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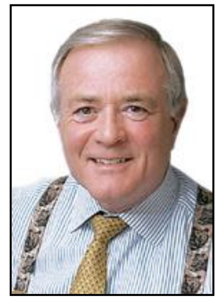

William Rutherford

Recent statistics underscore economic recovery's weakness

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The gross domestic product numbers just posted show U.S economic growth at 1.2 percent for the second quarter of 2016, and when added to the numbers for the first quarter, they show anemic 0.9 percent growth for the year to date. Economists had expected 2.6 percent growth after seven years of slow to no growth; the U.S. now exhibits more of the same.

The U.S. economy has grown at a 2.1 percent annual rate since the recovery began in 2009. The current expansion remains smaller than the one during Richard Nixon's administration, and that expansion lasted a mere three years. Even Janet Yellen, the Federal Reserve's chairwoman, sees slow long-term growth.

During this "recovery," 3.1 million more people fell into poverty, and the percentage of Americans in poverty climbed from 14.3 percent to 14.8 percent.

Sixty percent of households saw their income shrink between 2009 and 2014, while the bottom 20 percent saw their incomes decline by 8 percent over that time.

More people are on food stamps. According to the U.S. Department of Agriculture, 8.7 million more people were on food stamps in April than when the recovery started.

The number of people who dropped out of the workforce climbed 14 million.

There is less optimism. The IBD/TIPP Economic Optimism Index was 45 in July; anything below 50 represents pessimism.

With these numbers, it is no wonder that so-called "establishment" candidates are rejected and candidates of "change" surged during the presidential primaries. With pessimism so strong, Donald Trump mines discontent with his dark campaign. Hillary Clinton counters with an optimistic message. It is not clear at this time which message the voters will like better.

Despite all this pessimism, the U.S. markets offer promise due to their relative safety and security. With turmoil in Europe and the Middle East, and uncertainty in Asia, money has sought a safe haven in the U.S. markets.

U.S. equities and fixed incomes have been bid up. With the possibility of rising interest rates, the U.S. dollar has gained strength, which has encouraged yet more investment in the U.S., further buoying U.S. markets. Investors have sought yield, with utilities, telecoms and high-yield debt among the best performing sectors. Utilities have been bid up to historic prices of three times revenue.

Investors have also bid up emerging markets, which have significantly outperformed the U.S. year to date and still sell at only 11 times earnings compared to 22 times earnings for the U.S. Still, with a strong dollar and the threat of rising interest rates in the U.S., emerging markets, with all their debt priced in dollars, seem like a risky bet – unless you feel at home in China, India, Brazil and Russia. At Rutherford Investment Management we have a limited appetite for that risk.

The Federal Reserve has tried to make the case for an increase in interest rates. Its most recent policy statement read: "Near-term risks to the economic outlook have diminished." Yet it is hard to see a rate hike soon with the Fed so far off on its forecasts. Fed futures indicate a 34.4 percent chance of a rate hike this year.

The Fed has been worried about weak business investment, with good reason. Business investment fell 2.2 percent – its third quarterly decline. Spending on residential construction and remodeling slid 6.1 percent in the quarter. The only bright spot was consumer spending, which rose at a seasonally adjusted 4.2 percent in the second quarter, with growth in both goods and services.

With the economy going nowhere, the Fed will likely follow suit. Will a growth rate of 0 percent feel much different than a growth rate of 1 percent? Some forecasts are for bonds to gain 0.55 per year over the next 10 years, and stocks 1.15 percent per year over the same time.

Central banks are working in concert. Indeed Yellen has cited concern over the effect on international economies as a reason not to raise interest rates in the U.S. Even so, after all the effort of the central banks, we see slow to no growth in the world. This is worrisome as this bull market gets longer in the tooth, because central banks have used all the tools in their tool kit to no avail.

All the pessimism is a good thing, as it keeps the markets from getting frothy. Indeed the volatility index has been remarkably low. Earnings so far this quarter show 73 percent of companies beating analysts' estimates of their earnings; however, total earnings have declined year over year for the third quarter in a row.

The average dividend yield on S&P 500 stocks is greater than the yield on U.S. 10-year Treasurys – surely an argument for stock investments for those seeking yield.

Remember that the market climbs a wall of worry.

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