

MONTHLY ECONOMIC UPDATE

September 2015

MONTHLY QUOTE

“All human power is a compound of time and patience.”

– *Honore de Balzac*

MONTHLY TIP

Patience, not market timing, is often far more appropriate when markets take sudden and unanticipated turns in performance.

MONTHLY RIDDLE

At a big event, you can bet I'll be sent. Whenever there's action or a gathered flurry, I'll leave with my crew and I'm off in a hurry. I always try to tell the truth, even from the rain or snow without a roof. What kind of person am I?

Last month's riddle:

You can get into it easily if you are not careful, even though it lacks physical form. Getting out of it can be very difficult, even perilous. What is it?

Last month's answer:

Trouble.

THE MONTH IN BRIEF

Fears about the health of China's economy rocked Wall Street and other stock markets last month. The Dow Jones Industrial Average lost 6.57% in August, and other major U.S. equity indices followed it into correction territory. Not one consequential foreign benchmark posted an August gain. The anxiety also sent prices of oil and other commodities lower; oil rebounded before the end of the month, but many other commodity futures did not. The housing sector and a few encouraging U.S. economic indicators offered bright spots, but they were not enough to divert attention from concerns about China's economic woes.¹

DOMESTIC ECONOMIC HEALTH

With all the attention on China, some solid stateside data had to fight for space on the front page. Job creation was again strong in July, with employers adding 215,000 new hires to their payrolls. The broad unemployment rate remained at 5.3%, and the U-6 rate (unemployment + underemployment) descended slightly to 10.4%. Monthly hiring totals have averaged 235,000 since May.²

Second-quarter GDP turned out to be much better than originally thought. The second estimate of Q2 growth from the Bureau of Economic Analysis came in at 3.7%, way up from the initial 2.3% and topping the 3.1% consensus forecast at Briefing.com. Additionally, capital goods orders rose by 2.0% in July (0.6% minus transportation orders). July also brought a 0.6% rise for industrial output.^{3,4}

Hopefully, some of that increased demand for hard goods will be reflected in the Institute for Supply Management's upcoming manufacturing PMIs. ISM's August factory PMI came in 1.6 points lower at 51.1; that was its poorest reading since May 2013. ISM's service sector index climbed 4.3 points to 60.3 in July, approaching its all-time peak of 62.0 set 18 years earlier.^{5,6}

Some of the August responses to the two most-watched U.S. consumer confidence polls were compiled before the stock market corrected. That factor may partly account for the big leap in the Conference Board's consumer confidence index, which went from a revised July mark of 91.0 to 101.5. The University of Michigan's consumer sentiment index (which included responses collected after the record 1,000-point intraday drop of the blue chips) finished August at 91.9, one point underneath its preliminary August reading.^{4,7}

Consumers were spending and buying a little more. July had seen a 0.3% gain for personal spending, with the Commerce Department revising June's increase to the same percentage. Personal incomes were 0.4% improved in July, matching the rise seen in April, May and June. July's 0.5% boost in consumer wages was the largest since November. Retail sales rose by 0.6% in July.^{4,7}

Analysts who think the Federal Reserve should postpone a fall interest rate hike often cite negligible consumer inflation. The latest Consumer Price Index certainly supported their argument. In July, the headline and core CPI rose only 0.1%; that put the yearly rise in overall consumer prices at just 0.2% and the annual advance for core consumer prices at 1.8%. The Producer Price Index rose 0.2% for July with the core PPI up 0.3%.^{4,8}

On August 23, former Treasury Secretary Larry Summers published an op-ed piece in the *Washington Post* cautioning against a September interest rate hike by the Federal Reserve, writing that it would be “a serious error that would threaten all three of the Fed's major objectives: price stability, full employment and financial stability.” Economists polled by Bloomberg in late August still thought the Fed might

make a move this month, even after the stock market's swoon: 48% saw the central bank doing so. Another 17% felt the Fed would raise interest rates for the first time in nine years in October; 24% thought the move would be made in December.^{9,10}

GLOBAL ECONOMIC HEALTH

As August unfolded, compelling evidence appeared to show that China's powerful economic engine had downshifted. The nation's official manufacturing PMI slipped into contraction territory in August at 49.7, down from 50.0 in July. The reading on the private-sector Caixin/Markit PMI, which focuses more on China's small and mid-sized manufacturers, hit a 6½-year low of 47.3 in August, a decline from 47.8 a month earlier. A preliminary report also showed Chinese factory production contracting in August. China suddenly devalued the yuan at mid-month in what seemed like a desperate move to avoid economic deceleration and further slides in the Shanghai Composite. Investors worldwide feared what a slowdown in China's economy could mean for stocks, commodities, and GDP.⁵

Purchasing manager indices gauging manufacturing in other countries were mixed. Japan's Markit PMI rose to 51.7 in August; India's was at 52.3. Markit PMIs for South Korea (47.9), Taiwan (46.1), Indonesia (48.4) and Malaysia (47.2) all showed contraction. Markit's factory PMI for Germany read 53.3 in August, and the overall eurozone Markit manufacturing PMI was at 52.3; Italy's Markit factory PMI was at 53.8. The European Central Bank is easing to help euro area economies; perhaps this manufacturing sector expansion will hold up in the face of the headwind from Asia. Data showed the eurozone jobless rate declined 0.2% to 10.9% in July.^{11,12}

WORLD MARKETS

Losses were widespread in August. Not one foreign index tracked by the *Wall Street Journal* advanced for the month (but many remained positive year-to-date). Europe saw the following retreats: IBEX 35, 8.24%; ISEQ, 1.64%; RTS, 2.94%; FTSE MIB, 6.78%; CAC 40, 8.45%; DAX, 9.28%; FTSE 100, 6.70%. The descents among the Asia Pacific bourses: Sensex, 6.51%; Jakarta Composite, 6.10%; Nikkei 225, 8.23%; KSE 100, 2.84%; Hang Seng, 12.04%; Shanghai Composite, 12.49%; Kospi, 4.37%; S&P/ASX 200, 8.64%. As for the notable indices in the west outside the U.S., the TSX Composite lost 4.21%, the Bovespa 8.33%, and the IPC All-Share 2.30%.¹

As for major regional and multinational indices, the Europe Dow fell 7.45%, the STOXX Europe 600 8.47%, the Asia Dow 9.91%, the Dow Jones Americas 6.31%, the Global Dow 7.42%, the MSCI World 6.81%, and the MSCI Emerging Markets 9.20%.^{1,13}

COMMODITIES MARKETS

The major news here was oil staging a comeback. Light sweet crude rose 2.97% for the month, reaching an August 31 close of \$45.81 on the NYMEX. Unleaded gasoline managed no such gain – futures slipped 10.61% for August. Natural gas lost 0.99% for the month, but heating oil rose 6.37%. Crops had it rough in August, with all of the major ag futures in the red – soybeans fell 8.43%, wheat 2.86%, cocoa 2.68%, coffee 3.89%, cotton 0.42%, sugar 9.94% and corn 2.15%.¹⁴

Gold retreated 10.61% for the month, settling at \$1,138.90 on the COMEX August 31. Silver lost 1.82% in August, settling at \$14.56 at month's end. Copper futures slipped 0.91%, but platinum futures gained 2.65%. The U.S. Dollar Index was also among the August losers, declining 1.59% for the month to 95.82.^{14,15}

REAL ESTATE

Once again, the housing market offered good news. New and existing home purchases respectively increased by 5.4% and 2.0% in July, Census Bureau and National Association of Realtors data noted – and resales hit their fastest pace since February 2007. The Census Bureau reported a 2.0% increase in new home prices in the 12 months ending in July, and overall existing home prices (as measured by the 20-city version of the S&P/Case-Shiller home price index) were up 5.0% from a year earlier through June.^{16,17}

How were the readings on other important real estate indicators? NAR's pending home sales index had advanced another half-percent in July. Housing starts rose 0.2% in the seventh month of the year, yet building permits slipped by 16.3%.^{3,17}

As for mortgage rates, three of the four mortgage types tracked by Freddie Mac's Primary Mortgage Market Survey became less expensive between July 30 and August 27. Average interest rates on the 1-year ARM rose from 2.52% to 2.62% in that interval, but average rates fell by 0.14% on the 30-year FRM to 3.84%, 0.11% on the 15-year FRM to 3.06% and 0.05% on the 5/1-year ARM to 2.90%.¹⁸

LOOKING BACK...LOOKING FORWARD

When investors start to worry, the CBOE VIX usually heads north. In August, the "fear index" outpaced all other U.S. benchmarks. It gained 134.57% to an August 31 settlement of 28.43, ending the month up 48.07% YTD. Three lesser-known stateside indices also rose last month – the Barron's 400 gained 2.95%, the PHLX Oil Service 2.56%, and the PHLX Gold/Silver 1.81%. As for the major indices, the Dow sank 6.57% to 16,528.03, the S&P 500 6.26% to 1,972.18, the NASDAQ Composite 6.86% to 4,776.51 and the Russell 2000 6.40% to 1,159.45 (that August loss left the RUT down 3.76% YTD).¹

% CHANGE	Y-T-D	1-YR CHG	5-YR AVG	10-YR AVG
DJIA	-7.27	-3.34	+13.01	+5.77
NASDAQ	+0.85	+4.28	+25.19	+13.36
S&P 500	-4.21	-1.56	+17.59	+12.19
REAL YIELD	8/31 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.58%	0.23%	0.95%	1.65%

Sources: wsj.com, bigcharts.com, treasury.gov – 8/31/15^{1,19,20}

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends. 10-year TIPS real yield = projected return at maturity given expected inflation.

Volatility may or may not ease by the end of September. This month has opened with further indications of China's slowing economy – poor service sector and factory PMI readings – and an underwhelming reading on ISM's U.S. manufacturing index. If the Fed holds off on a rate hike in September, that decision may not give the market the euphoric lift some investors hope to see. If the August indicators coming out of America mostly affirm the health of our economy, then the market may find some stable ground in the diversions. Right now, China is influencing not only the minds but the emotions of investors – and when emotion creeps into investing, sometimes the wise move is to ride out the ups and downs. This year is certainly testing the patience of the equity investor.

UPCOMING ECONOMIC RELEASES: Here is the roll call for September: the Labor Department's July employment report (9/4), June wholesale inventories (9/11), July wholesale inventories (9/10), the preliminary September University of Michigan consumer sentiment index and the August PPI (9/11), August industrial production and retail sales and July business inventories (9/15), the August CPI (9/16), a potentially market-moving Federal Reserve policy statement along with August housing starts and building permits (9/17), the Conference Board's August index of leading indicators (9/18), August existing home sales (9/21), August new home sales and durable goods orders (9/24), the final September University of Michigan consumer sentiment index and the final federal government estimate of Q2 growth (9/25), August consumer spending and pending home sales (9/28), and finally the July S&P/Case-Shiller home price index and the Conference Board's September consumer confidence index (9/29).

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The DAX 30 is a Blue Chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The FTSE 100 Index is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. The BSE SENSEX (Bombay Stock Exchange Sensitive Index), also-called the BSE 30 (BOMBAY STOCK EXCHANGE) or simply the SENSEX, is a free-float market capitalization-weighted stock market index of 30 well-established and financially sound companies listed on the Bombay Stock Exchange (BSE). The IDX Composite or Jakarta Composite Index is an index of all stocks that are traded on the Indonesia Stock Exchange (IDX). Nikkei 225 (Ticker: ^N225) is a stock market index for the Tokyo Stock Exchange (TSE). The Nikkei average is the most watched index of Asian stocks. Karachi Stock Exchange 100 Index (KSE-100 Index) is a stock index acting as a benchmark to compare prices on the Karachi Stock Exchange (KSE) over a period. The Hang Seng Index is a freefloat-adjusted market capitalization-weighted stock market index that is the main indicator of the overall market performance in Hong Kong. The SSE Composite Index is an index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. The Korea Composite Stock Price Index or KOSPI is the major stock market index of South Korea, representing all common stocks traded on the Korea Exchange. The S&P/ASX 200 index is a market-capitalization weighted and float-adjusted stock market index of Australian stocks listed on the Australian Securities Exchange from Standard & Poor's. The S&P/TSX Composite Index is an index of the stock (equity) prices of the largest companies on the Toronto Stock Exchange (TSX) as measured by market capitalization. The Bovespa Index is a gross total return index weighted by traded volume & is comprised of the most liquid stocks traded on the Sao Paulo Stock Exchange. The Mexican IPC index (Indice de Precios y Cotizaciones) is a major stock market index which tracks the performance of leading companies listed on the Mexican Stock Exchange. The Europe Dow measures the European equity markets by tracking 30 leading blue-chip companies in the region. The STOXX Europe 600 Index is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. The Asia Dow measures the Asia equity markets by tracking 30 leading blue-chip companies in the region. The Dow Jones Americas Index measures the Latin American equity markets by tracking 30 leading blue-chip companies in the region. The Global Dow is a 150-stock index of corporations from around the world created by Dow Jones & Company. The MSCI World Index is a free-float weighted equity index that includes developed world markets, and does not include emerging markets. 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