Financial Wanderings

September 2014

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: -1.6% to 1,972

NASDAQ: -1.90% to 4,493

DJIA: -0.30% to 17,042.90

10-Year Treasury Yield:

+7.23% to 2.52%

Gold: -5.5% to $1,212/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.

Brad's SuperFive - The five big things you should hope I'm paying attention to.

Back in July, the S&P 500 was down 1.5%. In August, it gained 3.8%. In September, it was down 1.6%. Over those three months, the S&P 500 gained a grand total of 0.6%... Welcome to the most boring roller coaster ever. This is exactly the kind of market I've been expecting for more than a year, and I think it's going to continue.

There's not very much new information to report. So this is the perfect time to break out a new gimmick: Without further ado, I'd like to introduce "*Brad's SuperFive" – The five big things you should hope I'm paying attention to.*

1. The economy is strong – but not TOO strong.

Here's what the markets desire more than anything else: The best possible economic news that is still bad enough that the Fed won't raise rates too quickly. So far, that's exactly what we're getting. The strongest piece of news was our 2nd quarter GDP, which rose a whopping 4.6%. That matches the best quarter we've had since the financial crisis. Luckily, we had some weak news on jobs to offset that good news. In August, our economy only added 142,000 jobs. After months of 200,000+ jobs added, this was a disappointment – but disappointment in this case was actually a good thing. Across the board, the economy seems to be perfectly "kinda strong." I'll take that for now.

2. The rest of the world is struggling

All I'm asking is for one other place in the world to be solidly improving economically. If the rest of the globe was on semi-decent economic footing, the situation would be so much better here in America. But that's not happening. Europe? Not even close… Japan? Their GDP just dropped the most in five years. China is still the best "NAEGERWCFO" (Non-American Economic Growth Engine the Rest of the World Can Feed Off). But China is slowing down significantly, and is dealing with unrest in Hong Kong, which is vitally important to China's economic stability.

American corporations aren't really "American corporations" anymore. According to S&P, nearly 50% of the profits from companies in the S&P 500 don't come from America. That means a better economy in South America creates jobs here in America. More money in the hands of consumers in Asia raises stock prices here in America. We simply can't have an economic boom here in America with the rest of the world languishing.

(Cont'd on Page 2)

3. Business investment is finally increasing.

If there's one promising thing to hang our collective hats on, this is it. Businesses are making A LOT of money. According to S&P, the stocks in the S&P 500 are making 2/3rds more than they did in 2007 – BEFORE the financial crisis hit. In other words, businesses have not only recovered from the financial crisis – they've exploded past it. So far, all that wonderful money hasn't been put to work very productively. But here's the good part: Businesses are finally starting to invest that money in actual things (rather than paying out dividends and buying back their own stock).

Remember the strong GDP report? A very important part of that strong report was an almost 10% increase in "capital expenditures." That means businesses are buying equipment, machines, computers, software and all kinds of other good stuff. These are the kind of investments that create even more jobs, more wealth, and a truly sustainable economy. Why are businesses finally investing? The economy is broadly improving, and they anticipate more demand from consumers with open wallets. I hope this trend continues.

***Please see my related political rant "who are the real job creators" on the last page*.

4. Interest rates are absolutely going to rise

Do you like how I act like this is a sure thing? I was just as sure a year ago, and rates have fallen since then.

Predicting the markets is hard. I'm not going to get everything right. But just imagine how hard it would be for someone who lacks my wisdom, expertise and speling abilitty.

Perhaps it's not actually a sure thing, but the Fed's own words indicate they expect to begin raising rates next year (to this point, all they've done is slowly wind down their QE program). In theory, rising rates will slow the economy, which is what spooks the markets. As long as rates slowly rise, I won't be too concerned. However, there is a small but real potential for a "crisis." If the Fed loses control of inflation and/or interest rates, it could get ugly.

Here's what this comes down to: The Fed is trying to balance economic growth (which means keeping rates low), and combating inflation (which means raising rates). I believe it is absolutely clear that the Fed is going to err on the side of economic growth, which means the Fed won't be raising rates very quickly. They are confident they can control an overheated economy and the inflation that could come with it. I have my doubts about that. But given everything else going on in the world, the chance of an overheated economy seems pretty low.

5. Stocks have seen their best days

I said this at the start of this year and I still believe it fully: The easy money has been made. The amazing growth we've seen in stocks since the financial crisis (the S&P 500 is up more than 190% since March 2009) was forecasting exactly where we are now – back to a solid economy. Stocks won't keep going up unless they are anticipating something even better – and given all the things I've written about above, I don't think that's going to happen. The coming months and years are likely to be filled with plenty of ups, downs and sideways – but probably not any historic gains or losses.

So what should you make of all this?

Strategists at Morgan Stanley recently predicted this bull market could run for another five years and bring the S&P 500 up another 50%. I know those people are the "experts," But I'm not convinced (though I hope I'm wrong). I'll be pleased if we are up half that over the next five years. If I'm right, the best investments will be the kind that can eke out gains even in a weak market. That means investments that pay out income, or are flexible enough to take advantage of the roller coaster ride. I've been trying to focus my clients on those types of investments since the beginning of the year.

Extra Special Bonus Picture

The things that keep me up at night

This article originally ran exactly two years ago. I chose to run it again because it offers an interesting dose of perspective, and because I'm ~~lazy~~ busy and it was already written. It's also fun to look back at my predictions and laugh at myself/pat myself on the back. I couldn't resist adding current commentary. Those comments are in red.

September 2012: While I'm relatively optimistic about the coming years, repeating the same opinion over and over is not only dreadfully boring, it's not all that helpful. So, I thought it would be a good exercise to talk through some of the biggest, scariest hurdles our economy will have to leap if we are going to get back to something that could properly be called prosperity.

Here are the things that keep me up at night:

With the benefit of hindsight, being "relatively optimistic" two years ago sounds pretty smart. But I'm not going to make a big deal out of it.

Europe: Even in the best-case scenario, Europe is still stuck paying back trillions of dollars in debt for many years into the future. That kind of thing can be a pretty fierce headwind against economic growth. According to Standard and Poor's, nearly 30% of the revenues for the S&P 500 come from Europe. Therefore, pain in Europe equals pain in America.

How about that? We got the best-case scenario. There was no disaster, but Europe's economy is still incredibly weak. There's no doubt Europe's slow recovery has hurt the economy in America.

Interest rates: Do you remember the good old days, when savings accounts, CD's and money market accounts actually paid interest? That was before the Fed decided to force everyone to choose between zero interest rates or investing in risky assets.

While the Fed has announced their commitment to keeping interest rates low at least into mid-2015, it should be noted that they don't have complete control over interest rates. That's especially true for mid-term and long-term rates. However, even if the Fed is successful, it will only postpone the day of reckoning. Rates are going to rise at some point. If they rise gradually, we're only looking at a gentle headwind against economic growth. However, if rates rise sharply, it could be the start of our next crisis.

It's been two years… Rates haven't risen at all. I look dumb. Let's move on.

Paying off debt: The amazing economic boom from the 1980's until 2007 was fueled in a large part by rapidly increasing amounts of debt. According to the Federal Reserve, total US debt, which includes consumer, business and government debt, grew from just over one trillion dollars in 1968 to more than fifty trillion in 2010. Looked at as a percentage of GDP, we've nearly tripled our level of debt.

For years and years, all that beautiful money was poured into the economy, and it helped our economy grow by leaps and bounds. The problem is that it now needs to be paid back. Unfortunately, a dollar spent paying down debt is a dollar that won't be spent on new cars, houses or investments.

Phew… I look smart again. Americans have paid off lots of debt (though plenty still remains), and there's no doubt that impacted the economy over the last two years. But our consumers are stronger, and that's better for the long-term.

Inflation: The Fed has basically announced that they are focusing first, second and third on spurring economic growth, at the expense of controlling future inflation. If their aggressive actions cause inflation to pick up in the future, it'll be no big deal; they'll simply deal with it then. Since the Fed has boldly led us into robust economic growth and low unemployment, I think we can trust them to handle a little bit of inflation when it crops up.
The two previous sentences were brought to you by the evils of sarcasm.

Yes, when I read this recently, I laughed at my own joke.

Obama: My most staunchly conservative friends have assured me that if Obama is re-elected, he will nationalize all of our major businesses and industries and appoint himself dictator. As there's no historical precedent for this, it's difficult to determine exactly how the markets would react to such events. However, I think it's safe to say it would hurt a little.

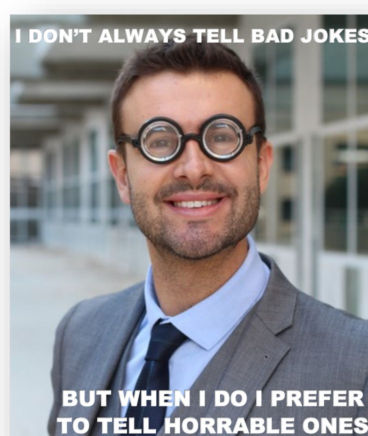
I'm scared to say anything.

China: China's future is both vitally important to the global economy and incredibly difficult to predict. Perhaps the most basic question is whether or not we can actually believe any economic numbers they give us. Even if you are trusting enough to take their numbers at face value, you can see why there is cause for concern. The Chinese economy, while still growing at a rate worthy of extreme jealousy, is slowing quickly. If the Chinese leadership can't steer their economy to a soft landing, the global economy will suffer.

China is still doing fine. Phew…

Aliens: This is where it gets tricky for me as a financial advisor. It's difficult to know exactly how to invest for the arrival of aliens. If they are violent creatures, a profitable bet would be weapons manufacturers. However, if they are friendly, a smart investor should consider technology. Just think of how cool the next iPhone could be with the cutting edge technologies from millions of light years away. Either way, I think it's reasonable to expect a rough ride in the stock market when the aliens make first contact.

I have nothing to add. The "aliens" thing seems kinda dumb to me now.



(Cont'd on Page 4)

(Things that keep me up at night...Cont'd from 3rd page)

Demographics: The baby boomers are retiring. That means a smaller ratio of people will be working and producing. That alone will cause significant economic impact. Further, those boomers will be selling billions of dollars in stocks to create their retirement income. Remember what happens to the price of something when massive amounts of people are all selling it (hint: the price goes down)? To top it all off, the aging of the baby boomers means ceding the fortunes of our fine country to flakey "gen-x'ers" like me. Admit it, now you're really scared.

Geopolitical Concerns: Yes, this was really just an excuse to use the impressive term "geopolitical."

If World War III is going to start in the next 10 years, my vote is for the Israel – Iran conflict to start it. But a creative pessimist could come up with many more points of potential danger. China is clearly a world power, and an unpredictable one at that. Europe, with all its troubles, could disintegrate into something worse than the great depression. Pakistan is a mess, and has nuclear weapons. Russia may be the scariest and most unpredictable of them all. To top it off, I read on the internet that the penguins of Antarctica are mobilizing with the Communist pigeons of San Juan Capistrano. That can't be good.

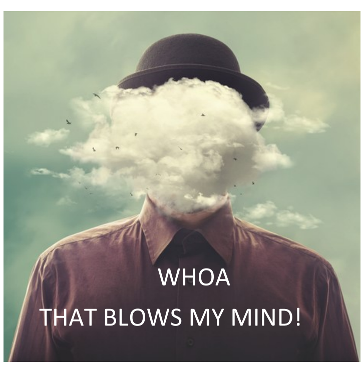
YOU HEARD THAT RIGHT! Two years ago I actually wrote: Russia may be the scariest and most unpredictable of them all.
Yes, this whole article was an excuse to brag about that one.

Who are the real Job Creators?

If there is one catch-phrase that embodies everything that's wrong with our political environment, it's "job-creators." The problem isn't that we are asking the question; clearly we need more jobs. However, job creation doesn't have the clear-cut answer many would have you believe.

You have to give credit to the Republicans for their impressive consistency. Given the slightest opportunity to label business owners as "job-creators," they've knocked it out of the park every time. Clearly, there's merit to that label. Businesses, as they become more profitable, tend to add jobs. Republicans use that logic to argue that we ought to make things as easy as possible on businesses. After all, any dollar not spent on taxes or dealing with regulatory red tape is a dollar that could be spent on hiring or investing. That absolutely makes sense to me. But is that the only answer?

Even with zero regulations and rock-bottom taxes, if there is no one to buy its products, a business isn't going to create many jobs. That's where the liberal side of the argument kicks in. Although the Democrats haven't done nearly the branding job that Republicans have, consumers are "job-creators" too. Even a highly profitable business won't create more jobs unless it expects increasing demand from consumers.
The obvious conclusion is this: Businesses AND consumers are BOTH job creators!



Probably a Mountain or a Lake

This is a photo of an amazing sunset from Cashmere on September 10th.

Let me first answer the obvious questions: Yes, this is real. No, I didn't Photoshop it – not even a teeny tiny little bit. It ***actually*** looked like this.

Allow me to explain how this happens: The refraction within the light wavelengths at this longitudinal latitude allows density build-up beyond the regressive mean of the humidity in the viscous air, thusly producing this amazing phenomenon.

Blackburn Financial
Registered Investment Advisor

If you would like to receive this newsletter via email, please email me at brad@blackburnfinancial.net.