Newsletter

State of the Economy September 2015

The long awaited correction finally hit the stock market during the 3rd quarter of 2015. The Dow Jones reached 18,312 on May 19 and now stands at 16,315 as of this past Friday's close. As many investors focus on how far their accounts have fallen recently, they should consider that in most years the stock market will have a decline of at least 10% or more in any given point. Moreover, a decline of 15% or more occurs roughly once every two years. Nevertheless, the stock market hasn't experienced a pullback like this since October 2011. In short, the market was due for a breather.

The economic indicators still look strong in the US, despite the recent fall in the stock market. The Federal Reserve's Beige Book provides 8 reports a year that reflect a snapshot of economic conditions. The Fed's recent report demonstrates the country is experiencing solid growth with the energy sector as the sole weak spot. Manufacturing activity was mostly positive and retail sales continued to expand in most districts. As the economic activity improves, the unemployment rate continues to drop. The jobless rate now stands at a 5.1%, closer to what the Fed considers full employment.

Even with the US economy holding strong, the Federal Reserve stuck to its dual mandate and avoided raising interest rates again. The Federal Reserve's mandate is to pursue maximum employment while controlling inflation. Based on the numbers, the US is now near full employment but still falling short of the Fed's 2% goal for inflation. According to Chairman Janet Yellen, downward pressure on inflation in the near term was likely to occur based on global economic developments. Her statement was a direct acknowledgment of the turmoil occurring in China and in the emerging markets. These developments could result in the Fed keeping rates lower for a longer period than previously projected. However, the Fed must be careful to avoid persistently low inflation. This can constrain banks from combating recessions or even increase the debt burdens of borrowers, which would negatively affect the economy as a whole.

The slowdown in China has been building for some time due to many factors and we are seeing the repercussions in their stock market. The Shanghai Composite Index fell over 40% from its peak and may still be overvalued. With signs of a sharp economic slowdown and a steep fall in exports, China actively devalued its currency. This allows for market forces to have more influence in setting the currency's exchange rate. The yuan, China's currency, has appreciated greatly in value over the last several years and this appreciation now appears to be weighing on the economy. It is certainly a tricky time for the People's Bank of China. On the one hand, they can continue to depreciate their currency to compete with fellow currencies. Hopefully, this makes their exports more competitive to low cost producers like Vietnam. Consequently, a depreciating yuan could hurt their ability to maintain stability and may increase Chinese corporations' heavy debt load, which are set in dollars. We will have to wait and see as the Fed and investors keep a close eye on what transpires.

With the negative performance year to date in the stock market, it is a great time to set up for a risk-tolerance check-up on your retirement account. Reviewing your portfolio is analogous to going to the doctor. It is always a good idea to periodically analyze your investment allocations over time. Do you really know what percent of your retirement assets are exposed to stocks? What percentage of your assets is invested in fixed income? Understanding your investment strategy will prevent you from making emotional decisions during the current volatility in the market. Since the market bottom in early 2009, stocks have been on a steady climb for the last 6 years. The current market correction should be a gut check for most investors. They have witnessed their investment statements fall into negative numbers the past few months. Instead of making a quick judgment, it is prudent to take a step back to think about your time horizon and risk tolerance.

When it comes to long-term retirement accounts, I like to preach that less is more. If you want to gamble, then feel free to try to time the market. Otherwise, it is beneficial to allocate your investments according to your risk profile and review your strategy periodically.

Sincerely,

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