MARKET INSIGHTS

Economic Update

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This weekly update provides a snapshot of changes in the economy and markets and their implications for investors.

Denotes updated information

Growth

In its final estimate, the BEA reported real 2Q GDP was unchanged at its second estimate of 2.5%. The government shutdown has delayed the release of several economic indicators. The standoff in Washington has begun to affect sentiment, with the NFIB small business optimism index falling slightly, the Michigan consumer sentiment expectations component showing weakness and the Rasmussen consumer index falling to lows for the year.

Jobs

The Bureau of Labor Statistics September employment report was not released in light of the government shutdown. However, other labor market indicators point to continued progress in employment, such as the ADP report, which showed that private payrolls increased by 166,000. Initial claims increased 66,000 to 374,000; however, a lot of this increase was due to special factors, such as a backlog in claims in California and the government shutdown.

Profits

With 4.8% of companies having reported thus far in earnings season, our internal tracking model suggests S&P 500 operating earnings will be $26.65 for the third quarter, representing 11.1% year-over-year growth. Although still an early estimate, this value would reflect another consecutive record level of earnings per share for the S&P 500.

Inflation

Consumer prices increased only 0.1% in August (up 1.5% year-over-year), on falling energy prices. Core prices firmed slightly, rising only 0.1% (up 1.8% year-over-year), which is the softest print since April. The core PCE deflator, the Fed's preferred measure of underlying inflation, inched up 0.08% in July (up 1.2% year-over-year). Producer prices increased in August by 0.3% on the back of higher fuel prices, while core prices were flat. Overall, the inflation environment remains benign.

Rates

The FOMC left rates and plans to purchase longer-dated U.S. Treasuries and mortgage-backed securities at the pace of $45bn and $40bn per month unchanged in September. The FOMC statement did not contain any material changes versus July's release, while the minutes revealed a Committee divided over September's tapering decision. While data dependent, consensus expectations still point to the Fed tapering asset purchases later this year and longer-dated treasury bonds seem to be pricing for that, with yields creeping toward 3%.

Risks

Financial turmoil caused by ongoing European sovereign debt crisis.
Higher oil prices due to turmoil in the Middle East.
An over-easy Fed may pose a longer-term threat to bond investors.
Credit conditions for individuals and small businesses remain challenging.
Government-induced fiscal drag could subdue economic growth.
Political stalemate in Washington could disrupt markets in the short term.

Investment Themes

- While earnings growth has slowed, low average inflation and interest rates still make stocks look cheap in relative terms.
- Large-cap and growth stocks look cheapest.
- High-yield bonds look cheaper than Treasuries, but a diversified approach to fixed income investing seems appropriate given economic uncertainty.
- Residential real estate continues to look attractive as a long-term investment.

J.P. Morgan Asset Management

Data are as of October 11, 2013.

Past performance does not guarantee future results.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

The S&P 500 Index is widely regarded as the best single gauge of the U.S. equities market. This world-renowned index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 Index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market. An investor cannot invest directly in an index. Indexes are unmanaged.

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