Financial Wanderings

August 2014

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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August Market Numbers:

S&P 500: +3.8% to 2,003

NASDAQ: +4.81% to 4,580

DJIA: +3.2% to 17,098

10-Year Treasury Yield: -8.91% to 2.35%

Gold: +0.4% to $1,284/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?

One humble man's wise interpretation of the key events of the past month. What happened, why did it matter and how did it impact the markets?

Last month, I took a courageous stand, and wrote this:

"Here's my bold prediction: We're going to have some good times in the coming months."

During August, the S&P 500 rose nearly 4% (its best August in 14 years) and crossed the 2,000 mark for the first time ever. I'm officially brilliant.

Here's the problem: My actual quote was neither bold, nor brilliant. Here's the entire paragraph:

"Here's my bold prediction: We're going to have some good times in the coming months. We're going to have some bad times in the coming months. We're also going to have some pretty boring times. In the end, I think we'll end up pretty close to where we are right now."

This whole "predicting the market" thing is pretty tough. Of course, I'll probably look brilliant again next month. I'm looking forward to that.

The Economy

All hail the ObamEconomy!

Yes, I only wrote that to get a rise out of my conservative friends – and because that picture is fabulous. But regardless of whatever credit Obama should or shouldn't get for it, the economy really is chugging along nicely. Remember last month, when the initial GDP report showed a 4% gain? At the time, I warned you that because of the wild

(Cont'd on Page 2)

(Why'd It Do...Cont'd from front page)

revisions these reports go through, you shouldn't get too excited about that strong number. Well, you can start getting excited – the 2nd revision showed an even better 4.2%. Of course, there's still a third revision…

Beyond GDP, consumer confidence rose to its highest level since 2007. 2007 was a decent year… Further, the "service sector" reached its highest level since late 2005 (the service sector is businesses that don't provide something "tangible." Think of hotels, restaurants and professionals – as opposed to Ford). That's a key part of the economy – and it's at the highest level since 2005. Remember 2005? Times were pretty good back then. Even better, fewer people lost their jobs over the last 4 weeks than any time since 2006 – and the economy was flying high in 2006. To top it off, factory orders reached their highest level ever. Do you remember "ever?" That was a long time ago.

Not only is the economy moving, but consumers have paid off lots of debt over the past few years. According to the Fed, the nation's household debt service ratio (basically debt vs income) dropped to 9.94%. That's a big drop from more than 13% back in 2007. That means a lot more people have a lot more money to spend on "stuff." It also means more people are now credit-worthy, which means they can borrow money to buy even more stuff. No, I'm not hoping Americans suddenly start racking up gigantic credit card debt again, but it's good news that more people are in the position to do so.

Amidst the barrage of strong economic news, there were a few disappointments. The best example was a somewhat weak retail sales report (sales were perfectly flat, which shouldn't be all that disappointing). However, the markets even put a positive spin on that: It was strong enough to show that consumers are still spending, but not strong enough for the Fed to quickly raise rates. That sounds like an okay story to me.

Allow me to summarize the last few paragraphs: **The economy is finally doing well**. I suggest we celebrate with a spontaneous exhibition of joy. Back by popular demand, it's time for the happy dance.

Employment

All this good news is getting wonderfully boring. But boring is still boring… So I'm going to go through it quickly. We added 209,000 jobs in July. That's after nearly 300,000 in June and 230,000 in May. The US economy has added more than 200,000 jobs for six consecutive months, which hasn't happened in more than 15 years. Not only that, they are high quality jobs (60% are above the average hourly wage), and more people are once again joining the workforce (the labor-force participation rate rose). Another good sign is that more of the "long-term unemployed" are finally finding jobs again (the percentage of long-term unemployed has dropped 0.5% in 2014). Not only that – the number of job openings reached the highest level in 13 years. More available jobs than at any time since 2001? That's a solid labor market.

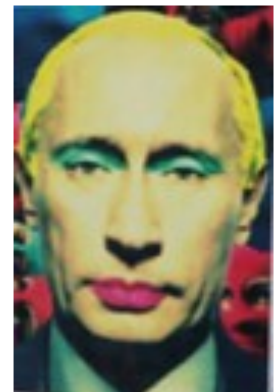
Corporate Earnings

Yes… This is good news too. According to Marketwatch, 77% of companies are beating their earnings expectations. The best part is the strong ***revenue*** growth of 4.4%. While earnings have been high in recent years, that's been mostly because companies have cut costs. Now, they are starting to actually bring in more money – that's a big deal. With any luck, those increased revenues will lead to more investment and hiring, which can keep this economy going.

Europe / Russia

It's been a long time since I've talked about Greece. I miss my friend… Unfortunately, I still have nothing interesting to say about Greece. But some Greece-like stuff happened in Portugal that I can tell you about: A bank went under, and the Central Bank of Portugal bailed it out with a cool $5 billion. You probably didn't hear about that did you? That's a good sign. A couple years ago, this would have been huge news. My conclusion is this: There's no more "crisis" in Europe. But just because the crisis is over doesn't mean wonderful things are coming. Europe has a weak, broken economy that is now on the front lines of an economic war with Russia.

Because of Russia's influence on the war in Ukraine, the West placed economic sanctions on Russia, which hurts Russia, but also Europe (where Russia is a major trading partner and energy provider). Of course, Russia responded with their own version of sanctions – which also hurts Europe. Europe doesn't need this. I wish Russia would behave. This is the perfect time for another unintentionally hilarious photo of Russian President Vladimir Putin.



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(Why'd It Do What it Did……..Cont'd from 2nd page)

Geopolitical stuff

Pick your favorite crisis: Ukraine, Iraq, Israel… There's been almost no reaction from the markets to any of them. Not only are stocks still reaching new highs, even typical "safe-haven" investments like gold aren't reacting – gold is down almost 7% since March. Even oil, which is relevant to each of these conflicts, hasn't reacted – oil is down almost 8% over the last 3 months. Why are the markets ignoring such scary, horrible things? The markets don't get emotional. Until there's a significant risk to the global economy, there probably won't be much impact. The only market action that can be linked to these conflicts is with US Government Bonds. As investors have flocked to the relative safety of our bonds, it has helped our rates stay low. In fact, in this way the problems across the globe may actually be helping our economy. As more money flows into America, it strengthens the dollar and keeps our interest rates low. That's what we call a silver lining.

So what should you make of all this?

For investors, these are the good times. The economy is legitimately growing – and it looks like it will continue. More people are getting jobs, businesses are making more money, real estate is still charging ahead, and we've had very little negative impact from the cesspools of the world. All this – and you are probably sitting on large gains in your portfolio. Every day I spend time considering what the coming months, years and decades might bring. That's my job to worry about. Your job is to sit back and enjoy this nice moment.

The Great(er) Depression

Back in the year 2000, I was a tiny speck among the hordes of new financial advisors hired during the tech bubble. Our job was to pitch financial stuff to adoring clients. Of course the tech bubble promptly popped, and those clients weren't so adoring any more… This was a perfect time for me to fall back on my training:

Buy and hold!!!! Make your clients hang on! It's ALWAYS the right thing to do! When the markets give you lemons, keep eating those lemons with gusto!

As it turns out, that was exactly the right advice, as the markets eventually recovered those losses – and investors who hung on were rewarded. The same story repeated itself during the financial crisis. Many stock investors lost 50% of their account value – and some of those people gave up on stocks. But those who hung on reaped the benefits of "buy and hold" once again. In fact, every single time the markets have tumbled, the best bet was to hang onto stocks for the long haul, and wait patiently for the recovery.

I'm here today to challenge that conventional wisdom: The stock market won't always go up, and it won't always recover quickly. One day, the best bet will be to bail out – and stay out – for a long time. The obvious argument for "buy-and-hold" is that the markets have always recovered, if given enough time. I think it's safe to assume that markets likely will continue to always recover. But what if it takes 40 years? My clients don't have that long.

What's the point of looking at the history of the market anyway? Is today's economy anything like the economy 40 years ago? Are today's markets anything like 20 years ago? From technology, to globalization, to regulations… everything has changed. Do you want to trust your hard-earned investments to stock market "rules" that were developed in economic times that are almost unrecognizable?

Even if you think the market performance from 50 years ago is somehow meaningful, if you think "big picture," it's a very small sample size. Over the next 500 years, don't you think we'll get "The Great(er) Depression?" All the studies show that buy-and-hold is the best strategy because it always has been. That will be true – until the time it's proven wrong. What if that time is during YOUR retirement? I don't think you should trust your retirement to a stock market rule based on the logic of: "*Well, ummmm… it hasn't happened yet*."

If "The Great(er) Depression" does come, and I can cushion the blow for my clients, I'll be worth my weight in gold. But that won't be an easy task. A year ago I was confident interest rates wouldn't fall… Wrong. Back in 2010, I was confident gold wouldn't keep going up… Wrong (although it has since fallen significantly, so maybe I get partial credit for that one). Of course, I've been correct on a lot of important things too, but predicting the markets & economy is a very tough game. However, I guarantee you won't avoid The Great(er) Depression with "buy-and-hold." At least I'm giving my clients a shot.

Besides hiring an amazing financial advisor, how can you plan for The Great(er) Depression if it hits during your lifetime? It's a simple answer (but simple doesn't mean easy): Aim for lots of savings and low expenses. That way, you don't have to be an aggressive investor in the first place. So, when The Great(er) Depression hits, your investments won't lose as much. Even better, you won't have a luxurious lifestyle to try to support.

Thankfully, my clients seem to appreciate this already. I don't have many clients taking out chunks of money for luxurious Mediterranean cruises or gold-plated, diamond encrusted cell-phones like mine.

I hope I'm wrong. I hope The Great(er) Depression never comes. But that doesn't seem like reality to me. We'll all be better investors if we take that to heart.

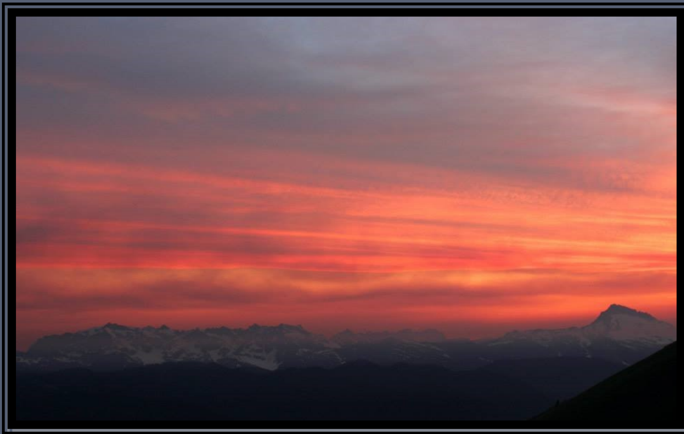
Hopefully maybe semi-interesting factoid of the month

These really are the good times. Not only have the markets gone up, and up, and up – it's been a remarkably smooth ride. According to BTN Research, from 2008-2011, the S&P 500 gained or lost at least 3% in a single trading day 85 times. That's more than 8% of trading days. However, from 1/01/12 through the end of August 2014, the S&P 500 has not gained or lost at least 3% ***in any single day***. That's a stretch of 669 consecutive trading days. These smooth-sailing days won't last forever – enjoy the ride.

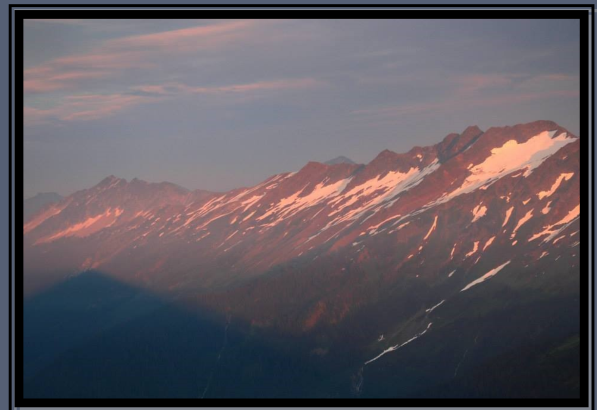
Probably a Mountain or a Lake

After being cooped up while an amazing thunderstorm rolled through my camp at White Pass (SW of Glacier Peak), I was excited to climb nearby White Mountain for some grand views. Unfortunately, the air behind the thunderstorm was full of smoke, and my views quickly turned into a smelly haze of disappointment. However, I was patient (not usually my strong suit), and while I sat on top of White Mountain, the smoke began to clear out just enough to make the sunset spectacular. There is nothing like a little smoke in the air to make amazing colors. It turned out to be a great night.

Looking up to the North Cascades.



Looking west to the Monte Christo Range & Sloan Peak (to the right).



Looking south to Indian Head Peak – note the shadow of White Mountain, the peak I was standing on.

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