An economist is someone who is good with numbers, but doesn't have enough personality to be an accountant. - Unknown

The View From Here

June 2016

Dear Clients and friends:

I've admitted over the years to being a "nerd." I once used the quote above to introduce a speech and noted that I'm about ½ accountant and ½ economist. Applying the wisdom of the statement, I'm left somewhere between. I've been to enough accounting "parties" to recognize that there's not much space in this so-called middle.

Nerd / geek or not, I do have a "smart phone" and somehow must have pushed a button that informed someone, somewhere that I wish to receive business and economic news automatically. Consequently, often as I arise for my 4 am old-style book-reading sessions, I receive messages designed to inform of the stuff that happened overnight. Fortunately I don't have to look anyone in the eye and feign interest.

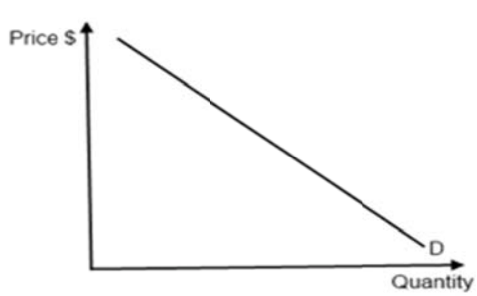
On a recent morning there was a message informing me that the U.S. economy had added 160,000 jobs in the previous month. And, that number was a little below the recent trend. Two pretty general questions come to mind: What does that mean? So What? Let's try to put some perspective on those two queries as we wrap our brains around some basic economic fundamentals.

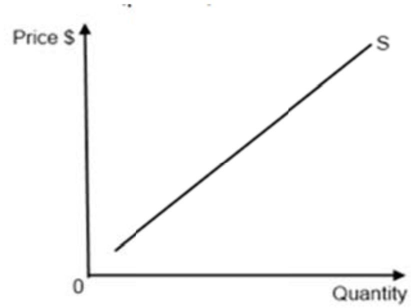
Thank you and God Bless,

Doug

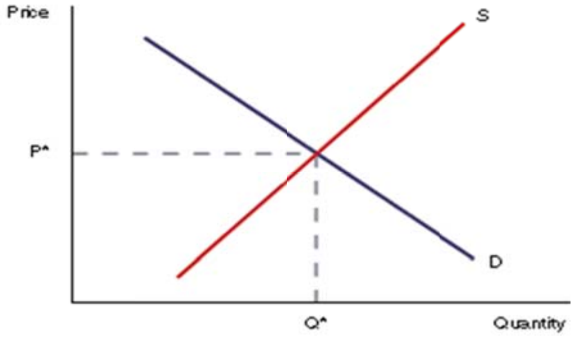
Economics 101

This discussion must start with some understanding of the concept or theory of **supply and demand.** The notions here are for *demand*: There exists a relation between the market price of something (a good) and the quantity demanded of that good. The higher the price of something, the fewer units consumers are generally willing to buy, and the lower the market price, the more units are bought. For *supply:* There is a relation between market price and the amount of a good that producers (suppliers) are willing to produce and sell. The higher the price, the more will be supplied, and vice-versa. If we graph these relationships, they look something like this:





These concepts are fundamental to understanding economics and sort of underlie other concepts. If we put them together the graph looks like this:



The important notion here is that the point of intersection of these two lines (the middle of the X in the lower graph) – where quantity supplied and quantity demanded represent market equilibrium - imply that the appropriate price is in place. In other words the price required by sellers equals the price required by buyers and all is in equilibrium – the world is at peace.

This then sets the stage for thoughts relating to the addition of 160,000 jobs to our U.S. economy as reported by my smart phone. Labor is something *supplied* by workers (me and many of you), and *demanded* (bought) by employers (generally businesses). If there are more jobs available than workers to fill those jobs – demand for labor exceeds supply of labor – employers need to raise the price they are willing to pay (wages) to attract workers. If there are more workers available than available jobs, workers must lower their wage expectations because employers can likely find someone else to fill scarce positions.

The 160,000 jobs added in the economy represent additional demand for labor. At the same time as the notification of jobs added, there was a notice that unemployment remained at 5% - meaning that 5% (1 in 20) of the workforce does not have a job and is available to fill these new positions. Unemployment here is loosely defined as the precentage of folks who want to have jobs, but don't have one. This then does not include kids, old folks (retired), stay-at-homers, folks simply not interested in jobs, etc. It includes only those actively seeking paid work. So the new jobs added may be offset by additional folks "reclassifying" themselves as seeking employment.

This concept becomes useful in forecsting – for instance, the Federal Reserve announced their intention to raise their vision for interest rates over the foreseeable future. Their confidence moving forward will be influenced by whether the economy continues to add jobs at a reasonable pace – otherwise they will be influenced to stop raising interest rates to encourage employers to borrow at lower rates to expand businesses and create jobs. Continuing increases in jobs available will indicate confidence in economic growth by decision-makers and suggest higher wage rates if demand for workers begins to exceed the supply of workers (see chart: if demand goes up, prices go up). Higher interest rates and higher wages suggest more expenditures (costs) for businesses – unless accompanied by higher sales (revenue), these higher costs will affect profits, and lower profits suggest lower stock prices. On the other hand, if higher sales exceed the cost of creating the sales (labor, interest, etc.) then higher profits result and the potential for higher stock prices exists.

Intuition is nothing but the outcome of earlier intellectual experience. - Albert Einstein

So the notice I received on my smart phone must be put in perspective of its effect on supply and demand, and must be considered in light of the trends in place over the longer term. We'll stay focused on things going on in our economy and remain vigilant in applying the tenets of prudent investing, financial integration and client service; you keep us informed. Call or come see us soon.