Financial Wanderings

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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November Market Numbers:

S&P 500: +2.48% to 2,068

NASDAQ: +3.48% to 4,792

DJIA: +2.51% to 17,828

10-Year Treasury Yield:

-7.23% to 2.18%

Gold: +0.34% to $1,176/oz

How Good is the Economy, Really?

I hear variations on this phrase often: *Brad, I don't care how good the stock market is doing, the economy is still weak*. When I hear that, I usually pretend to agree completely, because I'm far too much of a wuss to challenge someone face-to-face. However, in the comfort of my office, I can be a little more brave. So here's my official reply: *You're wrong. The economy is not weak anymore.*

Don't get me wrong; there's no boom, and I don't think one is coming. There are plenty of weak spots, and lots of room for improvement. However, if you take a broad view of the economy, you'll find it's growing solidly. Unfortunately, I believe much of the negative sentiment I hear comes from politics: "*The economy can't possibly be solid because we have a Communist as a President*." Arguing against that puts me in a tough spot; I don't want to be the guy defending *THE GUY*. It's a strange world we live in when saying "the economy is solid" means I love Obama. But I'm going to stick my neck out on this one by addressing the best arguments that the economy is still weak:

The Job Market isn't nearly as strong as it seems: While the economy has added millions of jobs in recent years, and the unemployment rate is back below 6% (5.8%), those numbers clearly overstate how strong our employment situation is. Here are the major problems: There are still far too many people who have left the workforce completely or are "underemployed," which means they aren't working as many hours as they'd prefer, or aren't using their full talents. The "U6 rate", which includes those people, is still at 11.5%. That doesn't sound nearly as good as 5.8%, does it? Further, many of the millions of jobs added in recent years have been low paying or part-time. Finally, there's been very little growth in wages, which means employees still have very little bargaining power – employers are still firmly in control of the job market.

Here's my response: Those are all very good points, and let me just point out that no economist or analyst I read or hear ignores those things. If you're a consistent reader of mine, you know I've pointed these things out many times.

Just like the economy as a whole, there is no boom in the job market – but there is absolutely Improvement. The 11.5% U6 rate I mentioned above is still too high. But one year ago it was 13.7%. That's a huge drop. It's also true that since the Great Recession, many of the jobs added have

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been low quality, but that is changing. According to the BLS (who puts out the government monthly jobs report), over the last year, nearly 60% of the jobs added have been above the average wage of $24/hour. Those aren't low quality jobs.

The one place we haven't seen improvement is in the last point: Wage growth. This is a real problem, and it doesn't seem to be changing anytime soon. But the job market as a whole is strong: We've seen 49 consecutive months of job gains. According to Forbes, that's the longest stretch since the 1930's. Further, this is the longest stretch of 200,000 or more jobs added a month since 1995. To top it off, there are more job openings right now than at any time since 2001. You can nitpick all you want – but that is progress.

Businesses still aren't spending: Yes, corporations are making boatloads of cash, more than at any time in the history of the world. But they aren't reinvesting that money in a way that will help the economy – they're just sitting on it.

Here's my response: This has absolutely been true, and there's no doubt it has hurt our recovery. But once again, things are changing. The recent strong GDP report showed business investment in new equipment rose at a 10.7% annualized rate in the third quarter. That follows a 9.7% gain in the 2^{nd} quarter. Those are big numbers.

Small business conditions are still weak: Maybe big multi-national corporations are doing well, but small businesses are still hurting.

Here's my response: It's hard to argue much here. Just about every report for small business shows conditions are still weak. However, the improvement we're seeing across the rest of the economy ought to put more money in the pockets of consumers, which should work its way into the cash registers on Main Street. One point I'll make is that small businesses are adding jobs at a strong clip. According to the ADP Jobs report (a private report that rivals the BLS report), nearly 40% of the jobs added in 2014 were added by small businesses. That's a good sign.

The middle class is still struggling: Maybe big multi-national corporations are making huge amounts of money, but the middle class is still weak.

Here's my response: Once again, it's hard to argue with this. The first few years of our economic "recovery" from the Great Recession pretty much benefited only huge companies and financial institutions (and their investors). For a truly sustainable recovery, it needs to flow to the middle class. Fortunately, we're making progress on that too. Retail sales, consumer spending, and consumer confidence are all improving and are at levels last seen before the crisis.

So what should you make of all this?

I began to get more optimistic about the economy in early 2013. But, I was a year early. In 2014, we've seen legitimate, broad improvement in the economy. If you want to deny that, I don't think you're honestly looking at the big picture. Our GDP grew 4.6% in the 2^{nd} quarter and 3.9% in the 3^{rd} quarter. While GDP isn't a perfect measurement, that's the best six-month period we've had since 2003.

Imagine where we'd be if Europe, Japan and China were doing well. Imagine where we'd be if the Sequester hadn't happened (it may help us over the long-term, but it certainly hurts over the short-term). Imagine where we'd be if our government had done anything to help the economy in recent years rather than torpedo it? The world is actively conspiring to make life hard on our economy – and yet it's growing.

Let me be very clear: I'm not giving credit to Obama. The credit goes to the resilience of the American people, and our businesses culture of efficiency, creativity, hard work, and risk-taking. Go America!

A Rare Moment of Political Candor

As the editor and chief writer of a major publication, I have a moral obligation to make the world a better place by bringing hard-hitting, insightful opinions to the world. Unfortunately, I may not have been doing my part. After I took a few political cheap shots in last month's newsletter, I received a number of comments about my amazing ability to "play both sides" while hiding my true feelings. However, I think my opinion is pretty clear. Let's take my comments from last month:

Here's what I wrote about oil:

With the mid-term elections upon us, Obama is once again making oil prices fall. You have to admit, he's pretty shrewd. Thankfully, he's also rigged the stock market to rise throughout his entire presidency, so he can't be all that bad (I'm just kidding Conservatives, I think every single thing he does is evil and Communist) (I'm just kidding Liberals, the only problem with him is he isn't liberal enough).

Here's what I'm saying:

It's silly that people actually believe Obama could, or has, manipulated the price of oil for political gains. I'm also poking fun at how sensitive and extreme both sides can be.

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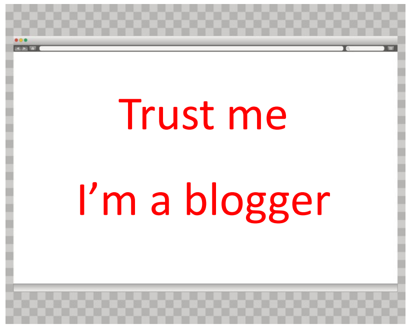
Here was my other political "joke," this time regarding America vs. China:

In October, the Fed announced the end of their third round of Quantitative Easing (QE), also known as "we're desperate to do something to help the economy because Congress is so hopelessly broken that China's governing system is starting to look kind of appealing."

Here's what I'm saying: We are in a battle – is democracy the best system, or is there a better way? Here in America, the truth is self-evident. But if you look around the world, they aren't nearly as convinced. If China can remedy their human rights abuses and corruption (neither will be easy), they'll have a strong case. Their case will be even stronger if American Democracy continues to flounder as it has in recent years. Here's a list of our recent accomplishments: The fiscal cliff, the sequester, the government shut-down, the debt limit debates, a credit-downgrade, and legislative paralysis broken up by periods of terrible legislation.

It's easy to blame our politicians – and they certainly deserve blame. But we have to do better as voters. Unfortunately, being an informed voter has become much more difficult. Twenty years ago, our news primarily came from highly professional journalists. Now, anyone with a blog, website, Twitter feed, or financial newsletter can seem credible.



I can't tell you how many times I've received emails, or have seen posts on social media that aren't just wrong – they are obvious, blatant, outright lies. And yet, they were passed along by some of the smartest, most successful people I know. If even the smartest among us are so blinded by bias that they can't see through the outright lies, what hope do we have when faced with more subtle forms of deception? With the complexity of the issues out there, it's very easy to twist the "facts" to make very compelling arguments that are completely wrong. Whether it's email, blogs, Facebook or Twitter, there's a lot of terrible information out there. This is a huge threat to our democracy.

There's no easy answer to this, and everyone will get fooled on occasion. But I do have a recommendation: We have to stop treating our political world like we treat sports. **We must stop being "fans."** A fan overly emphasizes their team's positives and ignores the strengths on the other side. A fan doesn't question what their team does, but reflexively challenges every single thing the other side does. It's great to be an irrational fan when it comes to sports; sports aren't important. But it's not okay to be irrational when it comes to our democracy. The future of mankind is at stake, and I don't want China to win.

Unfortunately, humans are naturally tribal. Nothing gets people excited quite like: "It's us against them." That works beautifully in sports, but we have to fight that instinct with politics. Instead of being a fan, we need to be critics – and not just of the people we don't agree with. Your side is lying and twisting the truth just as much as the other side.

What Am I Not Thinking of?

Recently, a handsome, distinguished, successful client asked me the following question: *"Brad? What's out there that we are missing? What should we be worried about that no one expects?"* Of course, I promptly listed off several insightful points that left this gentleman in complete awe of my powerful intellect.

Okay… What ***actually*** happened is that I mumbled something incoherent and then acted like my phone was cutting out. In my defense, it's a tough question: But it's a good exercise to go through. So… without further ado, here is my list of "*The Scary Things We Are All Too Dumb to Be Paying Attention To*:"

Stocks are overvalued because corporate earnings are artificially high: If you look at the price of stocks relative to earnings of companies (which is the standard P/E ratio), stocks seem to be at reasonable prices. However, what if earnings are artificially high because of the Fed's QE (Quantitative Easing) program? The Fed has been pouring cash into our economy over the last few years. Since QE has now ended, there's a risk that corporate earnings will fall – which would really hurt stocks.

Just to clarify, I believe QE hurt our economy more than it helped (by convincing consumers and businesses that we were still in a crisis, and by worrying the markets about what would happen when QE ended). If that's true, taking QE away shouldn't hurt too much. But I've been wrong before…

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Those crazy central bankers: Clearly, I'm not a fan of QE. There are just too many potential unknowns that come from dumping billions of dollars into the bond market and economy. However, the Fed seems to have navigated the minefields pretty well so far... That "success" has convinced central bankers all over the world to enact their own versions of QE. That brings the very real risk of a huge screw-up.

Those crazy bankers: There's no doubt we've learned some lessons from the financial crisis. But our financial institutions are still heavily leveraged (meaning they have lots of debt), wildly complex, and lack the transparency for even experts to truly understand what's happening within them. All this – and they are still "too big to fail." The best argument for just leaving them alone is that the more we handcuff our financial institutions, the less they'll be able to compete with other institutions across the globe. That's a legitimate concern, but the fact remains – there's a lot of risk in our financial world.

Oil drops too far which destabilizes Russia and the Middle East even more: Many of the OPEC countries make boatloads of money from oil, but have very few other sources of income. The same is true of Russia (to a lesser degree). Big money has a way of keeping things calm. However, if oil prices stay low, those countries might not have enough money to pacify their people. That could lead to even more unrest across the globe.

Israel bombs Iran: With all the other drama in the Middle East, it seems the nuclear ambitions of Iran have taken a back seat. Just a couple years ago, it seemed likely that unless Iran backed down, Israel would bomb their nuclear facilities. Well Iran hasn't exactly backed down. In fact, they still seem to be stalling. If Israeli (or American) bombs start falling on Iran, the markets won't like it.

China vs. Japan:

China has been bullying its neighbors more and more in recent years. There are ongoing squabbles over who controls several small islands, and vast spaces of open ocean. No one wants an escalation; but when tensions are high, small miscalculations can turn into something bigger. A blow-up between China and Japan would be devastating to the global economy.

Something that knocks out our electronic infrastructure: I'm not a scientist and I have very few technologically savvy bones in my body. But every time I hear about solar flares or cyber warfare, I get a little spooked. That's because we are so deeply dependent on technology in today's world. Yes, this does feel a little bit like the Y2K bug, which turned out to be nothing (Or… did it turn out to be nothing because we freaked out and prepared for it?). But this article isn't about the obvious stuff. The threat may be small, but it's real.

So what can you do about any of this? The first step is to hire a financial advisor who is smart enough to consider considering the things he hasn't considered. Unfortunately, even for someone as brilliant as that, these are difficult issues to plan for. I aim to help my clients navigate all the risks we face; but that's an impossible job. The best thing you can do is be well diversified, and not take more risk than you need to.

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