PARAGON CAPITAL MANAGEMENT, LLC

October 2017

Good News

Since the advent of 24-hour financial news channels/websites/apps several years ago there has been an onslaught of talking heads describing, discussing, and debating every piece of data that is reported, or about to be reported. It begins with forecasts about what the data will be; followed by conversations and charts about what it means, and finally a *post mortem* regarding what might have been missed or misinterpreted. The one constant is that each forecast, economic report, or even offhand comment by a person of interest is treated as though it is central and vital to the well-being of the economy and our knowledge of it.

The financial media rarely edits the economic landscape, as they have hours and hours of air-time to fill every day. The media seldom adds meaningful context that is concise and actionable. Too often, they spends segments and hours discussing a trivial point of data as though the data point itself were the end all, and be all. And far too often, the media focuses on the negative instead of the positive. Because, as we all know, bad news sells.

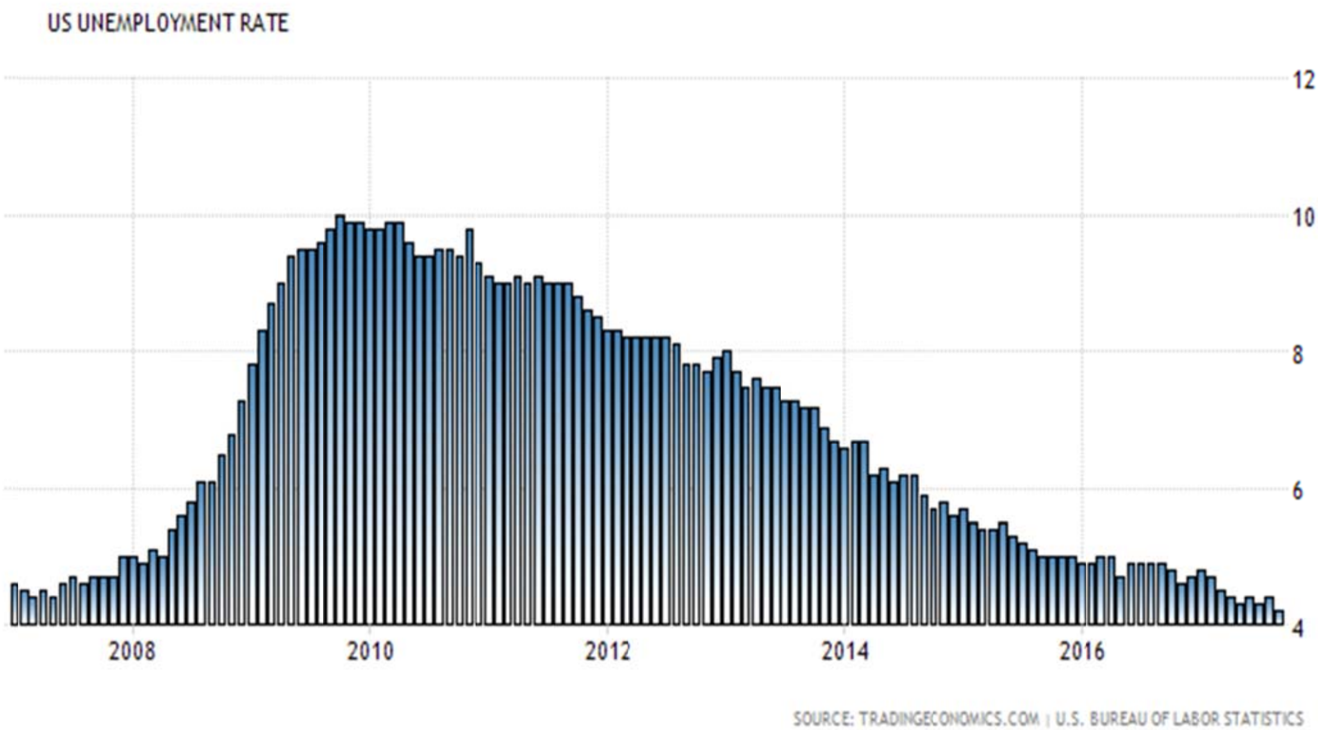
Since we rarely offer economic analysis we thought it would be timely to offer an opinion on the U.S. economy, and how it relates to our everyday lives. We will try to be as brief as possible, and point out some highlights.

The U.S. economy is good. As a matter of fact, it is in better shape than any time in the recent past. The most common measure of economic health is the growth of the Gross Domestic Product (GDP). As we can see by the chart below, the U.S. GDP grew 3% during the 2nd quarter of 2017. This is the fastest rate in almost three years, which reverses a trend of declining GDP growth over the past three quarters.

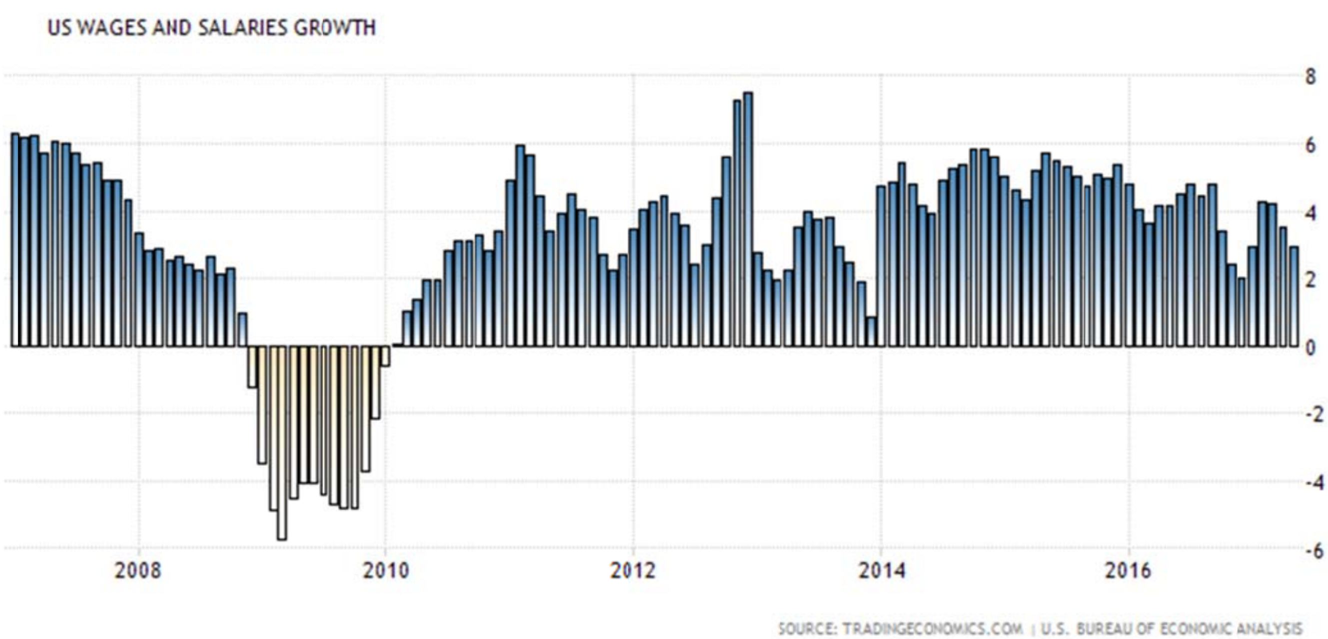
Although GDP growth came in above expectations for the 2nd quarter, estimates for the 3rd quarter have been falling due to the effects of the hurricanes (Henry, Irma, and Maria) during September. With lowered expectations, there is an increased chance of a positive surprise with any unexpected good news.

The first bit of good news came on Thursday, October 11 as the Department of Labor reported that the total number of laid-off workers receiving unemployment benefits fell to 1.89 million at the end of September. This is the lowest level in 43 years. New claims for unemployment benefits dropped to 243,000 (down 15,000) in the first full week of October. This is important because although new claims had been running at very low rates, they had spiked in September due to the hurricanes. The fact that the reversal in new claims for unemployment appears to have happened so quickly after the events shows how robust the economy actually is.

Speaking of unemployment, the unemployment rate unexpectedly dropped to 4.2% during September; down from 4.4% the previous month and below the consensus estimate of 4.4%. This is the lowest unemployment rate since February 2001, and continues the dramatic decline in place since the recession of 2009.



However, throughout the multi-year decline in unemployment, wage growth (inflation) has been remarkably constant and relatively tame for such an extended period of economic growth.



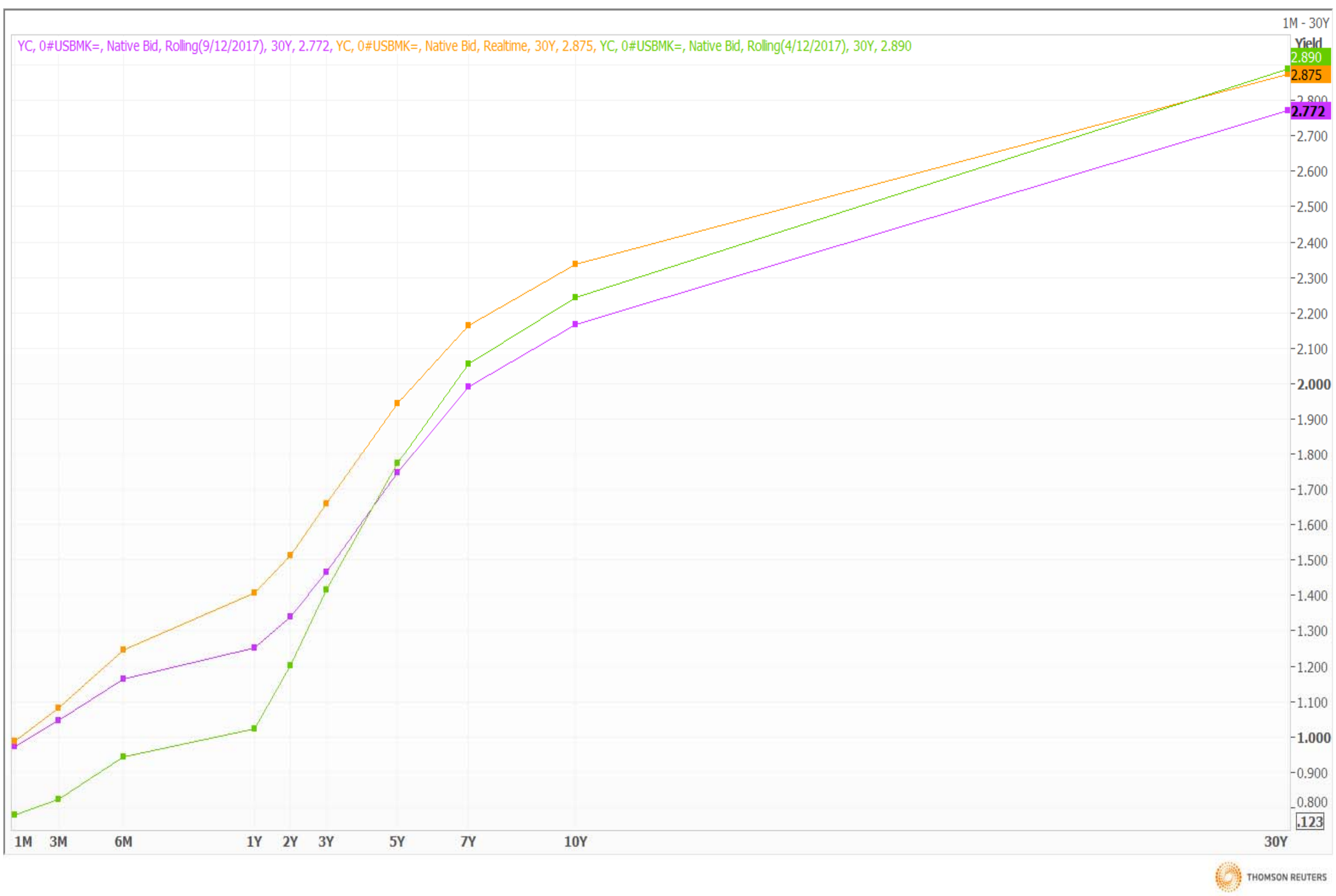
Overall inflation has been tame as well during the expansion, with productivity and lower prices due to technology providing downward pressure for many years. Lower prices for energy have driven inflation lower during 2014 and 2015.

So, with the economy growing, low unemployment, and low inflation what else is going right? As we all know, stock markets have been reaching new highs. As we discussed last month, not all stocks are benefiting equally, although value stocks did begin to gain on growth stocks during September. Even though the stock market has not experienced a 10% correction in many years, there are signs of a rolling correction. Through mid-August, 220 stocks in the S&P 500 were down more than 10% from their 52-week high, and 91 stocks (almost 1 out of 5) stocks in the index were down more than 20% from their highs. [Forbes, August 22, 2017]

The bond market, after its post-election swoon when the 10-year Treasury note went from a 1.8% to a 2.4% yield (remember, bond prices fall as rates rise) has settled into a trading range around the 7 to 10 year maturities. Interest rates at the short end of the yield curve (3 months to 1 year) have increased somewhat as the Federal Reserve has recently raised rates (tightened) at that end of the curve in anticipation of a faster growing economy.

More importantly, the "shape" of the yield curve has been changing over the last half year. In the chart below, the purple line is the yield curve from 6 months ago. The yield curve went from a 3-month yield of 0.78% to a 10-year yield of 2.24%. Fast forward five months to September, which is the green line, which shows that the 3-month yield had risen to less than 1% while the 10-year yield had fallen to 2.17%. This is known as a "flattening" of the yield curve and although not a bad sign on its own, can sometimes lead to a very flat, or even inverted, yield curve which typically indicates a slowing economy.

However, during the past month the middle part of the yield curve has risen to a more "normal" yield curve, as shown by the orange line. This indicates that the markets are forecasting a growing economy and maybe a little higher inflation. For investors it potentially means a final goodbye to the historically low rates we saw throughout 2015 and the first 10 months of 2016. It is highly unlikely that the 10-year U.S. Treasury note drops below 2% again.



In summary, the economy is doing well, and the preponderance of indicators show that it will continue to do so. Although we did not discuss international economies, they are also improving as of late. So, regardless of what else is going on in the news climate-wise, politically, internationally, or with your favorite teams, be reassured that the economy is continuing to do well.

As always, we welcome the opportunity to serve you, and we appreciate the confidence you have shown in Paragon. If there is anything we can do for you, please do not hesitate to let us know.

Coming Next Quarter: An update on our upgrades and improvements to better serve you.

Craig, Howard, Elizabeth, Ward & Brian

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