The Financial Navigator – August 2015 Newsletter

Hopefully you are enjoying your summer, and if so you may have missed the latest Trumpism and most recent news about Hillary's email challenges. Mixed in with the hyperventilating on TV about the political issues, there was some actual news as China devalued its currency the yaun which resulted in a noticeable drop in the Dow Jones average. The article *Devaluation Panic* discusses the Chinese move and puts in a bit of perspective despite some hysterical headlines in the financial press. Two additional articles, *The Deficit Shrinks Again* and *Rent or Buy* are short articles touching on the improving budget situation in the U.S., and the changing rent vs. buy decision.

Enjoy the rest of your summer, and as always feel free to forward this email to anyone that may share your interest, and let me know if you have questions about a specific situation.

Sincerely,

Bill Simpson, CFP®, MBA
Azimuth Financial Planning, LLC
(603) 373-8793
bsimpson@azimuthplanning.com
www.azimuthplanning.com

Devaluation Panic

Investors across the globe were sent into a panic recently when the Chinese Central Bank devaluated the nation's currency, the yuan. The U.S. market lost more than 1% of its total value, oil prices fell and global shares plummeted on news that China decided to make its currency two percent cheaper than it was before.

You actually read that right. Headlines raised the prospect of a global currency war, and there were hints in the press that nations might resort to trade barriers, which would slow down global trade in all directions. If you're following the story, you probably didn't read that the Chinese yuan, even after the devaluation, was actually more valuable against global currencies than it was a year ago in trade-weighted terms. Nor that China actually intervened in the global markets to make sure the devaluation didn't go any further in open market trading.

The background for the devaluation is China's slowing economic growth and its recent stock market volatility. The country is on track for a 7% growth rate this year—three times the U.S. rate, but sluggish by recent Chinese standards, and quite possibly unacceptable to the country's leaders. You probably already know that the Chinese stock market climbed to impossibly high levels earlier this year and then fell just as far in a matter of weeks. As you can see from the accompanying chart, the Chinese government marched into the chaos with a heavy hand, outlawing short sales, banishing hedge funds to the sidelines, suspending margin calls and even buying stocks directly in an effort to put a floor on prices. The theory was that the devaluation was part of this intervention, since it would make exports cheaper and boost sales, raising profit margins of those companies whose stocks were recently free-falling.

A more nuanced view of the situation is that the recent depreciation is a small step to keep the yuan's value in line with those of its peers, not a dramatic shift in exchange-rate policy or a part of the Great Shanghai Market Panic. Indeed, China's percentage of world exports has been steadily growing for this entire century, without any need to add the stimulus of a weaker currency.

A scarier scenario, which nobody seems to be talking about, is that China's endgame goal is to make the yuan the reserve currency for global trade—replacing the U.S. dollar. China is already lobbying to join the list of reserve currencies recognized by the International Monetary Fund. The new exchange rate is more in line with basic economic fundamentals, strengthening the argument that the yuan is not under the total control of an interventionist central government. But so long as China imposes strict limits on the amount of its currency that can flow into and out of the country, and attempting to manipulate its own stock market, this will be a difficult argument to make.

The Deficit Shrinks Again

You might remember some years back when the U.S. budget deficit was one of the biggest political issues on the campaign trail. Yet this year, after one Republican debate and a lot of jockeying for political position, the subject seems to have gone away. Why?

The most probable reason is that the U.S. has retreated from an unsustainable budget mess much faster than anybody anticipated. In 2009, when the U.S. government was stimulating the world out of the Great Recession, the government's shortfall came to $1.4 trillion, dangerously close to a red line of 10% of the economy, as outlined in "This Time It's Different," an analysis of government deficits around the world since the Middle Ages. Today, the projected deficit is lower by nearly $1 trillion: the fiscal year ending in September is expected to close out with a $425 billion deficit, more than $150 billion lower than economists expected at this time last year.

It might be harder for politicians to generate public outrage at a deficit coming in so far from the alleged tripwire: this year, the shortfall is projected at a much more manageable 2.4% of GDP.

The bad news in all this is that tax revenues for the first ten months of the fiscal year topped a record $2.7 trillion, almost 8% higher than the revenues collected over the first ten months of 2014—and most of it came out of the pockets of consumers like you. Individuals paid $1.3 trillion of the total, about five times more than corporations paid ($266 billion). Estate and gift taxes brought in an additional $16 billion.

Where is the money going? Roughly $738 billion was sent to Social Security recipients and $477 billion paid the medical costs for Medicare recipients. Another $496 billion went to defense spending and $398 billion is allocated to health spending. Roughly $209 billion went to net interest on our debt—Treasury bond and T-bill payments to investors and pension funds.

Rent or Buy

If you read articles that offer budgeting advice, you might see an item that says you shouldn't spend more than 25% of your income on housing costs. These days, that advice doesn't apply.

Why? According to the latest report from Zillow Group, which tracks rental housing affordability, the typical renter making the median income in the U.S. spent 30.2% of her income on a median-priced apartment. This is the highest rate since Zillow started keeping statistics in 1979. The average from 1985 to 1999 was 24.4%.

The rise appears to be driven by greater demand for apartments and rental units. In the second quarter of this year, due to strict lending standards, the U.S. homeownership rate fell to the lowest level in almost five decades, forcing a greater number of people into the rental market. However, those fortunate enough to obtain mortgage loans appear to be much better off than renters. With today's low interest rates, homeowners are paying, on average, 15% of their income in mortgage payments, well below the historical average of 21%.

Zillow found that rents were least affordable in Los Angeles, where residents were paying 49 percent of monthly income. The share in San Francisco was 47 percent, 45 percent in Miami, and 41 percent in the New York metro area.