▶ The Economic Truth 1-4
▶ Mid-year check in .. 5
▶ Time To Enjoy The Great White North? 5-7

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Cadence clips

FOCUSED ON WHAT MATTERS MOST.

The Economic Truth

If you're listening to financial television during your free time, you may be getting the impression that the economy is firing on all cylinders. The Wall Street consensus also seems to be in agreement that things are finally starting to pick up to the point where we'll start seeing "normal" 3-4% growth very soon.

We take issue with this narrative for two reasons: First, the facts are at odds with growth reaccelerating back to the 3-4% range we've seen in the past. Second, this economic growth narrative is often times whipped up to encourage buying into Wall Street investments. The bottom line is that if investors don't feel confident about markets, they won't invest and that's not profitable for Wall Street firms, plain and simple.

Here are some things to ponder…

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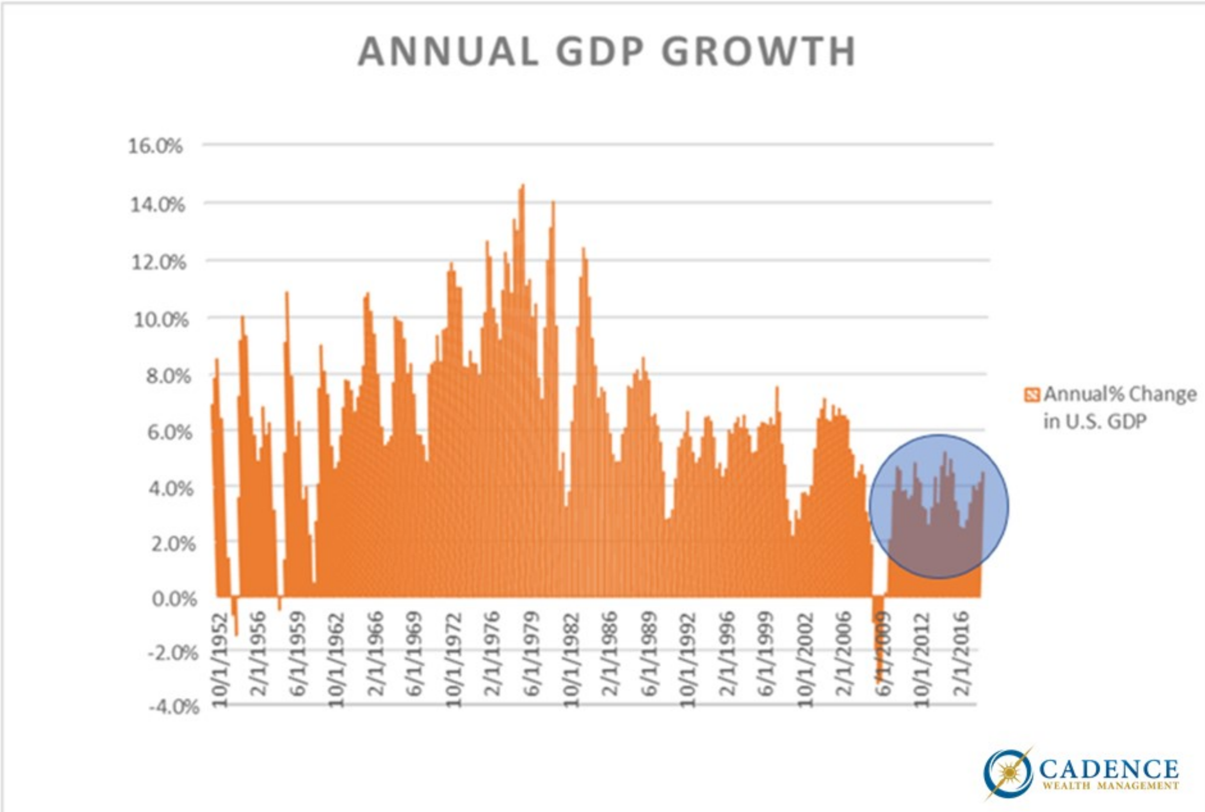
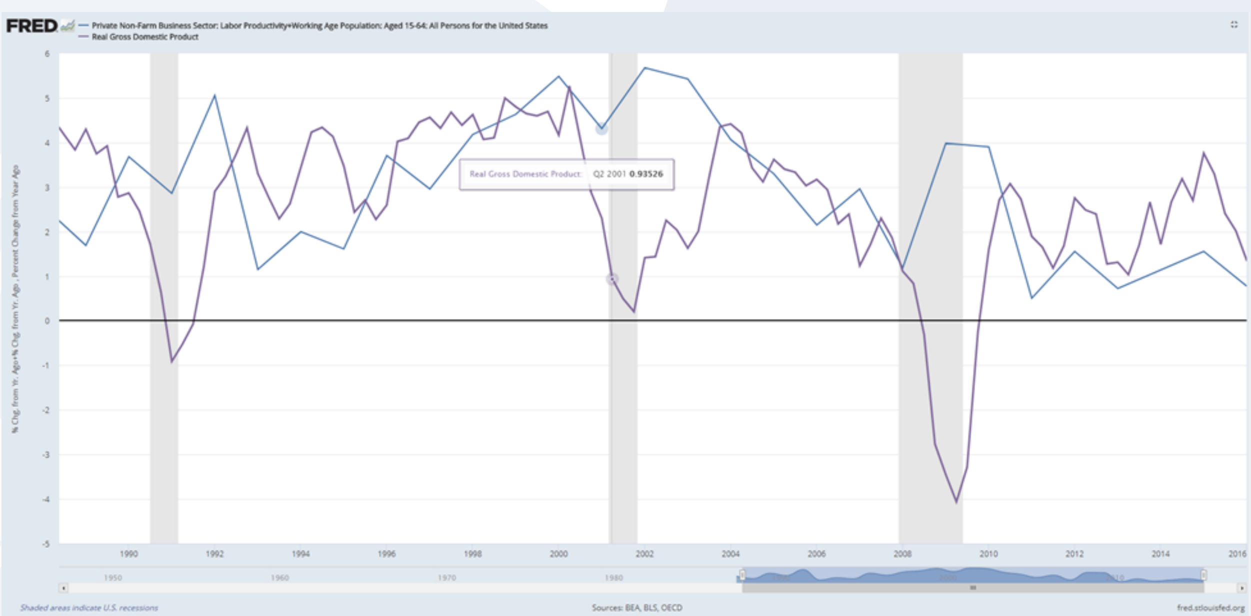
Economic growth (GDP growth), has been much lower in this last recovery than at any point in the last 70 years. The pattern is clear. Growth has effectively been stuck at between 3% and 4% nominal, and after inflation, 1%-2%. Our assessment is that this is due to long-term structural issues such as high debt levels, slower workforce population growth, and lower productivity. None of these things are expected to change for the better any time soon, and since they are the basic building blocks of economic activity, it's hard to see how growth will suddenly accelerate to that magic 3% - 4% rate after taking into account inflation.

You can see this trend very clearly in the chart below. Importantly, growth has been below average despite unprecedented levels of monetary stimulus from central banks – activity that is supposed to boost economic growth.



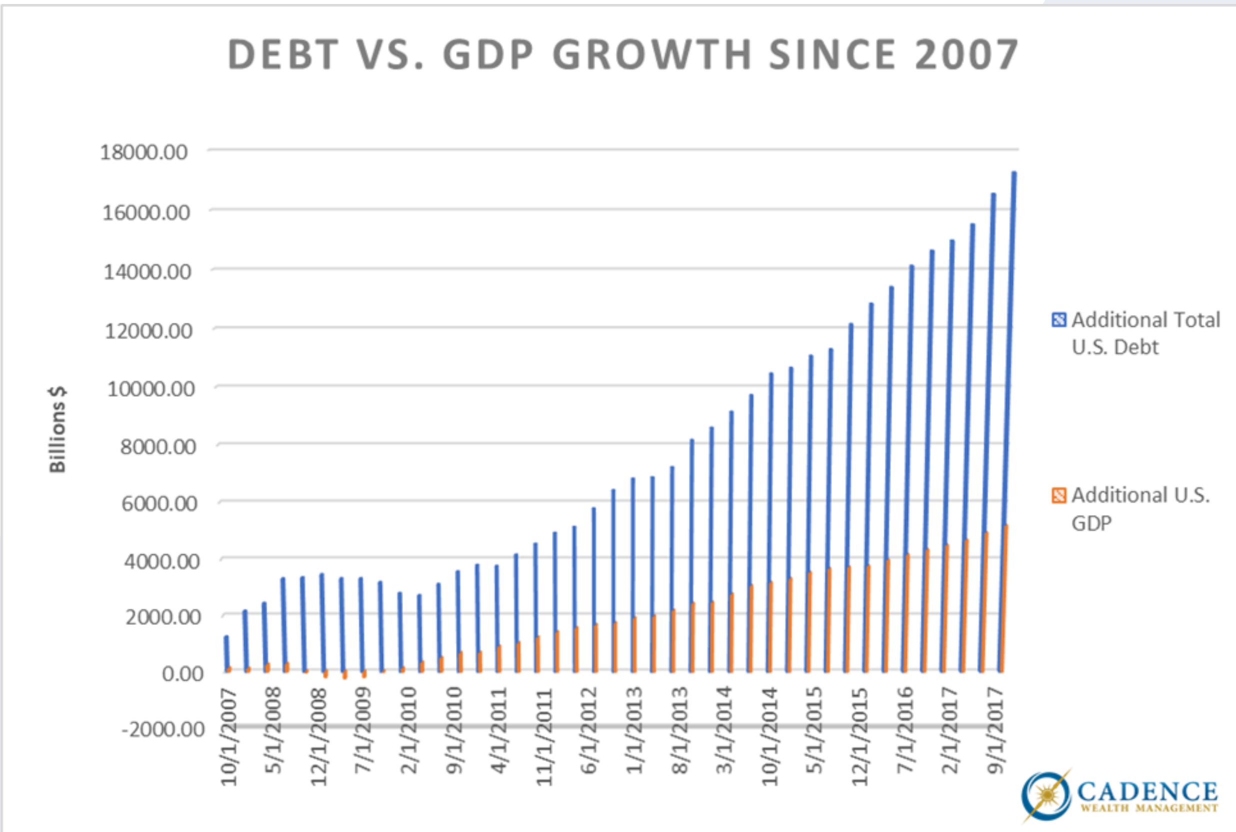
Here's a look at how closely GDP tracks productivity and population growth. It's worth noticing that shorter-term cyclical swings in the economy can pull GDP away from trend temporarily as it did in the last three recessions, but over the last 30 years growth has always seemed to bounce back to its potential as dictated by these two factors. With both population growth and productivity running below 1% (the most recent productivity report revised downward to .4% for Q1), the sum of the two would be hard pressed to keep us at a 2% Real (net of inflation) GDP growth rate. When we experience the downward part of this unusually long business cycle, you can rest assured GDP will once again deviate downward from this ~2% economic potential which will result in a longer-term average growth rate of well under 2%.



We of course would rather see much stronger economic potential, but that'll take more than just wishful thinking and empty promises from politicians, Wall Street experts, and others who have an interest in creating a rose-colored picture of things. It'll take a reduction of debt loads, a more robust growth in our workforce, and continued innovation that can help to drive output per employee. When these things get addressed, we'll feel much better about that 3-4% growth rate becoming a reality once again.

The Debt Headwind

What's especially sobering is that since the great recession of 2007, total debt levels in the U.S. have grown more than $17 trillion while GDP has only grown by a bit more than $5 trillion. In other words, it's taken more than $3 of debt to generate $1 of economic growth.



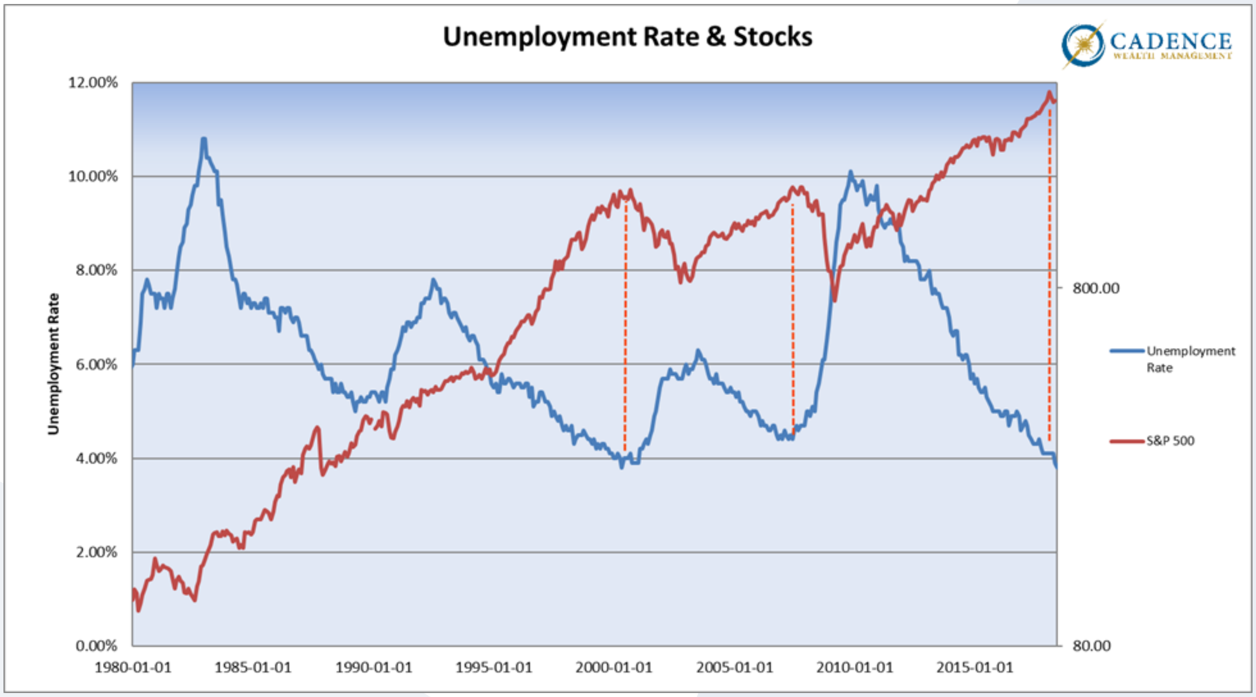
Since we know there is a limit to how much debt a society can function with, it's safe to surmise that when debt growth slows or reverses, GDP growth is much harder to come by. We are likely already at this point. GDP growth accomplished over the years through debt has effectively been growth borrowed from the future. This plays a big part in explaining why despite so much government and central bank stimulus since 2007, we've still had a very hard time getting back to what we'd consider a good economic growth rate. It also implies that growth going forward will have a very hard time reaccelerating to what we've been accustomed to. We have issues to work through first.

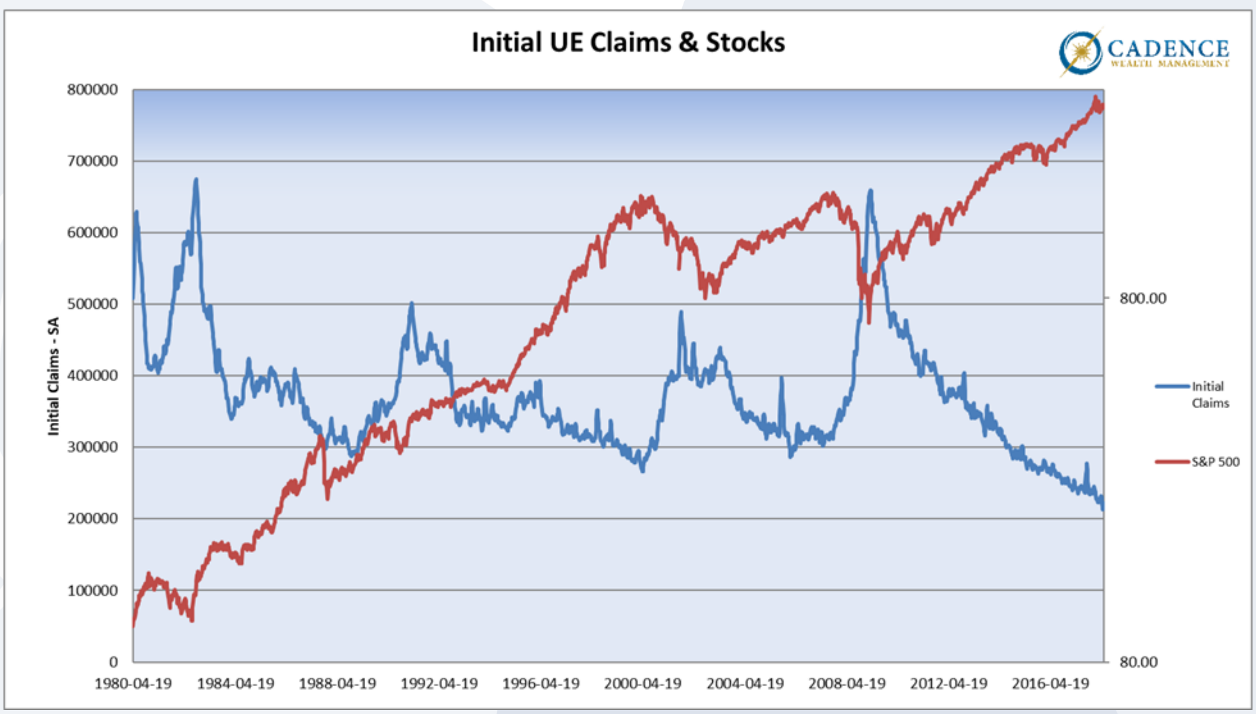
Does The Strong Jobs Report Refute This?

The most recent monthly jobs report came out last Friday and was solid on most counts. The pundits were very excited about it and used it as an example of how strong the economy is and where it's likely headed. Heck, even the President tweeted that he was excited to see it (an hour before it was released.) This is good, right? Of course. More people at work earning a living is always a good thing. There's no debating that. The question is, what does that mean for the stock market and economy going forward? Here's where we take issue with the narrative coming from financial media and all its players.

As we can see in the charts below, there's clear precedent for low unemployment rates and low initial jobless claims being a sign of an economic expansion that is much closer to its end than its beginning. This is neither good nor bad, it's just a normal outcome of the expansionary side of the business cycle. Once "full employment" has been reached – which is normally defined as the maximum number of people the economy can realistically employ – things tend to happen that sow the seeds of the next contraction such as wage inflation, higher interest rates, investor complacency, etc.

Most important to note, the last two recessions and bear markets began at levels of unemployment and jobless claims **above** those we're seeing now. In other words, despite how great it is having larger numbers of people employed, this doesn't necessarily mean good news for stocks or the economy going forward. These strong employment reports should leave you feeling much more cautious than comfortable.





Mid-Year Check In

In the first newsletter of 2018, we asked our clients to remember why they are investing in the first place. Investment results are not goals in and of themselves, but they are a component of achieving the goals we've set in life. With half of 2018 now in the history books, how are you doing with paying attention to what's most important?

If you have not done so yet because you just "haven't been able to get around to it", carve out some time to write a list of the things you can do that would make you happy, choose the ones to which you would like to commit, share your intentions with someone who will both help you and to whom you feel accountable, and then get to work.

In that January piece we also urged you to do something in 2018 you've always been meaning to do but for one reason or another have not: start a hobby, reach out to a long-lost friend, or perhaps take a trip north of the border (see the next article for ideas).

If you have not yet gotten to work on spending enough time on things that make you happy, or if you haven't yet started something you've always wanted to do, it's not too late! There's still half the year left. Remember: you work, save and invest to be able to enjoy life, so make sure you're taking the time to do so.

Time To Enjoy the Great White North?

A common theme in many of our meetings with clients is that travelling and experiencing new things makes them very happy. With the dog days of summer approaching and vacation season upon us, many people are looking for exciting places to go while also getting the most bang for their buck. Since September 2017, the US Dollar has appreciated against the Canadian Dollar by over 9%, so why not parlay that into some great trips north of the border?

Banff

Banff is nestled in the Canadian Rockies and is a great place to go during the summer or winter. Hiking, biking, rock climbing, rafting, and fishing dominate the summer while skiing takes over in the winter. With so many fun activities available all year round, let's take a look at a couple of Banff's places to stay. If you want to go higher end, the Fairmont Chateau Lake Louise is CA$1,499/night over the Fourth of July Holiday weekend, which in old fashioned Greenbacks is just $1,134.74. A little pricey? A more reasonable place to stay is The Grande Rockies Resort for CA$392.34 or US$297/night. No matter where you stay, you'll find quite a savings using the US Dollar compared to the Canadian Loonie!

Now that we've saved some money on lodging, here are a few of the area's many activities to spend it on. In the summer, taking a scenic, guided float tour of the Bow River would run from CA$55 to CA$90 or just US $41.63 to US $68.13. And in either summer or winter, you can take a stunning 8-minute gondola ride to the 7,500' summit of Sulphur Mountain on the Banff Gondola for CA$62 for adults 16 and over (US $46.93), CA$31 for children 6-15 (US $23.47) and free for children under 6.

Finally, all of that sightseeing makes one hungry, so it would be a good time to stop at the top-rated Bison Restaurant on Bear Street in Banff - they serve contemporary Canadian food and are also vegetarian-friendly. A Farmhouse Dinner there for two goes for US $39/person or you can try their famous Brunch which ranges from US $16-$18 per person.

Montreal

Feel like speaking a little French but don't want to fly 7 ½ hours to Paris? It's time for a 5 ½ hour drive to our northern French-speaking neighbors in Montreal instead. Besides saving on airfare (the cheapest non-stop flight from Boston to Charles de Gaulle Paris right now over the Fourth of July Weekend is $2,847/person in coach), let's say you wanted to stay at the Ritz Carlton in each respective city. The Ritz Carlton Paris would set you back $1,626 a night, compared to the Ritz Carlton Montreal at $697/night. With that almost $1,000 a night in savings, you can do quite a few things.

Let's check out some of the arts. You could go to the Musee des Beaux-Arts (Montreal Museum of Fine Arts) where you can see pieces by renowned artists Rembrandt, Picasso, Renoir, Cezanne, and El Greco among others. The museum also has a collection of 18th Century porcelain and artifacts from World War I. Admission is Just CA$23 – or US $17.41 for adults over age 31 and just CA$15 or us $11.36 for anyone 30 or younger.

If walking and seeing some of the city is more to your liking, touring Vieux Montreal (Old Montreal) has quite a few highlights. Vieux Montreal is the site of the original city of Montreal and the hub of the city's culture. You'll see horse-drawn carriages on cobblestone streets and notable sights such as the Basilique Notre-Dame, the Hotel de Ville (Town Hall), the Vieux-Port (Old Port) and the Marche Bonsecours (Bonsecours Market).

After all of that walking around, you are bound to work up quite an appetite. For a great idea of the culinary options that Montreal has to offer, you can try the three hour Montreal Secret Food Tour for CA$69 or just US $52.23. The tour includes highlights of Montreal's most famous dishes: Montreal-style bagels and poutine (french fries and cheese curds topped with a brown gravy). Paired with these treats, Montreal boasts quite a selection of local wine and beer that you can choose from. You can then top off the tour with a fresh fruit crepe! If a sit-down restaurant is more to your liking, Bistro 1843, a restaurant located in a historic home in Ile Bizard, is a gourmet experience to try. A typical selection of a soup or salad, a main course, and a dessert goes for around US $45/person (reservations recommended!)

So make sure you take the time to enjoy all of the hard work you've done to save, plan, and prepare for your goals. There is no time like the present to take advantage of our stronger US Dollar and book those trips that as recently as last September were 9% more expensive. Au Revoir!

CADENCE WEALTH MANAGEMENT