

Sather Financial Group, Inc.

Private Wealth Management

Third Quarter Commentary 2016 What Economy Will The President Inherit?

Six weeks away from the Presidential election, it is hard to know if we are electing the leader of the free world or refereeing a couple of three year olds fighting in the sand box. We'll be happy when it's over and can focus on the future.

The new President will inherit a national landscape that is struggling to progress above stall-speed.

The Federal Reserve recently lowered its long-run projection for U.S. Gross Domestic Product growth to 1.8%--still below their previously stated 2% target.

Cooling Indicators Suggest Slower Recovery

Retail sales, a strength of the expansion, have slowed, and industrial output remains in contraction. Meanwhile, businesses have slowed inventory building sharply.

RETAIL SALES

Percent change from a year earlier



Federal Reserve Bank of St. Louis

INDUSTRIAL PRODUCTION

Percent change from a year earlier



BUSINESS INVENTORIES

Percent change from a year earlier



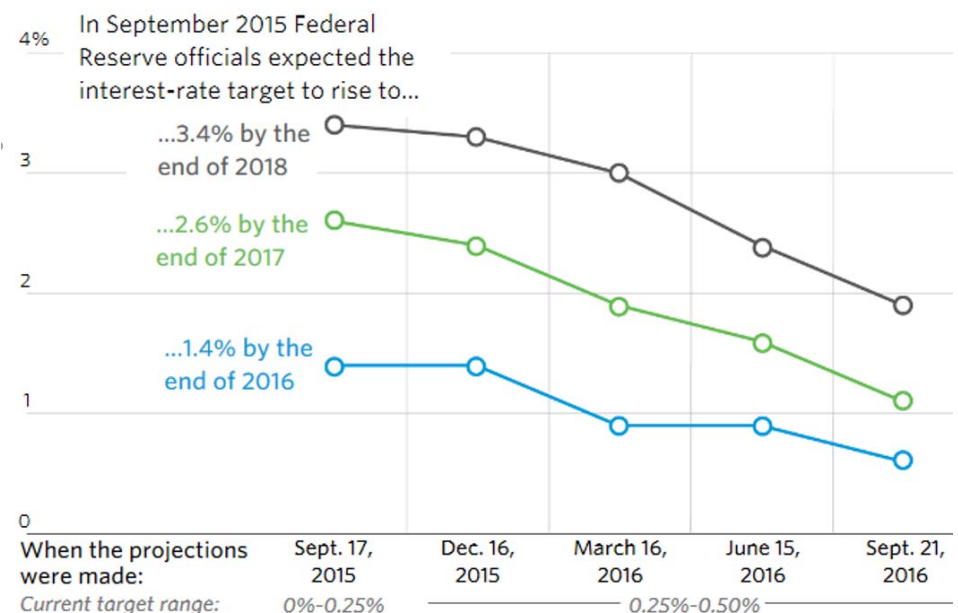
Source: The Wall Street Journal

Given the sluggish growth, the Federal Reserve is having to acknowledge that previous domestic interest rate projections were errantly high and that rates will most likely stay lower going forward.

This low rate policy continues to hurt traditional savers as fixed income investments produce woefully low cash flow.

This low rate environment also continues to push more and more investors into the stock market—whether they are properly equipped for the associated volatility that accompanies stocks or have the necessary long-term time frame.

Median projections and actual ranges for the Fed's interest-rate target

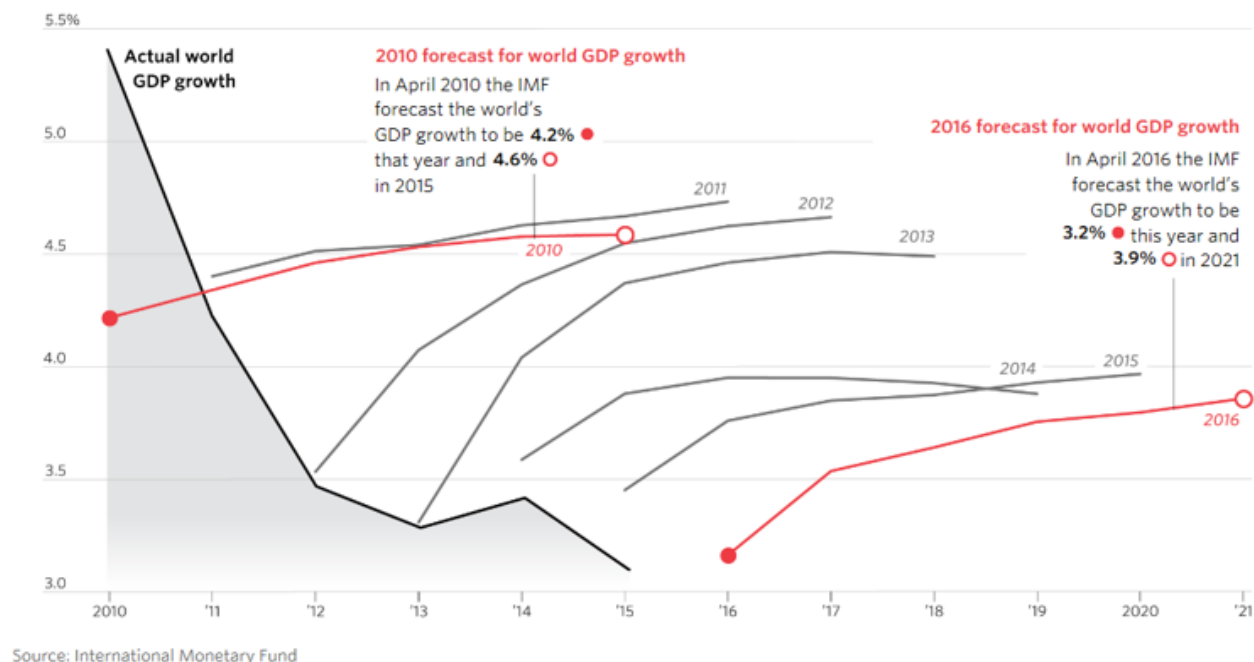


Source: Federal Reserve

Given how slow U.S. economic expansion has been, the rest of the world is experiencing similar, if not worse, problems. World GDP growth has fallen significantly over the past five years. Furthermore, projections five years into the future estimate growth well below historical averages.

Forecasts for the world's gross domestic product, change from previous year

Forecasts are shown for the forecasting year and the next five years. Forecasts are made in April of each year.



A world of sluggish growth leaves central banks very few options. As of the end of the third quarter, the 10-Year U.S. Treasury Bond pays a slim 1.6% interest. It fell as low as 1.366% in July—its lowest level ever.

As depressing as an investment in U.S. Treasury Bond's may sound, it could be far worse. One third of the government debt issued around the world currently has a negative yield. Let us repeat that....a negative yield.

This means you “invest” your money in a government bond and in return are guaranteed that you will receive no interest and less money upon maturity than you invested in the first place.

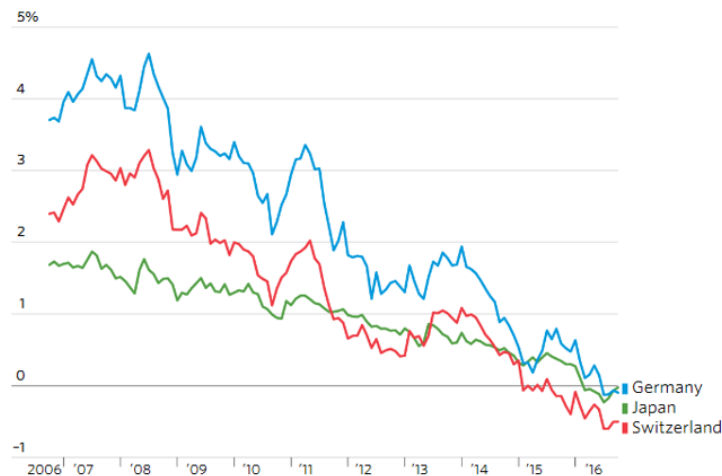
In investment terms, government bonds of this nature offer “all of the risk and none of the return.”

Falling bond yields have been a fixture of global markets for decades. The yield on the 10-year U.S. Treasury note hit its lowest level ever in July.

Yield on the 10-year Treasury note



Ten-year sovereign debt yields that are now negative

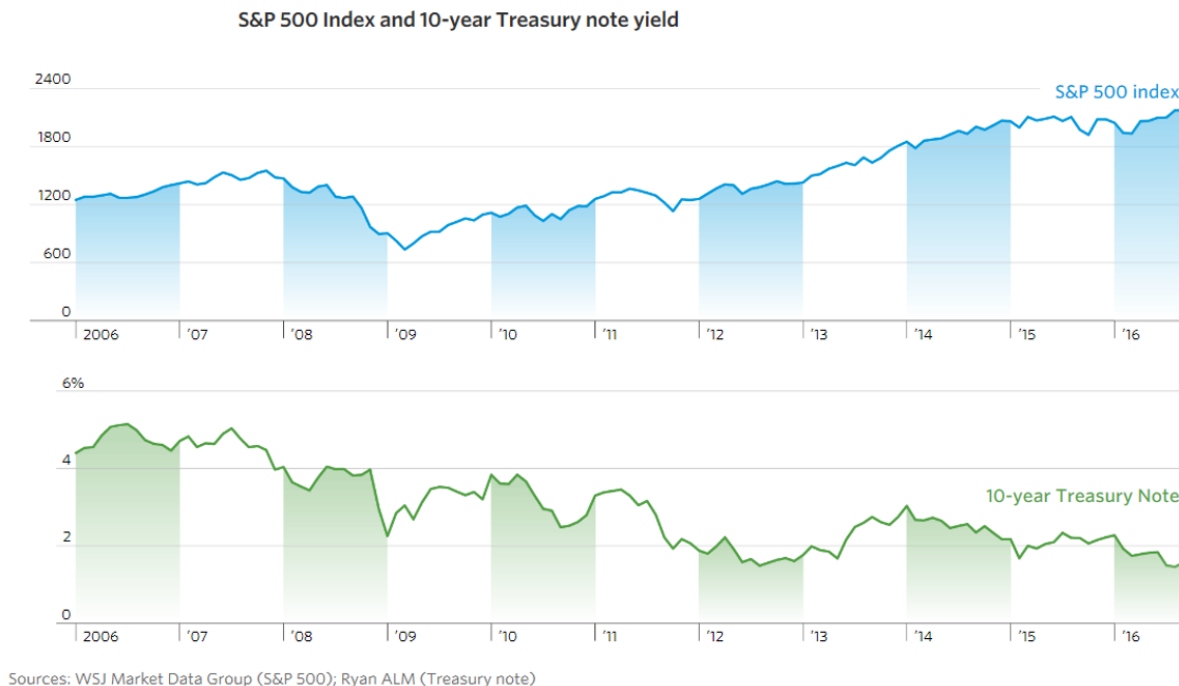


As noted above, in a world of low or negative interest rates, traditional savers have been shortchanged. They still have bills to pay and hope to retire someday.

Given the lack of options, as rates have fallen, more investors have plowed their funds into the stock market.

Although this makes us feel good that the stock market is going up, it does not do anything to make companies earn more. As such, valuations have become distorted as investors look for yield and a return of any sort.

Going forward, valuations and a proper assessment of quality are paramount.

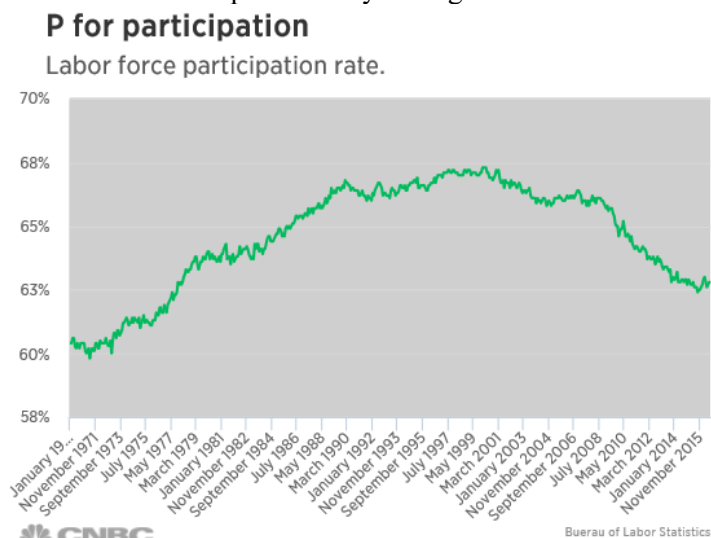
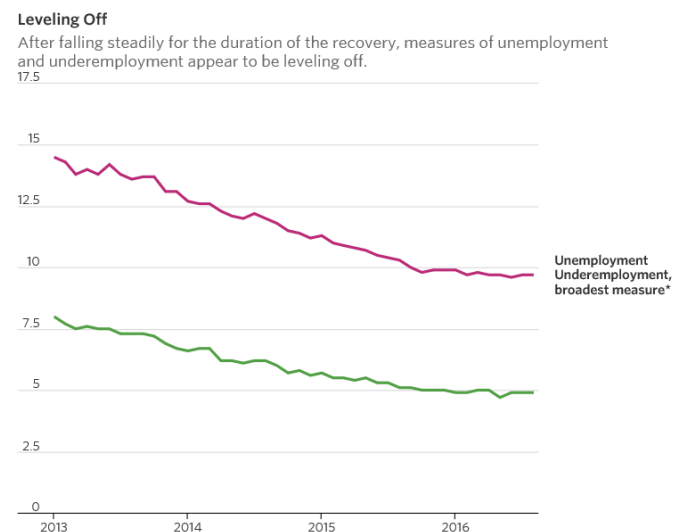


To truly have economic expansion we need more people working. As you can imagine, in a hyper competitive world, finding good paying jobs remains elusive.

Although the “official” unemployment rate is 4.9%, once you add in all the special categories of people that are excluded, the functional unemployment/under-employment rate is closer to 10%.

Another way of looking at this is the Labor Participation Rate—a measure of those age 16 or older who are actively in the workforce. That figure currently stands a bit above 63%—a level not seen in nearly 40 years.

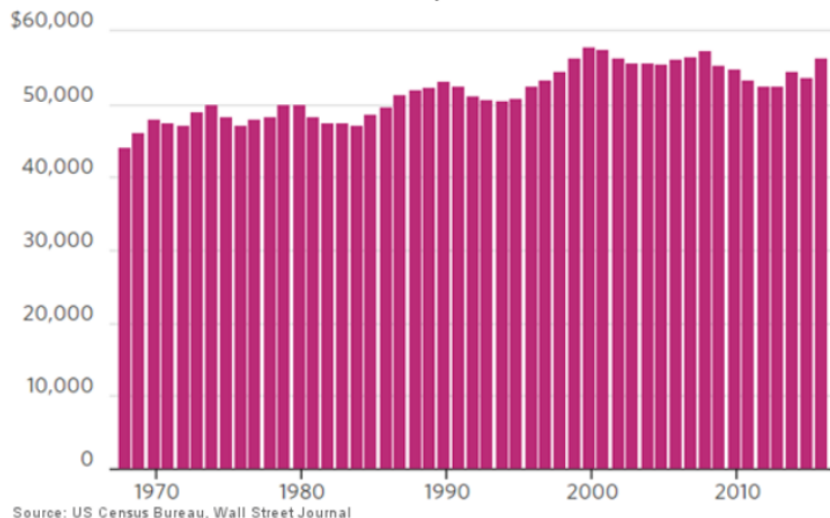
It is hard to have a meaningful economic expansion with so many people sitting on the sidelines. Furthermore, the longer people sit out of the workforce, the more likely it is that their skillset becomes permanently damaged.



Despite the negative news on employment, the average family's household income is finally back to the level it was in 2000. The last fifteen years have been a long, hard battle.

However, this is an important figure since GDP is about 65% consumer spending. As family's make more, they are able to spend more.

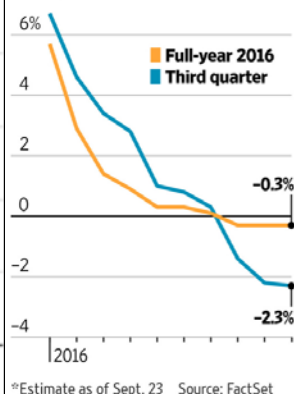
Median Household Income - \$56,515 in 2015



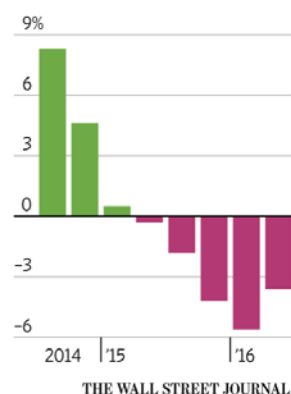
Low Expectations

Analysts have cut their forecasts for U.S. corporate-earnings growth and expect the slump to continue in the third quarter.

Analysts' forecasts, S&P 500 earnings, change from a year earlier



S&P 500 earnings, change from a year earlier



Amidst a backdrop of this nature, many investors often choose to stick their head in the sand. It's overwhelming—even for professionals. The non-stop blast of news, the internet, friends and family, etc. is hard to shake.

However, as the chart below points out, there is always something to worry about and always someone who declares that the sky is falling. Trying to time the market is a fools game.

The world certainly has its challenges. However, some of the greatest inventions and innovations have come at the darkest hours. Capitalism and entrepreneurship always find a way of overcoming obstacles when you least expect it.



Sincerely,

Dave

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