KWB 2017 1st Quarter Update

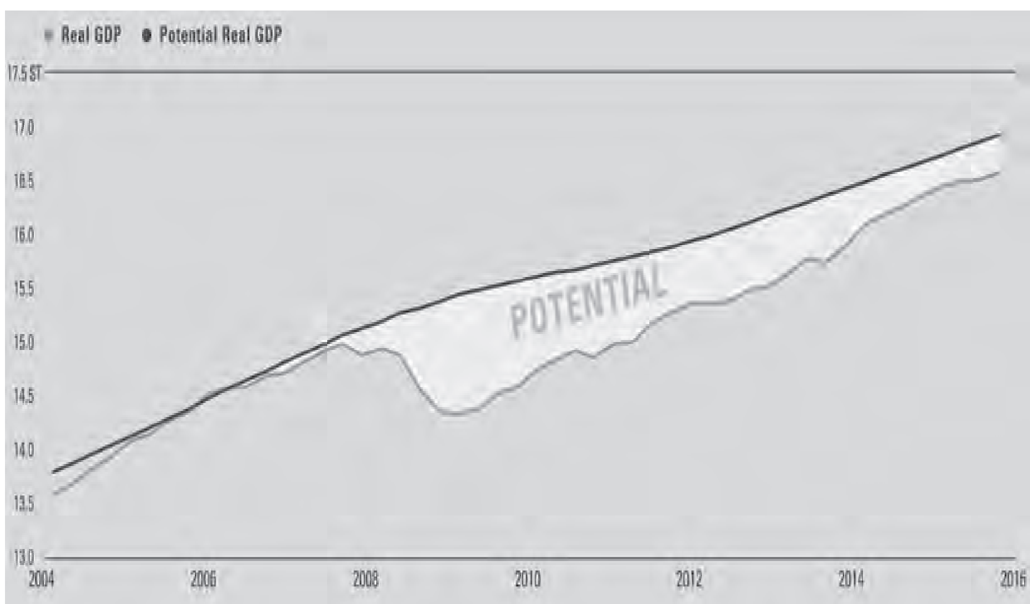
The Potential of the US Economy

On December 14th, KWB hosted an event with special guest speaker Burt White, the Chief Investment Officer at LPL Financial. Burt has a way of making mundane and hard-to-understand topics clear and concise while mixing in hilarious anecdotes about his family, which includes four daughters. For those who couldn't be with us, we wanted to share some of Burt's thoughts as we move into 2017. You can also access LPL Financial's 2017 Outlook at our website - www.kwbwealthmanagers.com/commentary

Why Aren't We Living Up to Our Potential?

First, Burt discussed the potential of the U.S. economy and the large gap between the Great Recession and the recovery we've had since. According to LPL, the size of the previous five recessions has corresponded with the size of the subsequent recoveries. In other words, the further the decline generally the larger the rebound. If the size of the current economic recovery, which began in March 2009, had responded similarly to prior recoveries we should have enjoyed a growth rate of 5-5.5%. However, this recovery has only experienced a GDP (gross domestic product) growth rate of about 2% per annum. This has led to a $365 billion gap between the economic potential of the economy and the real GDP.

Burt believes there are two main culprits of this gap: The Fed and stagnant wages.



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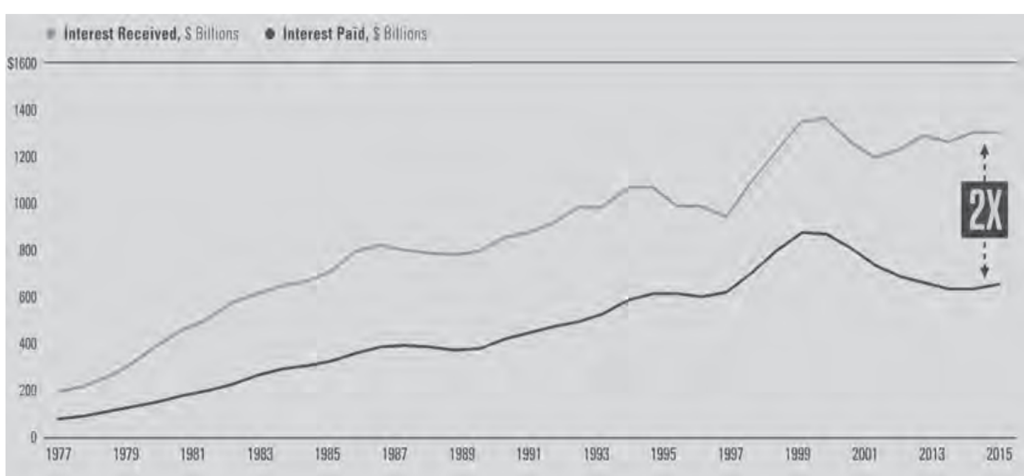
The Fed Thinks We're Still in the Hospital

On December 14th, the day of our event, the Fed raised rates for only the second time since the end of the Great Recession. Historically, the Fed raises rates an average of 18 times between recessions.

Burt likened the Fed's low rate policy to a hospital patient. Typically, when a patient is well enough, the hospital will release the patient and they continue to recover on their own. In the economy's case, the Fed has kept it hooked up to life support by means of low interest rates. As the economy gets better, the Fed will continue to raise rates. The fact that the fed has raised rates twice is a sign that they believe the economy is on the mend. Low rates are good in the sense that they should spur people to spend. Even after two increases loan rates to buy houses, cars, etc. are relatively low making big purchase items affordable. However, low rates affect both the interest we pay and the interest we receive. Actually, the interest we receive ($1.2 trillion) in the U.S. is double the interest we pay ($600 billon).

With that said, low rates have hurt two times (2x) more than they have helped. Burt demonstrated this by showing how much money it would take to generate $100,000 in income per year from 2-year Treasury Notes. In 1980, it would have taken about $760,000 to generate $100,000/year in income. In 2000, it would have taken about $2,000,000. Today you would need nearly $14,000,000 to generate that same $100,000 in interest income.

Since people must now save more to generate a similar amount of income, especially the newly retiring Baby Boomers, we are experiencing a savings glut. Burt surmises that at this point, the Fed raising rates will be better for the economy than the market seems to realize.



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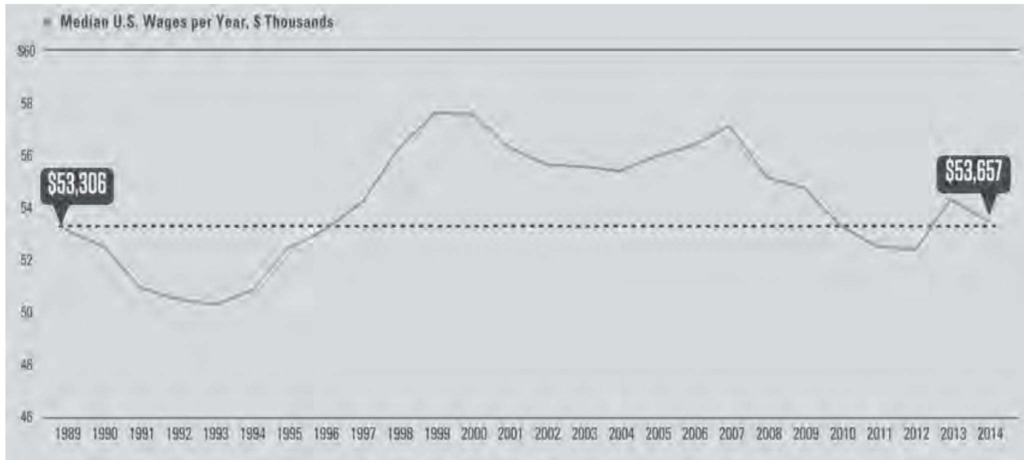
Average vs. Median Net Worth



Here's a small refresher course on Average vs. Median. (5+20+200)/3 = 75 is the average. The median, 20, is the middle number. In the US, we have a large gap between average and median net worth. Of the top 20 countries in average net worth, the U.S. ranks 4th at $301,000. By median, the U.S. ranks 19th at $45,000. We have so many billionaires that on average, we look great, but the median American has been struggling for some time.

In 1990, the median U.S. wages/year was $53,306. Today, that number has climbed to $53,657. That's equal to a $13/year raise, or enough to buy two extra Big Mac Value Meals each year.

President-Elect Trump

Politics aside, Burt White did touch on the President-Elect's policy proposals. Burt believes that from what has been proposed, Mr. Trump will likely be more pro-growth in some areas and more protectionist in others. Overall, he believed that no matter who was elected, the economy was and is poised to continue to grow in 2017. LPL puts the current chance of a recession in 2017 at about 5%. They assert the consumer will continue to carry the economy and corporate earnings will continue to grow. Perhaps growth may have been a bit slower under a Clinton presidency, but the economy would have grown all the same.

Finally, Burt closed talking about the stock market. He pointed out that too few people are invested in stocks today. In 2007, before the Recession, 65% of U.S. adults were invested in the stock market. Today, only 52% are invested in stocks. For perspective, currently 49% of adults play the lottery. This can be viewed as a contrarian signal that perhaps, even though we are entering year 8 of the bull market that began in 2009, the stock market has potential for even more gains.

With the combination of low rates, the need for many to increase their wealth and the potential for continued economic growth, investors may want to step up and take note.

We'd like to thank those of you who could join us last month and we promise that we will continue to do events like this in the future in order to help educate our clients further. We believe 2017 will be an exciting year for both our clients and KWB as we roll out new technologies designed to benefit all of us in the years to come. Thank you for your continued trust in KWB and here's to a prosperous 2017.

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