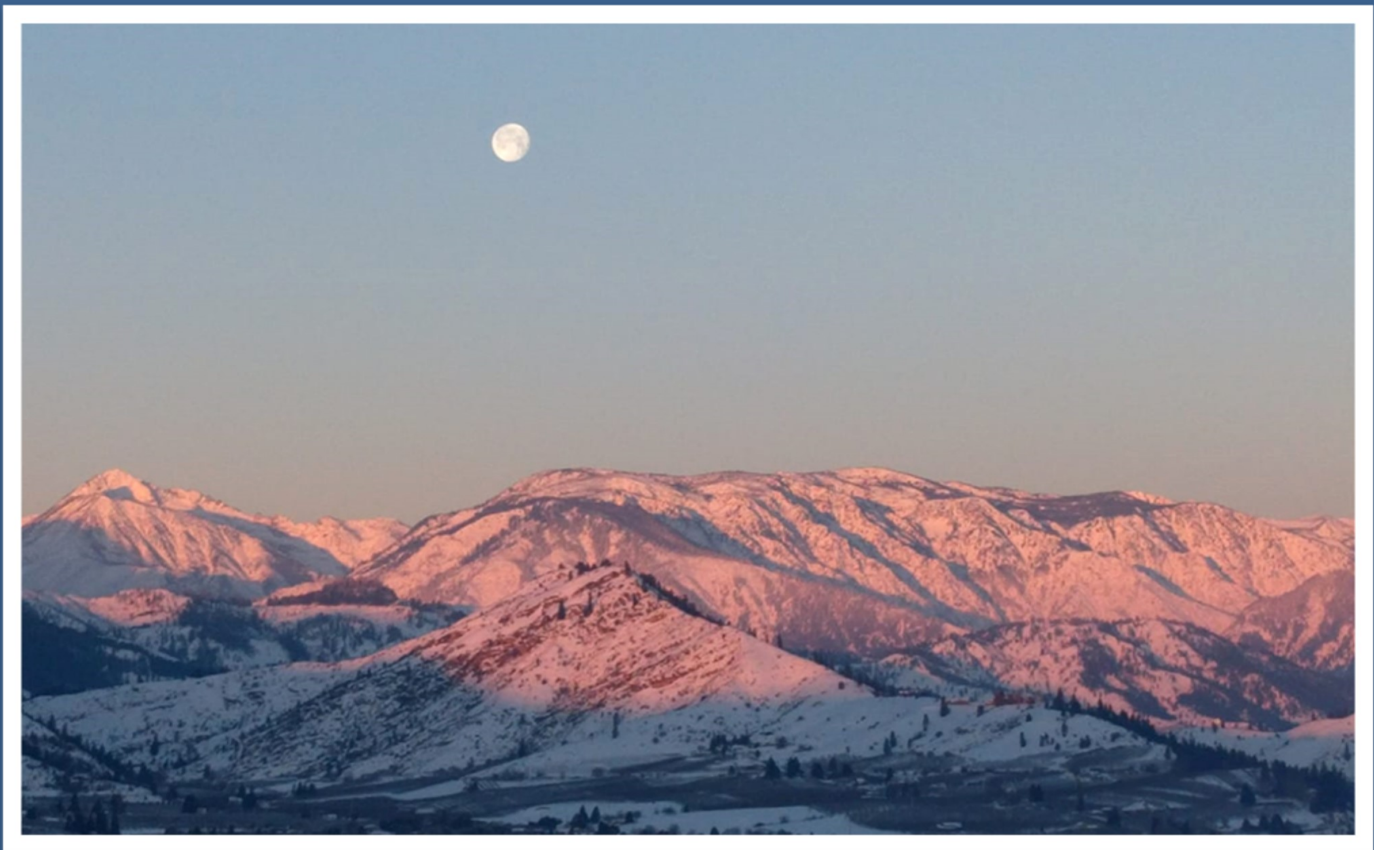
A flat yield curve is worrisome because it's a step in the direction of an "inverted yield curve," which occurs when short-term rates become higher than long-term rates. Historically, an inverted yield curve has been a remarkable predictor of an upcoming recession.

The Fed also must consider that countries across the globe still have ultra-low rates. If interest rates in America are significantly higher than the rest of the world, it could draw billions of dollars into America. That might sound like a good thing, but huge flows of money can destabilize the global economy and push the dollar higher.

So, there are many risks for the Fed, many risks for the economy, and many risks for the markets. But when has that not been the case? The global economy is growing well, so the Fed thinks it can afford to raise rates – and I agree with that. I just don't think we should ignore the risks.

Probably a mountain or a lake

This photo is from a cold recent morning in Cashmere,
looking towards Mt. Cashmere and Icicle Ridge.
Oh, how I love the area we live in.



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