KALOS *Market Commentary*

October, 2015

Domestic Good News vs. International Bad News

Unless you have been completely isolated from all news sources, you know that U.S. and global equity markets have had a terrible six weeks. After the S&P 500 bounced back strongly in late August to recover about half of its yearly losses, the index gave back nearly all its gains during a dismal September. On the year, the S&P 500 is down over 8% through September 29th, and over 11% from its all-time high on May 21, 2015. Yet, as poorly as U.S. markets have performed, international equity markets been far worse. Developed market are down nearly 20% from their highs, and emerging markets are off almost 30% from previous highs. Energy master limited partnerships (MLPs) have lost over 35% this year and are down over 40% from their tops. Many commodities have experienced similar declines. It's been a rough six weeks!

Recent losses have been driven by multiple factors, but weakness in China appears to be the major driver. Concerns over slowing growth and possibly greater unseen problems are rattling investors across the globe worried about exports to a key global market. China's stock market decline of over 40% from its highs has also added to investor angst.

China also remains a key factor in the slumping demand for commodities, although slowdowns in Brazil and problems in various other emerging markets are also impacting commodities demand. As commodity prices have declined, particularly oil, various economies and companies have cut growth expectations, which has also driven down various markets.

Against this backdrop, investors are still digesting the Greek crises, the strong dollar, Russia's invasion of The Ukraine, the largest emigration of peoples since World War II, Japan's struggling reform movements, on-going oil price drops, and countless smaller issues.

The complexity, volume, and diversity of the challenges will likely result in ongoing volatility, at least well into the fall. In past years, sharp declines have been largely driven by a single challenge such as oil prices (last October), the Greek crisis (twice) and interest rate changes (June of 2013). This summer, circumstances have been a bit different. Not only are there varied disruptions, market challenges are more international, which can be more difficult for investors to decipher.

Against this backdrop, I believe that separating domestic issues from international events can add some clarity.

Domestically, the economy appears to be moving forward at the relatively constant albeit uninspiring pace it has followed over the past several years. GDP is growing at around 2.0%, which is fairly low, but remains steady as has been typical of this anemic recovery.

Household spending is expected to grow by a robust 5% this year, a bit higher than last year's 4.7% increase. Consumer confidence index data released in late September showed an increase to 103.0, topping economists' expectation of 96.1. The September increase followed a sharp rise in August, likely driven up by an increasingly positive jobs market. The rising numbers indicate that consumers will increase spending, which accounts for 70% of the U.S. economy. Consumers also appear much more willing to purchase discretionary items such as clothing, entertainment, restaurant meals and education. Very simply, consumer spending should increase and positively impact the economy. New single-family home sales also rose more quickly than expected in August, which should further boost multiple areas of the economy tied to housing.

Small Businesses report more hiring. Jobs creation is expected to average about 215,000 jobs per month through year-end, which is enough to drive down the unemployment average. Overall, numerous signs appear to signal that global economic headwinds have not significantly impeded U.S. growth to date.

Concerns are mostly arising from international economies and the exposure that many U.S. firms face due to their significant international presence, particularly in the commodities and oil sectors. Caterpillar cut their sales forecast, exacerbating fears of slowing global economic growth. Caterpillar, the world's biggest mining and construction equipment maker, also said it could cut up to 10,000 jobs and shut plants as the mining and energy sectors face ongoing challenges. Various other international industrial and commodity companies such as Boeing, Joy Global, and General Electric have seen their shares slide sharply as investors fear their earnings report because of international pressures.

Not surprisingly, sluggish global economic growth is negatively impacting energy producing parts of the country. Texas, Oklahoma, Louisiana, New Mexico, North Dakota, and other states are feeling the impact of cheaper commodity prices, which filters down into demand for goods and services ranging from steel products to machinery to spurious services. Lower farm commodity prices also threaten the Midwest, where farmers are seeing incomes shrink as demand slows for farm goods.

In late September, **Goldman Sachs announced that it expects sales growth for S&P 500 companies to shrink** this year for the first time in five years.

Against this backdrop, interest rate changes are likely less of a driver than they have been in past years, or even earlier this year. Federal Reserve Chair Janet Yellen said last week that she still expects rates to increase this year, and New York Federal Reserve President William Dudley Monday suggested the central bank could act as soon as October. Still, the interest rate increase has been so long anticipated that its arrival will likely be a relative non-event, and could even be welcomed by investors who could interpret the increase as confidence by the Federal Reserve in U.S. and global markets.

As we move into fourth quarter, the market will likely be driven by investors' interpretation of whether domestic good news or international weakness will impact earnings more significantly. In this case, investors are likely to extrapolate future earnings expectations from limited amounts of data, and therefore, markets may react quite strongly to seemingly small announcements. Overall, current market levels appear quite reasonable, and likely represent a good entry point for longer-term investors. But, investors should probably expect a fairly volatile market over the next several weeks and even months as investors struggle to make sense of diverse and complicated information from multiple sources.

Daniel Wildermuth
Kalos Management, Inc.
CEO

11525 Park Woods Circle, Alpharetta, GA 30005
Phone: 678.356.1100, Toll Free: 866.525.6726,
Facsimile: 678.356.1105,
ClientServices@KalosFinancial.com

KALOS MANAGEMENT