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**AS GOOD AS IT GETS**

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In writing my semi-annual newsletter, I try to share with you what I think are the most important developments that affect the economy and your investments. One of my favorite resources is from the economist Fritz Meyer whose analysis I subscribe to. The following is some information from his July 2017 webinar.

Many think the stock and bond markets have gone up too far for too long and we’re due for a correction or even a crash. Fritz agrees that the stock market is on the high side but he says that we have a “Goldilocks Economy” and high valuations are deserved especially considering the alternatives. He says our economy is operating at full potential with full employment and the economic data doesn’t get better than this. Also the rest of the world is expanding simultaneously for a change. Consumer spending is 70% of our economy, with consumer income up 3.5% and a saving rate of 5.5%; much higher than before the Great Recession. This bodes well for the largest part of our economy. Retail sales are up 3.7% year over year (YOY) even though department stores sales are declining, retailers like Amazon and Home Depot are growing strongly. Retail growth is not slowing it is just changing. The Federal Reserve’s financial obligations ratio, which measures the average household’s fixed expenses, is at only 15.5% of income so consumers have plenty of money to spend if they want to. Real gross domestic product (GDP) growth is good at 2.1% YOY and 3.7% before inflation. Nominal average hourly earnings are up 2.5% YOY with real earnings at all-time highs due to our low inflation rate. Manufacturing jobs are declining due to automation but are being replaced by increased jobs in education, healthcare, professional, and business services which pay as well if not better.

There are always people who are predicting a stock market crash. If you listened to them you would have missed a 12% to 14% gain over the last year. The stock market is currently in the third longest expansion since the 50’s but that in itself doesn’t mean it must end soon. Sure, the stock market cannot continue to provide returns like we have seen recently forever, but the stock market normally provides returns close to 10% over the long term including dividends. This is comprised of 7.3% average growth in stock price plus 2.2% dividends which equals 9.5% total return. Why is this so? Well, the intrinsic value of a company is equal to its future earnings and since companies are growing their earnings at 7.3% then shouldn’t their stock price go up 7.3%?

Is the stock market going to crash soon? There have been only 2 times that the stock market dropped 20% or more, 1963 and 1987, without a recession. So you might ask: is a recession coming? Eventually yes, but there are no signs of a recession happening soon. Growth in our economy is natural and we don’t simply slip into a recession. The Fed has caused every recession in modern times by raising short-term interest rates above long-term rates which means that banks can’t make more money by making loans. I don’t think this happens unless inflation gets out of hand, and with inflation stubbornly below 2% I don’t think that is likely. Speaking of inflation; the 10 year inflation protected US Treasury is yielding less than ½%. This is unnatural. Historically, investors have required 2% above inflation for locking up their money for 10 years. Why are interest rates so low? It’s because central banks around the world are keeping interest rates unnaturally low. This is about to change as the world’s economies are finally growing in lockstep. Central banks are indicating that unnaturally low interest rates are no longer needed. So the US central bank (Fed) has indicated it will let long term interest rates like mortgages start rising in September and the European Union is indicating rising rates in the beginning of next year. This is all unprecedented as we have never seen central banks stimulating their economies as they have since the Great Recession. Can they unwind their stimulus without causing disruption? What does all this mean to you? The stock market appears to be the place to be long term, while the bond market appears more risky than normal. Don’t hesitate to call me with any questions.

Your Friend ,

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