LIBERTY
ASSET MANAGEMENT, INC.

October 2016

Middle-Class Earnings Move Forward

A recent release from the Census Department reports that, six years into the economic recovery, the middle class has finally seen household earnings increase. Though the reports are generally viewed to show that the middle class is burgeoning, there are those who believe this to be a false positive. Let's examine the data and what it truly means for the middle class.

Benefiting the Middle Class

The term "middle-class" is used extensively in the media, but the exact parameters of who that applies to may be unclear for some. So first, let's try to define what makes a family "middle-class." First and foremost, because different areas have varying standards of living, there are no exact numbers for determining "middle-class" finances. According to Pew Research Center, a family of four must earn $46,960 to $140,900 annually to be considered "middle-class" in the United States. Alternatively, in terms of net worth, $0 to $401,000 is considered "middle-class," according to NYU Professor Edward Wolff.

Middle-class earnings per household rose by 5.2 percent (inflation-adjusted) from 2014 to 2015. This figure includes increases for families of all ethnic backgrounds and for all major age groups. Last year marked the largest single-year household earnings increase for the middle class in nearly 50 years and is the first annual increase for middle-class families since 2007. Average household income for a middle-class family is now $56,500.

Between 2014 and 2015, the amount of full-time, year-round workers increased by 2.4 million. This is the highest number of total, full-time working adults since the recession began. Together, the information regarding growing wages and increasing employment paints a positive picture of the current state of the middle class's working situation.

In addition to increased earnings and higher employment rates, poverty levels and the number of Americans without health insurance also sharply declined between 2014 and 2015. The official poverty rate dropped by the largest amount in a single year since 1999, from 46.6 million to 43.1 million. Similarly, those without insurance declined from 33 million to just 29 million.

Cautious Optimism

Though tentatively interpreted as the middle class recovering from the recession, there may be need for cautious optimism when considering these statistics. It is important to note that the numbers that are consistently being cited by the media are based on "household" earnings, not individual earnings. Individual earnings are increasing at a much lower rate, at just 1.5 percent for men and 2.7 percent for women.

While the nominal value for household income is the highest it has been in nearly 20 years, purchasing power for the middle class's median income is lower than its peak in 1999. Even given the recent earnings increase, the middle class is still earning less than it was in 1999 when considering inflation.

Though the increase in earnings was significant in relation to 2014 numbers, this is the first time that such an increase has happened since the recession. Therefore, some analysts suggest that 2015 should be considered an outlier and not necessarily indicative of an improving middle class.

While the recent data regarding middle class earnings is generally positive, it is important to take the report with a grain of salt. Though household incomes are on the rise, purchasing power in the middle class has yet to regain the high point set back in 1999. Similarly, while poverty levels are the lowest that they have been since the recession, they are still higher than before the recession began. Whether the increase of earnings will continue to rise remains to be seen, but for now, the recent bump is some of the best news the middle class has gotten in the past decade.

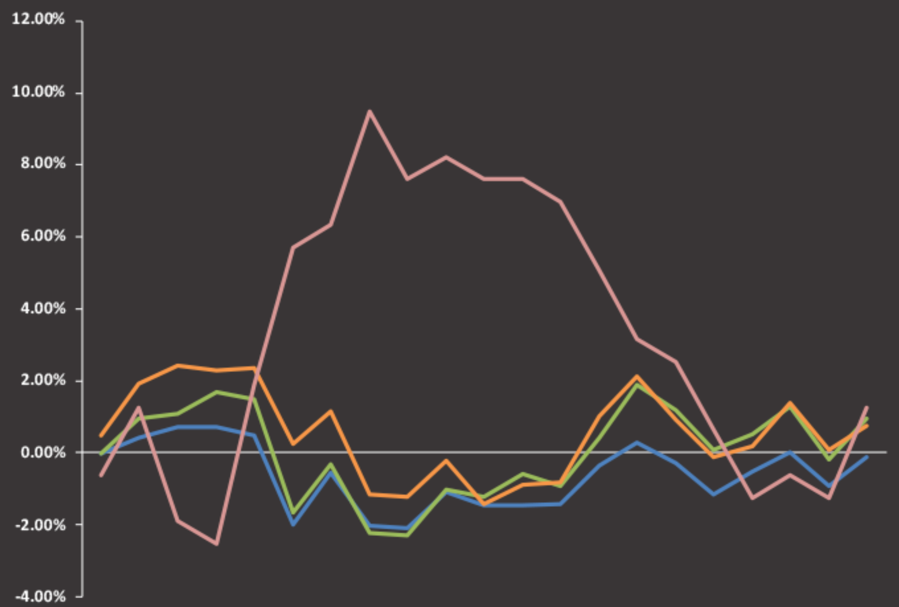
the market at a glance
SEPTEMBER

U.S. Large Cap
(S&P 500)
2,168.27 (-0.12%) ▼

U.S. Mid/Small
(Russell 2000)
1,251.65 (0.95%) ▲

International Large
(NYSE International 100)
4,886.26 (0.76%) ▲

U.S. Treasuries
(U.S. 10-Year Treasury Yield Rate)
1.60 (1.27%) ▲



Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly.

The market in action

- Wells Fargo & Co. faces a Senate hearing and a $185M fine after it reveals its employees had created over two million fake customer accounts since 2011. Wells Fargo immediately fired 5,300 people associated with the fraud and suspended the cross-selling programs that had incentivized account falsification.
- After months of discussion, Bayer AG reaches deal to buy Monsanto Co. for $66B. The acquisition, if approved by regulators, will be the largest takeover of a U.S. business by a German corporation.
- The World Trade Organization lowers its forecast of global trade growth in 2016 to 1.7 percent from 2.8 percent. If accurate, it will be the first time in 15 years that international trade grew less than the total world economy—suggesting governments are focusing their attention on growing their domestic economies.
- Yahoo Inc. announces it was the victim of the largest hack in history, stating that as many as 500M of its user accounts may have had their data stolen. The breach is not expected to affect Verizon Communication’s $4.8B acquisition of Yahoo, which began in July.
- Volkswagen AG receives notice of a $9.1B misconduct lawsuit filed by its own investors. The suit claims that Volkswagen’s production of emissions-cheating engines, which led to billions of dollars in government fines, was a fiscally irresponsible decision by management.
- Postal Savings Bank of China Co. debuts on the stock market with the largest initial public offering of 2016. Although the stock remained relatively flat on its first day, the Hong Kong-based bank fetched an initial market valuation of $7.4B.
- The Institute for Supply Management reports that U.S. manufacturing contracted in August for the first time in six months as factory production drops by the most since 2012. Meanwhile, factory production in the United Kingdom jumped to a 10-month high in August despite expectations it would suffer from the “Brexit” vote.
- Canadian fertilizer companies Potash Corporation and Agrium Inc. agree to an all-stock merger that will create a $36B agricultural-chemicals giant.

The Bottom Line of For-Profit Education

In August, ITT Technical Institute, one of America's largest for-profit colleges, stopped accepting new student enrollment. Then, just a few weeks later, ITT Tech announced that it would be closing all of its 137 campuses and ceasing all online education, leaving its 35,000 students without a clear path to finish their degrees. With many for-profit colleges recently being subjected to legislative action, legal investigation and closures, the future of for-profit colleges has become increasingly bleak.

Criticisms of For-Profit Schools

Since the Great Recession, for-profit tuition rates have soared; currently, the average tuition at a for-profit university is roughly twice that of state universities. In a 2014 TIME article of the top 5 colleges "that leave the most students crippled by debt," ITT Tech was second only to the University of Phoenix, another for-profit institute. However, even expensive college degrees can be beneficial if they adequately increase a person's earning potential.

Unfortunately, according to the U.S. Department of Education, just 27 percent of students that began attending for-profit colleges in 2008 had graduated by 2015. This graduation rate is dismal compared to those of public colleges (58 percent) and private nonprofit colleges (65 percent) over the same period. Even worse, students found that for-profit universities do not have the job placement numbers that they were expecting.

For-profit universities are institutions that are privately owned or publicly traded, so it's not surprising they will seek to make some money off their students. However, when the degrees do not lead to successful careers, graduation rates are low and tuition is high, there is a clear problem with how these schools operate.

Because of these issues, for-profit universities have come under fire by the government agencies, and ITT Tech isn't the first. In early 2015, Corinthian Colleges Inc., which has educational subsidiaries such as Everest College, was forced to close over 100 of its campuses after a government-led investigation into reports of false advertising of hiring rates for graduates.

Similarly, the Consumer Financial Protection Bureau ordered California's Ashford University and Colorado's University of the Rockies to pay back a combined $23.5 million in student loans on account of "misleading students about the cost of borrowing for loans."

ITT Tech Shut Down

According to a report by ITT Educational Services (the college's parent company) for the fiscal year 2015, a large number of ITT Tech campuses and online programs were not meeting Accrediting Council for Independent Colleges and Schools standards. Therefore, credits earned at ITT were deemed "unlikely to be transferrable to or accepted by any institution other than an ITT Technical Institute." Additionally, ITT Tech was sued by the Consumer Financial Protection Bureau in 2014 for its use of predatory lending tactics and was later investigated for fraud by the Securities and Exchange Commission in 2015.

Ultimately, the government became so skeptical of ITT Tech's ability to provide students with an adequate education at a reasonable cost, it barred the school from accepting students that used federal grants and loans. Because federal grants and loans made up over two-thirds of its revenue in 2015, ITT Tech had no choice but to immediately cease operation of all of its campuses and online courses.

For-profit universities are enticing because they have flexible scheduling and make it easy for students to be accepted into programs and get loans. But if a school builds its core business on attracting students instead of educating them, problems are bound to follow. With hundreds of for-profit schools closing in recent years and severe legislative action being taken, the end of the modern for-profit education may be at hand.

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