Executive Economic Outlook And Summary

Fall/Winter 2013/2014

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This edition of Multop Financial's Economic Outlook largely hinges on how much you believe in the story of *"The Boy Who Cried Wolf"*. For the purposes of our story, "The Boy" is our Government and "The Wolf" is the effects of the government shutdown and the separate issue regarding our national debt limit. If there really is a wolf, then we should all treat this very seriously. But if this is a case of "crying wolf" as we know it, then a continued bull-market should be expected. Let me explain:

Most forward-looking economic indicators are pointing upwards, towards continued growth in the economy. We see housing prices going up, all measures of national unemployment continue to decline and companies have generally started to deploy capital they have been sitting on for the past several years. Our dollar has strengthened overall in the world and volatility remains reasonably tame. So you might ask, "What's the problem?" The answer depends on one thing, the wolf.

"The Wolf", as mentioned above, is the never-ending saga about how the US Government can be shut down and we will go into default if we don't continually extend our debt limit. Since 2011 this saga has unfolded time and time again, each time ending with nothing more than "The Boy" (Congress & the President) crying about a nonexistent wolf. Please don't mistake this as placing individual blame solely on the President, the House or the Senate; it's a combination of each party playing political theatrics for their own cause and claiming a different potential disastrous economic outcome. If this time "The Wolf" is real and the Government is seriously shut down for an extended period of time and we default on our debt, then we are in for a very tough road. The problem is, knowing whether or not "The Boy" is telling the truth this time.

Here are a few economic figures we believe are worth taking note of:

- **The S&P/Case-Shiller Index** reported late September that home prices are continuing to rise. The 20-City composite showed a 12.4% annual increase over the past 12 months. In our previous economic outlook (published in May 2013) this figure was 9.3%, indicating an increasing rate at which home prices are appreciating. This will likely begin to slow once the effects of rising interest rates are realized by new potential home buyers.
- **The Conference Board Consumer Confidence Index®** increased from 81.0 to 81.5 between July and August. This is substantially higher from April's figure of 68.1 and indicates increased optimism on the state of the economy by consumers. While this figure is showing a positive direction, a reading of 100 would historically be considered average.
- **The Institute for Supply Management's PMI® Index** reported a slight increase of manufacturing activity in August for the third consecutive month, and the overall economy grew for the 51st consecutive month. August's PMI® reading, highest of the year, indicates increased expansion in the manufacturing sector, a positive economic signal.
- **The National Federation of Independent Business** shows small business expansion continues to be flat to negative. While the total reading showed essentially no change over the month, prior in-depth analysis painted a different picture. Sharply higher Future employment plans were contrasted significantly with the increasingly negative expectations for improved general business conditions. Overall the NFIB has sated it does not expect to see clarity over our economic direction until the effects of Obamacare are better understood.
- **The Commerce Department** reported consumer spending advanced 0.7% from May through July. The increase is likely due to the overall improvement of the US job market causing people to feel more secure about their household income. Spending on "large-ticket" items, like automobiles, has been a major contributor. The effects of increased food and energy prices have not appeared to discourage the US consumer.

CONTINUE ON BACK

- The national unemployment rate has shown signs of improvement over the past 12 months, currently sitting at 7.3% according to figures released by the **Bureau of Labor Statistics** through August 2013. This shows a slow but steady decline since its peak in late 2009. However, when adjusted to account for those who have quit looking for work and adding those who are "underemployed", the figure known as "U-6 unemployment" is currently 13.7%.
- **U.S. real Gross Domestic Product**, increased at a revised annual rate of 1.1% in the first quarter of 2013. In the second quarter, real GDP increased 2.5% annualized.
- **CBOE Volatility Index (VIX**) Despite a brief spike in June, the VIX has remained relatively low for quite some time. Currently it sits at 16.60. Note: The 10-year average for the VIX is 20.26. The last time the VIX regularly traded above its 10-year average was June of 2012. Looking forward, we would expect to see the VIX rise from current levels.

In our last Economic Outlook we cautioned investors that bonds were positioned for sharp losses and we continue to maintain that viewpoint. As an individual investor, you should generally view overall positive economic news as a good sign for equity (stock) investments, assuming there is no wolf. However, you should also view this economic growth as a strong negative for bonds, especially bonds with longer maturities. Interest rates generally go up when economic conditions are good and when interest rates go up bonds and bond funds can get hit hard. This coupled with the potential that the Fed will eventually stop its current bond purchasing program adds additional pressure on bond prices in general. Because of these factors, Multop Financial is currently advising clients NOT to hold bond positions unless they have a very short time horizon because the risk of principle loss is very high. For a list of potential alternatives to bond positions please contact us directly.

Internationally speaking, European stocks appear to be in a good position for gains. Technically, US stocks are in a much stronger financial position but because Europe looks as though it is emerging from its recession, there will likely be opportunity for investors who are willing to accept the risk associated with these types of investments. With respect to Emerging Markets, Multop Financial feels this sector is likely to underperform vs. non-Emerging Market funds simply because we are seeing several geographic areas which appear to be in an economic slowdown along with a substantial amount of civil unrest throughout the underdeveloped world.

What does this mean for your investments? Since we are currently in a "Bull-Market" which has been reconfirmed several times according to The Dow Theory and other economic indicators, Multop Financial is continuing to recommend that clients maintain a reasonably valued stock portfolio mostly focused on US equities for the near future. Because of the "wolf" risk; we believe having an exposure to equity based non-stock market correlated assets is also attractive. Regardless of the outcome of *"The Boy Who Cried Wolf"*, you can rest assured Multop Financial is watching this matter very closely and will communicate with our clients if we believe a change to your portfolio is warranted. If you are not yet a client, but would like to learn more about the guidance we offer under these types of circumstances please don't hesitate to contact us.

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