

Equities Slip on Double Rate Hike Concern

August 29, 2016 — U.S. stocks fell fractionally for a second week after Fed Chair Janet Yellen’s highly anticipated speech in Jackson Hole, Wyoming conveyed no new insights on when the central bank may raise interest rates. Yellen said the case to “raise interest rates has strengthened in recent months” as the economy approaches the central bank’s goals, but she refrained from discussing specific timing. However, following an hour-long rally after Yellen’s speech, Fed Vice Chair Stanley Fischer said in a CNBC interview that he saw Yellen’s comments were consistent with a September rate hike and a subsequent 2016 increase could follow as early as December. Fischer’s comments sent the S&P 500 tumbling 20-points and sparked a Friday jump in the implied odds for a September hike from 24% to 30%, and up to 42% by Monday morning.

In economic data, new home sales unexpectedly jumped over 12% in July to an almost a nine-year high, while July existing home sales fell 3.2%, their first drop since February. Meanwhile, durable goods orders increased 4.4% last month, while orders for business equipment (a sub-set of durable goods orders) rose for a second month, up 1.6% the most since January. On Friday, Commerce officials downwardly revised their estimate for second quarter GDP growth from 1.2% to 1.1%, while governmental data showed U.S. corporate profits fell 2.2% from year ago levels. Lastly, the University of Michigan’s final August reading of consumer confidence fell to a four-month low.

For the week, the S&P 500 slipped 0.67%, ending the week with its first three-day slide in two months. The Dow Industrials lost 0.85%, while the NASDAQ Composite edged 0.35% lower. Eight of the ten major sectors ended negative, with Utilities (-2.21%), Healthcare (-1.80%), and Energy (-1.34%) falling the most. Financial (+0.37%) and Technology (+0.05%) outperformed. Total trading volume slowed to an average of 5.8 billion per day last week, the slowest non-holiday weekly average since June 2015. The US Dollar Index strengthened last week, rising to 95.566. Crude oil futures fell by 3% last week, ending at \$47.64/oz., while gold retreated 1.5%. Treasury prices also declined last week, pulling the yield on benchmark 10-year Treasury notes up 5.1 basis points to 1.630%

What We’re Reading

- [Fischer: Two Hikes in 2016? ↗](#)
- [Consumer Spending Rises for a Fourth Month ↗](#)
- [Iran Deploys Air Defense Near Nuclear Site ↗](#)

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Week’s Economic Calendar

- Monday, Aug 29:** Personal Income & Outlays, Dallas Fed Mfg Survey;
- Tuesday, Aug 30:** S&P/Case-Shiller Home Prices, Consumer Confidence;
- Wednesday, Aug 31:** Mortgage Applications, ADP Private Jobs, Chicago PMI, Pending Home Sales;
- Thursday, Sept 1:** Jobless Claims, Productivity & Costs, Markit PMI Mfg, ISM Mfg, Construction Spending;
- Friday, Sept 2:** August Non-farm Payrolls, International Trade, Factory Orders

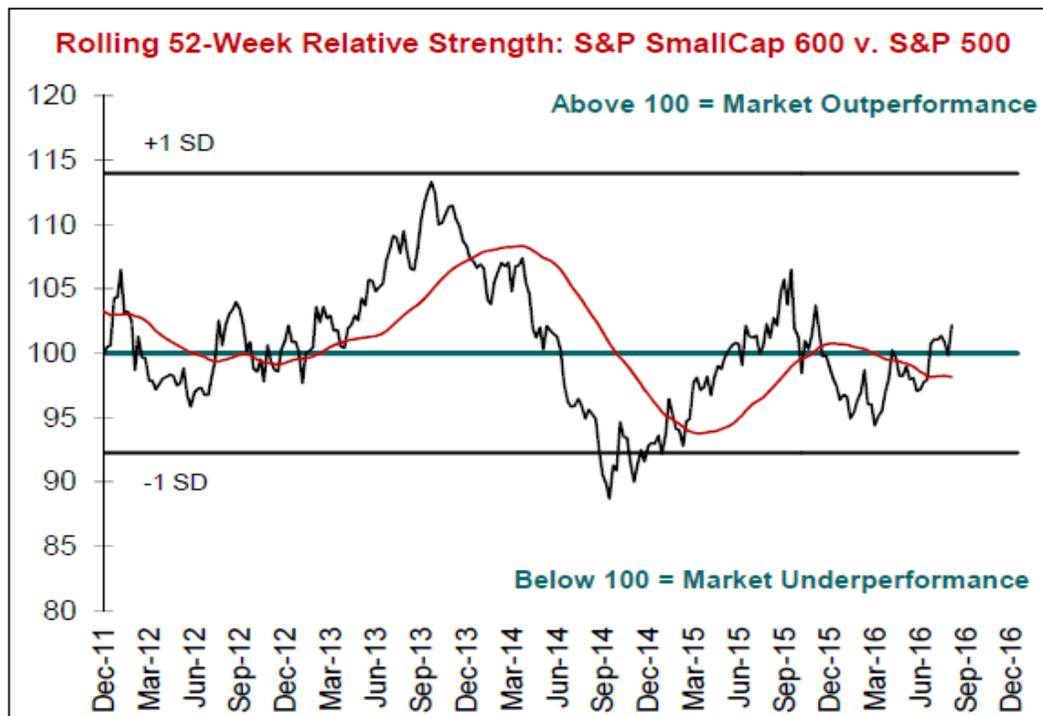
Market Watch

Source: Morningstar

Stocks	1-Week	MTD	3-Months	YTD	1-Year	3-Years
Dow Jones Industrial Aver	-0.85%	-0.20%	3.18%	5.57%	12.93%	7.16%
S&P 500	-0.67%	0.00%	4.33%	7.67%	14.24%	11.73%
NASDAQ Composite	-0.35%	1.26%	6.79%	5.13%	12.47%	13.95%
Russell 3000	-0.57%	0.10%	4.78%	7.84%	13.26%	11.09%
MSCI EAFE	0.18%	1.05%	2.50%	1.47%	2.68%	1.75%
MSCI EM	-0.96%	3.35%	13.57%	15.52%	17.25%	1.29%
Bonds						
Barclays US Agg Bond	-0.15%	-0.43%	2.00%	5.52%	5.59%	4.36%
Barclays Municipal	0.12%	0.15%	1.84%	4.55%	6.89%	6.46%
Barclays US Corp High Yield	0.25%	2.03%	5.90%	14.27%	9.83%	5.43%
Commodities						
Bloomberg Commodity	-1.45%	0.86%	-0.36%	8.38%	0.05%	-13.44%
S&P GSCI Crude Oil	-2.99%	14.52%	-3.72%	28.62%	23.37%	-23.38%
S&P GSCI Gold	-1.51%	-2.33%	8.44%	25.06%	17.86%	-1.63%

Chart of the Week

Small-cap Stock Rotation Despite Hawkish Fed Rate View



Source: S&P DJ Indices. Data: 12/31/10 - 8/26/16.

After digesting Fed Chair Janet Yellen's speech at Jackson Hole, Wyoming on Friday, markets were encouraged that the economy was getting strong enough to endure a second rate hike in December, a full year after the first one. Then Vice Chair Fischer clarified that both September and December were in play. The equity markets' intra-day price surge then folded like a poker player with an empty hand. Yet the S&P SmallCap 600 closed higher on the week, unlike its large-cap sibling. In the S&P Dow Indices chart above, we see the S&P SmallCap 600 Index most recently rising 1.16% month-to-date in August, whereas the S&P 500 is up just 0.004% (red line, essentially unchanged so far this month).

According to S&P Global Market Intelligence, several factors may explain this rotation: foremost of which is the current "Fischer view" which advocates more than one rate hike during the remainder of the year. This view, again according to S&P is one in which foreign yield-starved investors may be attracted to the heftier relative payout of U.S. fixed income, pushing up the value of the U.S. dollar, which would likely have a deleterious effect on U.S. exports. In the past 36 months, the S&P 500 has recorded a 0.72 monthly correlation with the U.S. Dollar Index (DXY) versus a correlation of 0.55 for the S&P SmallCap 600. And don't think the Fed will be put off by an upcoming presidential election. The Fed has raised short-term rates six times in the third quarter of election years since WWII: 1948, 1956, 1980, 1988 and twice in 2004.

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Glossary

The **Barclays U.S. Aggregate Bond Index** is an unmanaged index composed of Barclays Credit government bond index, mortgage backed securities index, and asset backed securities index and is generally representative of the US Bond market.

The **Barclays U.S. Corporate High Yield Index** measures the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below, excluding emerging market debt.

The **Barclays U.S. Municipal Bond Index** is an unmanaged, market-value-weighted index of investment-grade municipal bonds with maturities of one year or more.

The **Bloomberg Commodity Index** is a broadly diversified index that allows investors to track commodity futures through a single, simple measure. It is composed of futures contracts on physical commodities and is designed to minimize concentration in any one commodity or sector. It currently includes 19 commodity futures in five groups. No one commodity can comprise less than 2% or more than 15% of the index, and no group can represent more than 33% of the index (as of the annual reweightings of the components).

The **CBOE Volatility Index® (VIX®)** is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. Since its introduction in 1993, VIX has been considered by many to be the world's premier barometer of investor sentiment and market volatility.

The **Consumer Price Index (CPI)** is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

The **CRB Index** is a pricing index that measures changes in the price of 22 commodities that are believed to be among the first to react to changes in economic conditions.

The **Dow Jones Industrial Average** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ.

The **Hang Seng Index** is a market capitalization weighted index of the stocks of the 33 largest companies in the Hong Kong market. The Hang Seng Index is a price weighted/share price index which measures movements in the prices of shares, but not of their dividends.

The **MSCI EAFE Index** (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada.

MSCI Emerging Markets is designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index.

The **NASDAQ 100 Index** is a modified capitalization-weighted index of the 100 largest and most active non-financial domestic and international issues listed on the NASDAQ. No individual listing can have more than a 24% weighting. Launched on February 1, 1985, the index carried a base value of 125.

The **NASDAQ Composite Index** includes all domestic and international based common type stocks listed on The NASDAQ Stock Market. The NASDAQ Composite Index is a broad based index.

The **Producer Price Index** is a family of indexes that measures the average change over time in the selling prices received by domestic producers of goods and services. PPIs measure price change from the perspective of the seller. This contrasts with other measures, such as the Consumer Price Index (CPI), that measure price change from the purchaser's perspective.

The **Russell 1000 Index** comprises the 1,000 largest companies in the U.S. equity market, and is a subset of the Russell 3000 Index. The Russell 1000 is a market capitalization-weighted index, meaning that the largest companies constitute the largest percentages in the index, affecting performance more than the smallest index members. The inception date for the Russell 1000 and 3000 indices was January 1, 1984.

The **Russell 3000 Index** measures the performance of the largest 3,000 U.S. companies representing approximately 98% of the investable U.S. equity market.

The **S&P 500** is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

The **S&P SmallCap 600** measures the small-cap segment of the U.S. equity market. Introduced in 1994, the index is designed to track the performance of 600 small-size companies in the U.S., reflecting this market segment's distinctive risk and return characteristics. The index measures a segment of the market that is typically known for less liquidity and potentially less financial stability than large-caps, the index was constructed to be an efficient benchmark composed of small-cap companies that meet investability and financial viability criteria.

The **S&P Growth Index** is a float adjusted, market capitalization weighted index of 317 stocks drawn from the S&P 500 Index that exhibit strong growth characteristics. S&P Dow Jones Indices uses three factors to measure growth: sales growth, the ratio of earnings change to price, and momentum.

The **S&P GSCI Gold Index**, a sub-index of the S&P GSCI, provides investors with a reliable and publicly available benchmark tracking the COMEX gold future.

The **S&P GSCI Crude Oil Index** is a sub-index of the S&P GSCI and provides investors with a publicly available benchmark for investment performance in the crude oil market.

The **S&P Value Index** is a float adjusted, market capitalization weighted index of 364 stocks drawn from the S&P 500 Index that exhibit strong value characteristics. S&P Dow Jones Indices uses three factors to measure value: the ratios of book value, earnings and the sales to price sales metric.

The **Shanghai Composite Index** is a stock market index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange.

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. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalization companies across 18 countries of the European region: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

The **U.S. Dollar Index** is a weighted geometric mean that provides a value measure of the United States dollar relative to a basket of major foreign currencies. The index, often carrying a USD_X or DXY moniker, started in March 1973, beginning with a value of the U.S. Dollar Index at 100.000. It has since reached a February 1985 high of 164.720, and has been as low as 70.698 in March 2008.

West Texas Intermediate (WTI) is a crude oil stream produced in Texas and southern Oklahoma which serves as a reference or "marker" for pricing a number of other crude streams. WTI is the underlying commodity of the New York Mercantile Exchange's oil futures contracts.