Financial Wanderings

April 2015

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

(and made even awesomer by Andrea Dickerson)

Brad Blackburn, CFP ®

Financial Advisor
Blackburn Financial
121 Cottage Ave.
Cashmere, WA 98815

509-782-2600

brad@blackburnfinancial.net

April Market Numbers:

S&P 500: +0.90% to 2,086

NASDAQ: +0.80% to 4,941

DJIA: +.40% to 17,841

10-Year Treasury Yield: +2.5% to 2.05

Gold: -0.07% to $1,183/oz

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.

Why'd it do what it did?

This year has been pretty boring. The stock market is up a little bit. The economy is growing a little bit. All the same stuff is happening in all the same places across the globe. There's just not much compelling stuff for me to report. Maybe I'll get lucky and we'll get a big crisis I can write about. That'd be awesome.

The biggest story continues to be the slowing economy. Almost every measure of the economy is slowing down. GDP was only up 0.2% in the first quarter. In March, only 129,000 jobs were created. Consumer spending, retail sales, durable goods, manufacturing… Nearly every measurement has been weaker over the last few months. But not only is the economy losing steam, corporate earnings are falling for the first time in years. So what's happening here?

The Weather

Let's look back to the first quarter of last year. We'd been through years of painfully slow economic growth, and there were legitimate questions as to when we'd ever be able to break out of the "slow-growth economy." To make matters worse, the stock market boomed in 2013; so if the economy didn't step up in 2014, the stage was set for a major disappointment. This was crunch-time, and the world was watching... Would the economy come through?

(DRAMATIC PAUSE)

No, the economy responded by falling a whopping 3% in the 1^{st} quarter of the year.

But then it got better – a lot better. During the rest of the year, the economy grew at a rate of nearly 4%. So why am I telling you this now? Because a year ago, many "experts" chalked up the bad economy to an unusually destructive winter, and they turned out to be right: Huddling under blankets around a fire isn't the most economically productive way to spend your day.

(Cont'd on Page 2)

Why'd it do what it did?......Cont'd from page 1)

Those same experts are saying the same thing this year. I hope they are right. Just like last year, it's clear that the markets believe it.

The Dollar

Since last summer, the dollar is up nearly 20% versus other currencies. That's a very short, very quick move in one of the most important parts of the world economy. Those things make an impact.

The rising dollar isn't all bad. But one major drawback is that it makes American products less competitive overseas. As a result, US exports fell to a 2½ year low. The volatile dollar hurts in other ways too. Imagine you're sitting in a corporate boardroom trying to decide whether to make a huge overseas investment. Wouldn't it help to know precisely what your costs are going to be? That's pretty hard when currencies are fluctuating wildly (yes, there are hedging techniques). That has a little bit of a paralyzing effect on business.

The Fed

Yes, the world is still worried about what the Fed is doing. Will they raise rates in June? Or will it be September? Or sometime in 2016?

Apparently this question still matters to decision-makers across the globe. I don't see what the big deal is. The Fed has made it very clear that rates will not be rising quickly. In fact, Fed member Jeffrey Lacker made this point very well when he said:

"In current circumstances, raising the funds rate target a notch or two is less like taking away the punch bowl and more like just slowing down the refills. We will still be spiking the punch—just not quite as rapidly as we have been."

They "*will still be spiking the punch*!" Rates can go up quite a bit, and still be incredibly low. Can we please stop worrying about it? This is the primary reason I was unhappy with all the cartwheels the Fed has done since the financial crisis. The world is focused on the Fed to a ridiculous, unhealthy level. Let's move on.

So what should you make of all this?

The economy is slowing, and earnings are falling; but, the stock market is going up. That's 2 against 1. But what if the stock market is right? Remember back in 2013, when stocks had a great year, but the economy was still stuck in mud? There was a lot of "bubble" talk back then, but it turned out that the stock market was forecasting the improving economy. The stock market was right back then, and it might be right again. This economic slowdown might be temporary; the result of bad weather, the rising dollar, worries about the Fed, and natural ups and downs.

But, however you want to justify it, earnings are falling, and the stock market is still rising. By definition that means stocks are getting more expensive. There's a real chance that the economy and earnings will recover later in the year, and if that happens, the markets will probably be fine. But every step in our current direction is a step into riskier waters.

How to never pay taxes on your investments

To celebrate the passing of April 15th, I've decided to share a secret. To date, I've only shared this with people who are much more important than you. However, I believe this is the right time to share it with the little people. You're welcome.

Through thousands of hours of deep meditation, a rigorous yoga practice, and many online courses, I came to the following revelation: ***Almost any time you make money, you have to pay taxes.***

To take advantage of this truly insightful revelation, I'm announcing a new portfolio for my clients to take advantage of: ***The Low Tax Portfolio (LTP).*** The ultimate goal of the LTP is to lose money on every trade (of course, even a skilled financial wizard like myself can't guarantee losses on EVERY trade -- that's just not realistic). Through this sophisticated, cutting-edge investment technique, the LTP practically guarantees my clients will NEVER pay taxes on their investments.

It's really quite simple; I'm shocked I'm the first person to think of it. But sometimes it takes truly special people to move the human race forward.

** The LTP is not real. I always want my clients to have gains, and therefore taxes, in their portfolios.
** Yes, this is a rehashed article from last year. Leave me alone about it.

Apple and random small countries

In the first quarter of 2014, Apple's revenue was a whopping 45.6 billion dollars. That puts Apple's revenue producing power on par with the entire country of New Zealand.

But one of the problems of making so much money is how difficult it is to keep growing at a high rate. It's much easier to grow quickly when you're small – as opposed to being one of the biggest businesses in the history of mankind. So it's particularly impressive that Apple's revenue grew 27% from the first quarter of last year, to the first quarter of this year. Over that same time period, New Zealand's GDP only grew 3.5%. Those New Zealanders are slacking; they must be drinking too much beer.

I want to take a step back for just a moment to truly admire what Apple has done from a pure greed standpoint. From an already unbelievably high level, they were able to increase their revenue by more than 50 billion dollars – in one year. That's more revenue than the GDP of Serbia!

I don't have any meaningful point to make about this. I just find the raw numbers behind Apple's kingdom to be pretty amazing. I also like talking about other countries. I have a knack for geography.

China's stock market is on fire

The Shanghai Index is up more than 120% in less than a year. At the same time, China's economy is at its slowest pace since 2009. That's not how things are supposed to work. Does that mean there's a bubble in Chinese stocks?

One of the hallmarks of a bubble is throngs of "normal people" jumping into the bubble. Remember all the people who quit their jobs in the late 90's to "day-trade" tech stocks? Or the people who began "flipping houses" before the Financial Crisis? Well, according to the Financial Times, Chinese investors opened 4.8 million new stock trading accounts in March and then another million more in early April. That means there are lots of brand new investors jumping into Chinese stocks.

Another hallmark of a bubble is that people lose track of healthy risk/reward trade-offs. One way to measure that is to track how many new "margin" accounts are opened. In a margin account, investors borrow money to invest, which amplifies their gains in a good market. But margin accounts can be particularly brutal in a bad market. In China, the number of margin accounts doubled over the last year.

So what's causing the bubble? For years, the most worrisome Chinese bubble was their real-estate bubble. The Chinese authorities were worried too. So they took steps to deflate the bubble. That seems to have worked so far, but now all the money that was flowing into real estate is flowing into the stock market. There just aren't many good places for Chinese investors to put their money. In that way, China mirrors the US, where ultra-low interest rates are forcing investors into stocks.

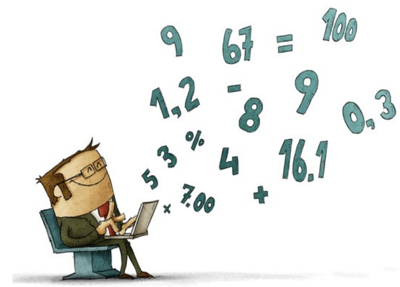
While it's clear to me there's a bubble, that doesn't mean it's about to pop anytime soon. I continue to believe that the Chinese leaders have plenty of ammunition to prop up their economy and stock market for a few more years. However, their job is getting more difficult. My official prediction is that China is going to go through some tough times in the next decade or so. But the crisis isn't here yet.

I'm not a "numbers guy"

Don't misunderstand me, I don't hate numbers. I enjoy kicking back with a cocktail and pondering the hypotenuse coefficient of Pi as much as the next guy. It's just not a very big part of my job. However, I do have a very cool calculator. I even knew how to use it back when I studied for my CFP® test. But I've only used it one time since then.

I just don't have the need. If I have an urge to calculate the internal rate of return of an investment, there's a program for that. If I want to know the P/E ratio for the S&P 500, I have approximately 432 different financial information sources ready to feed me that information.

I spend my time trying to make sense of the financial world, working with clients, and helping them exercise good judgement. Crunching numbers isn't a big part of the job.



The Goldilocks economy

My recent crystal ball theory was that the slowing economy would lead to more volatility in the markets, and we've seen that to a degree. But what if I am wrong?

What if this slowing economy is actually a good thing for the markets? If the markets are overly focused on interest rates and the Fed, this might be the perfect scenario. As long as our economic growth isn't too strong, there's no risk that interest rates will climb too quickly. This scenario has been called "The Goldilocks economy" by people who must like that idea more than me. I'd rather see growth. In a strong economy, interest rates need to go up. It's not such a terrible problem to have.

Blackburn Financial
Registered Investment Advisor