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Thomas Cymer CFP® CRPC® Presents:

WEEKLY ECONOMIC UPDATE

July 7, 2014

WEEKLY QUOTE

"Find your place, and let the world gravitate to you."

- Diana Vreeland

WEEKLY TIP

If you're curious about what retirement might be like, how about arranging a preview? Think about taking a 3-week vacation or even a longer break from work (your business or employer permitting).

WEEKLY RIDDLE

What do the words *civic* and *level* have in common?

Last week's riddle: There are two of them, and one can usually see what the other sees, but they can never see each other. What are they?

Last week's answer: Eyes.

DOW TOPS 17,000 AFTER TERRIFIC JOBS REPORT

America's jobless rate is fast approaching the Federal Reserve's 6% target. Thanks to employers adding 288,000 new hires, unemployment dropped 0.2% to 6.1% in June. The U-6 rate (unemployed + underemployed) declined to 12.1%, a low unseen since October 2008; from June 2013 to June 2014, the number of Americans out of work for more than six months shrank by 1.2 million. The news helped inspire a rally: at the closing bell Friday, the Dow settled at a new all-time high of 17,068.26.[1,2]

ISM INDICES SINK SLIGHTLY

The Institute for Supply Management's latest factory sector and service sector PMIs didn't quite meet expectations, but they were still well above 50 (the demarcation between sector growth and contraction). ISM's manufacturing PMI came in at 55.3 for June, ticking down 0.1 points from May; its non-manufacturing PMI had a June reading of 56.0 compared to May's 56.3 mark. Economists polled by MarketWatch had forecast June's ISM factory PMI to hit 55.7 and expected no change in its service sector PMI. Factory orders also decreased in May, as the Federal Reserve reported an 0.5% retreat following the 0.8% rise in April.[3]

PENDING HOME SALES JUMP 6.1%

The May gain was the greatest monthly improvement noted by the National Association of Realtors since April 2010 (when the first-time buyer tax credit was set to expire). Analysts polled by Bloomberg believed May would bring a gain of 1.5%.[4]

NEW QUARTER, NEW GAINS

With a 2.00% rise across four trading days to 4,485.92, the Nasdaq set the pace for the big three U.S. indices last week. The Dow gained 1.28% on its way to Friday's record close, and the S&P 500 added 1.25% during the week to settle at 1,985.44 on July 3.[5]

THIS WEEK: No economic reports or earnings releases are scheduled for Monday, but results from Alcoa and The Container Store kick off the Q2 earnings season on Tuesday. Minutes from the June Fed policy meeting arrive Wednesday. Thursday, earnings from Progressive and Family Dollar complement the latest initial claims numbers and the Census Bureau's report on May wholesale inventories. Friday brings Q2 results from Fastenal and Wells Fargo.

% CHANGE	Y-T-D	1-YR CHG	5-YR AVG	10-YR AVG
DJIA	+2.97	+13.88	+21.22	+6.60
NASDAQ	+7.41	+30.27	+29.94	+12.36
S&P 500	+7.42	+22.91	+24.30	+7.64
REAL YIELD	7/3 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO

10 YR TIPS	0.37%	0.48%	1.87%	1.96%

Sources: USATODAY.com, bigcharts.com, treasury.gov - 7/3/14[2,6,7,8]

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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The Troubling National Debt

It is projected to grow even larger. What does that imply for the economy?

Provided by Thomas Cymer CFP® CRPC®

In 1835, something financially remarkable happened: the federal government paid off the national debt.[1]

It hasn't happened since. Through myriad presidential administrations and economic cycles, the national debt has persisted. Wars, depressions and recessions have all helped send it higher, and while it can shrink in the short term, it isn't going away. Currently it stands at $17.6 trillion, with $12.6 trillion of it held by the public.[2]

The big picture is disconcerting. In fall 2013, the non-partisan Congressional Budget Office said that the national debt amounted to 73% of U.S. GDP. The CBO sees it declining to 68% of GDP by 2018, but then increasing to 71% by 2023 as a consequence of rising interest rates and spending boosts for Social Security and health care. CBO projections have the country's debt equaling 100% of its annualized growth by 2038 - a milestone best not reached or approached.[3]

If the national debt should grow over the next decade, what would the impact be? It would be felt subtly, but it would be notable.

The greater the U.S. debt-per-capita, the greater the default risk for the federal government - meaning that newly issued Treasuries would need to have higher yields to appeal to investors. A bigger percentage of federal tax revenue would go toward paying the interest on the national debt, leaving fewer tax dollars for federal services and programs. Consequently, borrowing for economic enhancement projects would become harder, with a reduced standard of living for American households as a possible byproduct.[4]

Higher Treasury yields have three distinct implications. They can lessen appetite for risk; if the yields on Treasuries start to look pretty good compared to the returns on equities or corporate

securities, investors may run to the "risk-free" Treasuries. Indirectly, this could encourage more inflation: higher Treasury yields could prompt yields on corporate securities to rise, which would force those corporations to hike prices on goods and services, i.e., inflation. Lastly, mortgages would become costlier as their interest rates are linked to Treasury yields and the short-term interest rates established by the Federal Reserve. Costlier mortgages imply fewer homebuyers, which in turn leads to lower home prices and reduced net worth for homeowners.[4]

Under current projections, what might happen by 2038? If America reaches to a point where its debt does roughly equal its GDP, a considerable economic price could be paid. In addition to a loss of confidence on the part of foreign investors, you would have a loss of flexibility on the part of the federal government.

Other nations might lose faith in our ability to pay our debt obligations. If that happens, we would find it harder or more expensive to borrow money. More and more federal borrowing could discourage private investment (although incomes and inflation-adjusted output could still rise). If the federal government needed to spend ever-increasing amounts of money to pay down the interest on the nation's debt, shifts in fiscal policy and significant tax law changes would no doubt occur. The greater the percentage of federal spending given over to the national debt, the less capable the federal government would be to respond to an economic, geopolitical or environmental crisis.

The CBO's forecast has sounded an alarm, and some view the national debt crisis as an emerging national security issue.

We incur some debt to foster economic expansion. Take the recent federal stimulus programs, for example. Taking on debt of that kind can be worthwhile as a step toward economic recovery. It is the other kind of debt - debt in response to today's consumption - that risks handing future generations dilemmas.

While an ever-increasing national debt is a problem, a manageable national debt we can live with. We can't turn back the clock to 1835. Andrew Jackson's early struggles with debt as a land speculator led to his dream of a debt-free America with a federal government that didn't need any credit. By selling off huge chunks of federal land and vetoing every spending bill that came his way, the seventh President cut the federal deficit from $58 million to $0 in six years. Coincidentally or not, a lengthy depression soon began.[1]

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Citations.

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Citations.

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