Pioneer Bank & Trust

Trust & Investments

Local.

704 7th Ave, PO Box 729
Belle Fourche, SD 57717-0729
Phone (605) 892-3494
Fax (605) 892-2115

2001 W Omaha St, PO Box 9189
Rapid City, SD 57709-9189
Phone (605) 341-2265
Fax (605) 341-7425

140 E Jackson Blvd, PO Box 10
Spearfish, SD 57783-0010
Phone (605) 642-2725
Fax (605) 642-1736

September surprise

October 2—The current economic expansion is now over six years old. For much of that time, investors have been expecting the Fed to begin pushing interest rates upward "soon." At the beginning of 2015, the emerging consensus seemed to be that the first steps could come as soon as June, but no later than September.

Once again, the consensus was wrong, because no action was taken by the Fed. Some observers believe that a rate hike by December remains on the table, but the chance of a delay into 2016 can't be dismissed.

One factor in the Fed's thinking may have been the extraordinary selloff in global equity markets in August. On August 24, the Dow Jones Industrial Average fell 1,089 points in the morning, an intraday record. The market recovered, to close down just 588.40 points, but the volatility revealed flaws in the pricing of ETFs.

The "circuit breakers" were tripped repeatedly that day. After the 2010 "flash crash," the SEC instituted circuit breakers for individual securities. (See http://www.sec.gov/investor/alerts/circuitbreakers.htm for details.) These individual halts occurred nearly 1,300 times on August 24, according to *The Wall Street Journal*. The trading halts created some cascading difficulties, as some electronically traded funds (ETFs) could not be valued when trading had been halted in some of their underlying securities. In fact, according to the *Journal*'s analysis nearly 80% of the trading halts were for ETFs. Some fine tuning of the system may be needed.

A terrible jobs report

The Fed justified not raising interest rates by suggesting that the economic recovery remained fragile, and inflation remains muted. That judgment was vindicated by the release of the September jobs report, which came in well below expectations. What's more, the rosier August report also had to be downgraded. Only 136,000 jobs were created in September, according to the Labor Department, roughly 25% fewer than the expected 173,000.

Unemployment remains steady at 5.1%, but that cheery number masks major weakness in the labor market. The participation rate fell again, from 62.6% to 62.4%. That means more and more people are simply dropping out of the labor market. Labor force participation hasn't been this low since the early years of the Carter administration, in October 1977. A record 94.6 million people are not in the labor force, compared to 148.8 million workers. With all this slack in the labor pool, it shouldn't be surprising that wages remain stagnant. Fewer workers means lower national income, lower tax collections and higher deficits.

A September report from the Census Bureau confirmed that stagnant wage growth is not an isolated phenomenon. Across the entire income spectrum, everyone is off of their peak earnings. For example, the middle quintile of workers reached their peak in 2000, and wages in this group are down 6.9% since then. The second quintile peaked at $90,331 in 2007, and remains 2.8% below that as of 2014. Even the top 5% are 4.8% below their peak earnings.

The weakness in wages may explain in part why the unconventional candidates for president have proven so popular this year.

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