Financial Wanderings

September 2015

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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September Market Numbers:

S&P 500: -2.6% to -1,920

NASDAQ: -3.28% to 4,620

DJIA: -1.5% to 16,285

10-Year Treasury Yield:

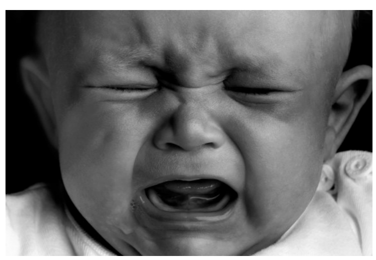
-8.14% to 2.06%

Gold: -1.5% to $1,115/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?

It's been a rough couple months… Since its all-time high in July, the S&P 500 has fallen more than 10%. On the year, it's down nearly 7%, which pushes the S&P 500 all the way back to where it was in May 2014. That hurts.



However, I was able to gain a little bit of perspective by reading a prediction from my favorite financial newsletter writer guy. Here's what I wrote regarding the future of the markets when the S&P 500 was at this same level in May 2014:

Just because the markets aren't likely to keep going straight up doesn't mean we're headed for a crash. Can't the markets level off and take a break for a while? That doesn't sound so bad. We'll enjoy some good times, and maybe a couple healthy panics (over Iraq, or Ukraine, or China, or oil prices, or who knows what…). But my crystal ball doesn't see a boom or bust in the near future.

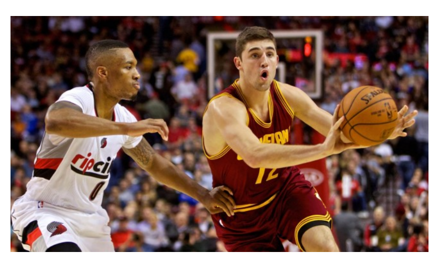
Not only does that look like a brilliant forecast, but from that perspective, the recent drop we've experienced is merely a part of the natural ups and downs in the markets. This is the "correction" everyone has been expecting for years. In other words, it's probably not the end of the world.

As soothing as that is, I do have legitimate worries. The most troubling thing to me is that the global economy is standing on one strong leg – and it's America. Thankfully, it's a big leg, and our economy is holding steady.

<u>The economy</u>

The economy has slowed down since last year. But that's really not a fair comparison. If economic years were basketball players, 2014 would be Lebron James. 2015 hasn't been THAT good, but we're doing just fine.

2015 = Chelan native Joe Harris



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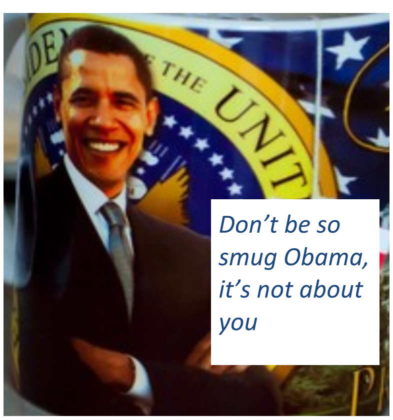
Employment continues to be strong. The unemployment rate dropped again to 5.1%. That's an impressive number, but as I've discussed many times, the unemployment rate is a very flawed statistic. So let's look at employment in a couple different ways: According to Marketwatch, there were more job openings in July than at any time in history. In addition to that, the number of people filing for unemployment has fallen to lows we haven't seen in nearly 20 years (back to the height of the dotcom bubble). That means very few people are losing their jobs, and those that do have a historically high number of job openings to choose from (whether they have the skills to fill those jobs is a different question).

In addition to employment, GDP continues to be solid. In the 2nd quarter, our GDP grew at 3.7%. In fact, our GDP has been solid for years. According to the conference board, if you exclude government spending from the normal GDP equation (because of the Sequester, government spending has fallen, which has a negative impact on GDP), our GDP has averaged 3% since 2010. That's nearly six years of solid private-sector growth.



I truly hope it continues. As we've just seen in the stock market, nothing goes up in a straight line. At some point, our economy will endure another downturn. In a global economy that's already shaky, that could be a very big problem.

__The Fed__

The markets still can't keep their eyes off the Fed. I'm not completely sure whether the Fed is paralyzed or

brilliant, although I'm leaning towards paralyzed.
For my conflicting thoughts on the topic, please check out the other columns in this newsletter.

__China__

What if our worst fears about China are overblown? What if China has this thing under control? Since the Chinese stock market hit its low in late August, the Shanghai Index has calmed down significantly, and has actually gained nearly 4%.

Maybe we shouldn't celebrate yet, because the economic news out of China continues to be weak. For example, according to Marketwatch, China's industrial profits are down nearly 9% from a year ago, manufacturing has fallen to levels not seen since the financial crisis, and exports have fallen significantly – and this is just the bad news from August.

Although China's economic news continues to be weak, things do seem to be calming down. Everyone expects China to slow down; it's a crash the world is worried about. If China can hold steady in the coming months, I think the markets will celebrate.

__So what should you make of all this?__

This is a spooky time to be an investor. The American economy is about the only solid thing in the world right now. But let's look at it another way: The American economy is the only solid thing in the world right now!

Perhaps America is strong enough to pull the rest of the globe out of its doldrums, or at least hold on long enough for the world to recover. If that happens, the world will rejoice and shower America with the love and adoration we deserve; and peace and happiness will flow around the world. That will be nice.

Maybe the Fed is smart

I've been ticked off at the Fed for years because they kept stomping on the gas pedal even though we were clearly beyond the "crisis." Although my arguments were brilliant and compelling, there's still a chance they were wrong. What if I focused too much on one goal of the Fed, while ignoring a different goal? What if there really is a crisis – and the Fed is fighting it heroically?

The Fed has two basic objectives: Full employment and stable inflation. From the standpoint of full employment, the Fed should have laid off the gas pedal years ago. However, from the standpoint of inflation, there may be a real problem. Even though the Fed has been doing cartwheels and somersaults to spur on our economy, we're not even at 2% inflation (the CPI is up 1.8% over the last 12 months). That probably sounds like a good thing to you, but most economists think a moderate level of inflation is a good thing. Inflation tends to encourage spending and investment. After all, if your money is worth less every day, you might as well spend it today. It also helps lessen the impact of debt, because borrowers end up paying back their debt with less valuable dollars.

However, the Fed striving to increase inflation has much less to do with how glorious inflation is, and much more to do with fighting off the opposite of inflation: Deflation. With deflation, as cash sits in your wallet, it becomes more valuable. That doesn't sound so terrible, but here's the problem: That encourages people to keep money in their wallets, which hurts the economy. Deflation can become a vicious cycle: As more people cling tightly to their cash, demand drops further, which causes more deflation, which causes more people to cling to their wallets… It's not a good situation, right Tom?

"Deflation," get it?

Deflation is particularly brutal when there's a lot of debt in an economy. That's because with deflation, the value of your money increases over time, which means a fixed mortgage payment gets more and more expensive every month.

Obviously, there's still a lot of debt in America, which is why deflation is particularly scary. So maybe the Fed has it right, and ultra-low interest rates are still necessary. Perhaps, while I've mocked them in recent years, the bold actions of the Fed have courageously saved us from a deflationary spiral…. That's a good argument, but I still think I'm right.

Maybe the Fed is paralyzed

One year ago, at their September meeting, the Fed predicted that by the end of 2015, their target rate would be at least 1% higher. That means they expected to raise rates three or four times by now -- and yet, they haven't moved once. It's not because the economy isn't growing. Over the last year we've added nearly 2.7 million jobs (according to the BLS) and our GDP grew nearly 3%.

Their official rationale is that the global economy is weak, inflation is low, and they are a bunch of scared wuss

So why isn't the Fed raising rates?

(Cont'd on Page 4)

Maybe the Fed is paralyzed .... Cont'd from page 3)

ies… Maybe I'm just bitter because I told everyone who'd listen that the Fed would finally raise rates in September (they didn't). My hunch was that the Fed would raise rates by the smallest possible amount and then whisper all kinds of calm sweet-nothings to the market:

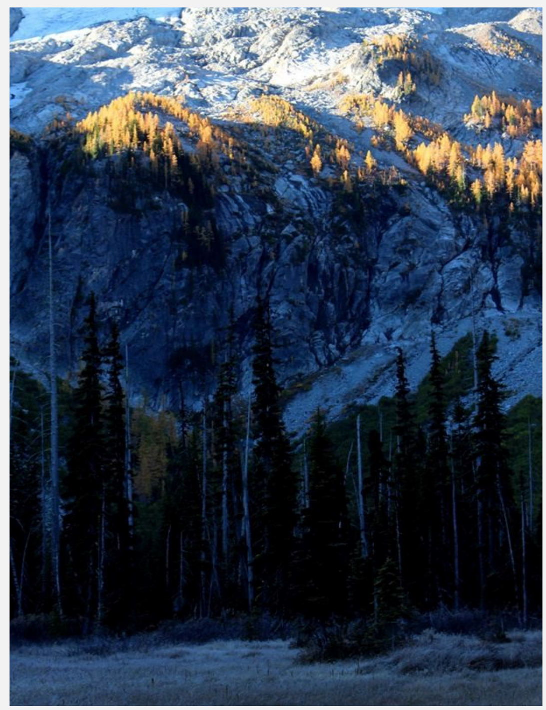
"Yes, we're raising rates, but everything is going to be okay. Don't be scared, we're only raising rates a little, and we're never, ever, ever going to do it again."

Instead, the Fed appears completely paralyzed. What do they know that we don't? Given what I can see of our economy, it's utterly ridiculous and borderline reckless for interest rates to still be at zero. Keeping rates so low has the potential to cause bubbles, imbalances, and all kinds of other weird stuff. For example, I've been saying for years that one of the reasons our corporations aren't aggressively investing their massive earnings into employees, equipment, training, and software is because they are worried about what will happen when rates rise. It's hard to do business that way.

I wish the Fed would project a little bit of confidence. Although the global economy is weak, America's economy is growing solidly. It's time for the Fed to take off our training wheels; they are slowing us down.

Probably a Mountain or a Lake

I recently took a trip to Horseshoe Lake, which has long been a favorite spot of mine. I went in search of Larch trees at the peak of their amazing golden fall color – and I found them.



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