Financial Wanderings

September 2016

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

September Market Numbers:

S&P 500: -0.1% to 2,168

NASDAQ: +1.7% to 5,312

DJIA: -0.8% to 18,308

10-Year Treasury Yield: +1.2% to 1.60%

Gold: 0% to $1,317/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.

Can consumers keep consuming?

Although American consumers aren't incredibly strong, they are still propping up the U.S. economy. Although the U.S. economy isn't incredibly strong, it's still propping up the global economy. That's a lot of weight riding on the backs of American consumers. How long can they keep it up?

I'm bringing this up because retail sales recently declined for the first time in 5 months. The first thing to realize is that 5 out of the last 6 months, we've had positive retail sales, which is a very good sign. However, a drop is still a drop, and consumer spending also recently dropped for the first time in 7 months.

This highlights my major concern about the economy: What if American consumers slow down? Unfortunately, I worry that 2 of the major trends that led to strong consumers aren't likely to last: Lots of jobs, and the strong real estate market.

Jobs

When people have jobs, they tend to spend more.

We've been averaging nearly 200K jobs added per month for almost 4 years. But the job market is slowing down too. After averaging 230,000

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jobs per month in 2015, we've only averaged 180,000 so far in 2016 (to be fair, that's still pretty good).

The unemployment rate is already below 5%, and there are a record number of job openings. We've been adding so many jobs for so many years, it's almost as if we've run out of workers, especially for higher paying jobs. Given that reality, it's hard to imagine the job market continuing to be as strong as it's been.

Real Estate

I have similar concerns with real estate, which is also directly related to consumer spending. When home prices rise, and homes are selling like hotcakes, it gives people confidence to spend more. That idea is often referred to as the wealth effect.

But skyrocketing home prices can't continue either. Home prices have been rising much faster than incomes, which almost by definition means it's not sustainable. But my bigger worry about real estate is the direction of interest rates. For years, mortgage rates have fallen; and every bit that mortgage rates fall makes buying a home more affordable.

But the opposite is also true. If rates start to rise, even just back to where they were a year ago, homes will be less affordable. That can't help but slow down rising home prices.

So, even with impressive job growth, a strong real estate market, and strong consumer spending – our economy is barely growing. I'm concerned what could happen if the strongest parts of our economy become a little less strong. That scenario seems entirely possible to me.

All eyes on the Fed

The biggest financial news of the month, which was the biggest financial news of the year, and the biggest financial news of the last half decade – was the Fed. Perhaps I'm being overly dramatic about it, but I'm tired of the market's complete fascination with anything remotely associated with the Fed.

Here's the big news: The Fed didn't raise interest rates. Predictably, the markets celebrated. *"Uncle Fed will make it all better!"* But I worry that the Fed is losing its credibility, and I'm not the only one. At the end of last year, the Fed predicted they would raise rates four times this year. But here we are at the end of September – and they've done nothing.

Naturally, inquiring minds start to wonder: Why aren't they raising rates? What changed their mind? While the economy isn't strong, it's not much weaker than it was last year when they predicted four rate increases. So, are they scared? Or lazy? Or maybe just paralyzed? Or perhaps this is all a political conspiracy, as Donald Trump has claimed?

(Cont'd on Page 3)

(All eyes on the Fed.....Cont'd from page 2)

It's no conspiracy, but there's a growing sense in the financial world that the Fed is scared of the markets. The theory goes that after the steep stock market drop earlier this year (the worst start to a year ever), the Fed was too spooked by the markets to raise rates.

But here's the problem: The Fed isn't supposed to pay attention to the irrational short-term swings of the stock market. Their obligation is to soberly watch the long-term trend of employment and inflation – neither of which justify our ridiculously low interest rates.

So, there's a perception that the markets are controlling things – and the Fed is just along for the ride. Of course, the Fed has heard these criticisms, and knows their credibility is at stake, in much the same way as when a parent gives in to a temper tantrum. For that reason, in the coming months, I think there's a chance that the Fed will surprise the markets – simply for the sake of surprising the markets.

Of course, by not raising rates in September, the Fed did the exact opposite of that. So maybe I'm completely wrong. Maybe the Fed will keep tiptoeing around the markets for much longer than I expect. But this situation can't last forever.

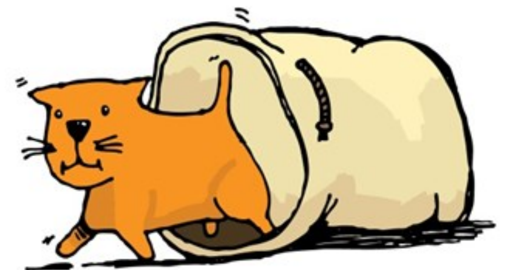
Don't forget about Europe

Sometimes, in a quiet moment, I dream of what our recovery from the Financial Crisis would have looked like if the rest of the world wasn't such a basket case. Even the tiniest bit of help from other major economies of the world would have really helped.

Europe has been particularly disappointing. In just the last few years, they've had the PIIGS crisis, a Greek drama, a very weak economy, Brexit, and banking problems that are continuing to this day with Deutsche Bank. Individually, most of the European economies are modest. However, as a whole, Europe has arguably the biggest economy in the world (along with America and China). So Europe really matters to the global economy.

As much as I'd like to bet on a European recovery, if only because they are due for a turnaround, it's just so hard to imagine how that's going to happen anytime soon. Brexit, over the long-term, could be a major domino in pulling apart the EU. So far, Brexit hasn't proved to be any big deal. The markets have recovered, and while Britain's economy took a small hit, it hasn't been the end of the world. That might encourage other European countries reason to consider leaving the EU themselves.

Recently, at a conference of EU leaders, Italian Prime Minister Matteo Renzi threatened that the European Union would become a "ghost." In other words, he's threatening that if he didn't get his way, the EU would break up. So, the idea of leaving the EU is a legit idea now. Greece cracked that window open, and Brexit cracked it a lot wider. Now it's a real thing.



If Europe can't figure out a way to really get their economy going, some European politician is going

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(Don't forget about Europe.....Cont'd from page 3)

to run for office on a platform of leaving the EU – and win. There are small movements like this already all over Europe. Now that we have threats being tossed around like it's nothing, it's probably just a matter of time until there's another legitimate threat to break up the EU. The markets probably won't like that.

Probably a Mountain or a Lake

I made it up to Lake Ida recently.

You gotta love the mountains in Fall.

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