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Thomas Cymer CFP® CRPC® Presents:

WEEKLY ECONOMIC UPDATE

June 2, 2014

WEEKLY QUOTE

"You've got to take the bitter with the sour."

- Samuel Goldwyn

WEEKLY TIP

Before you go shopping, draw the line at how much you will spend and resolve not to cross it.

WEEKLY RIDDLE

What can go down a chimney when it is down, but can't go up through a chimney when it is up?

Last week's riddle:

What always shows up in the middle of March and the middle of April?

Last week's answer:

The letter R.

HOW OPTIMISTIC ARE CONSUMERS?

No firm conclusion can be drawn from May's major consumer economic polls. The Conference Board's consumer confidence index rose 1.3 points to 83.0. That was its second-best reading in the past six years. The University of Michigan's final May consumer sentiment index dipped to 81.9 from April's reading of 84.1. Fresh Commerce Department data also sent mixed signals. Consumer spending contracted 0.1% in April even as consumer incomes rose 0.3%.^{1,2}

PENDING HOME SALES IMPROVE AGAIN

They rose 0.4% for April, the National Association of Realtors said; this follows a 3.4% March increase. March's S&P/Case-Shiller home price index showed an overall 12.4% annualized gain in house prices - quite good, but down appreciably from the 12.9% yearly advance recorded in the February edition.²

Q1 GDP REVISED DOWN; BETTER NEWS FOR DURABLES

Reviewing declines in exports, business investment and business stockpiles, the Commerce Department said Thursday that the economy actually shrank 1.0% in the first quarter even with a 3.1% advance in personal spending. April's durable goods orders surprised to the upside, however - they were up 0.8%. Economists polled by MarketWatch had forecast they would retreat 0.8%.^{2,3}

WHO SOLD IN MAY?

There was no exodus from stocks last month. May saw a 2.10% gain for the S&P 500. In an abbreviated trading week, the S&P rose 1.20% to settle at 1,923.57 Friday; the Dow (+0.67% to 16,717.17) and the Nasdaq (+1.36% to 4,242.62) also advanced.^{4,5,6}

THIS WEEK: On Monday, ISM's May manufacturing PMI arrives plus earnings announcements from Quiksilver and Krispy Kreme. Tuesday brings the Commerce Department's report on May auto sales and the Census Bureau's report on April factory orders. Wall Street interprets the May ISM service sector index and the May ADP job change report Wednesday, plus a new Federal Reserve Beige Book and Q2 results from Hovnanian. May's Challenger job cuts report appears Thursday along with earnings from J.M. Smucker and VeriFone and the latest initial claims numbers. The first Friday of June brings the Labor Department's May employment report.

% CHANGE	Y-T-D	1-YR CHG	5-YR AVG	10-YR AVG
DJIA	+0.85	+9.09	+19.33	+6.39
NASDAQ	+1.58	+21.52	+27.82	+11.31
S&P 500	+4.07	+16.27	+21.86	+7.16
REAL YIELD	5/30 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.26%	-0.05%	1.67%	1.97%

Sources: USATODAY.com, bigcharts.com, treasury.gov - 5/30/14^{6,7,8,9}

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.

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Rising Interest Rates

How might they affect investments, housing & retirees?

Provided by Thomas Cymer CFP® CRPC®

How will Wall Street fare if interest rates climb back to historic norms? Rising interest rates could certainly impact investments, the real estate market and the overall economy - but their influence might not be as negative as some perceive.

Why are rates rising? You can cite three factors. The Federal Reserve is gradually reducing its monthly asset purchases. As that has happened, inflation expectations have grown, and perception can often become reality on Main Street and Wall Street. In addition, the economy has gained momentum, and interest rates tend to rise in better times.

The federal funds rate has been in the 0.0%-0.25% range since December 2008. Historically, it has averaged about 4%. It was at 4.25% when the recession hit in late 2007. Short-term fluctuations have also been the norm for the key interest rate. It was at 1.00% in June 2003 compared to 6.5% in May 2000. In December 1991, it was at 4.00% - but just 17 months earlier, it had been at 8.00%. Rates will rise, fall and rise again; what may happen as they rise?^{1,2}

The effect on investments. Last September, an investment strategist named Rob Brown wrote an article for *Financial Advisor Magazine* noting how well stocks have performed as rates rise. Brown studied the 30 economic expansions that have occurred in the United States since 1865 (excepting our current one). He pinpointed a 10-month window within each expansion that saw the greatest gains in interest rates (referencing then-current yields on the 10-year Treasury). The median return on the S&P 500 for all of these 10-month windows was 7.93% and the index returned positive in 80% of these 10-month periods. Looking at such 10-month windows since 1919, the S&P's median return was even better at 11.50% - and the index gained in 81% of said intervals.³

Lastly, Brown looked at the S&P 500's return in the 12-month periods ending on October 31, 1994 and May 31, 2004. In the first 12-month stretch, the interest rate on the 10-year note rose 2.38% to 7.81% while the S&P gained only 3.87%. Across the 12 months ending on May 31, 2004, however, the index rose 18.33% even as the 10-year Treasury yield rose 1.29% to 4.66%.³

The effect on the housing market. Do costlier mortgages discourage home sales? Recent data backs up that presumption. Existing home sales were up 1.3% for April, but that was the first monthly gain recorded by the National Association of Realtors for 2014. Year-over-year, the decline was 6.8%. On the other hand, when the economy improves the labor market typically improves as well, and more hiring means less unemployment. Unemployment is an impediment to home sales; lessen it, and more homes might move even as mortgages grow more expensive.⁴

When the economy is well, home prices have every reason to appreciate even if interest rates go up. NAR says the median sale price of an existing home rose 5.2% in the past year - not the double-digit appreciation seen in 2013, but not bad. Cash buyers don't care about interest rates, and according to RealtyTrac, 43% of buyers in Q1 bought without mortgages.^{4,5}

Rates might not climb as fast as some think. Federal Reserve Bank of New York President William Dudley - whose voting in Fed policy meetings tends to correspond with that of Janet Yellen - thinks that the federal funds rate will stay below its historic average for some time. Why? In a May 20 speech, he noted three reasons. One, baby boomers are retiring, which implies less potential for economic growth across the next decade. Two, banks are asked to keep higher capital ratios these days, and that implies lower bank profits and less lending as more money is being held in reserves. Three, he believes households and businesses are still traumatized by the memory of the Great Recession. Many are reluctant to invest and spend, especially with college loan debt so endemic and the housing sector possibly cooling off.⁶

Emerging markets in particular may have been soothed by recent comments from Dudley and other Fed officials. They have seen less volatility this spring than in previous months, and the MSCI Emerging Markets index has outperformed the S&P 500 so far this year.²

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