

QUARTERLY ECONOMIC UPDATE

A review of 2Q 2015

QUOTE OF THE QUARTER

“A problem is a chance for you to do your best.”

– Duke Ellington

QUARTERLY TIP

Keeping federal tax returns, W-2s, 1099s, year-end account statements, and sample pay stubs for 6-7 years is sensible, in case you make an error in reporting income. The IRS wants you to keep the past 3 years of federal tax returns just for proof of income, deductions, and credits claimed.

THE QUARTER IN BRIEF

A 2.10% June retreat left the S&P 500 down 0.23% for Q2 2015, putting an end to its 9-quarter winning streak. The quarter’s biggest economic events occurred in late June – Greece defaulted on its debt, the commonwealth of Puerto Rico said a default was imminent, and China’s stock market plunged. The Federal Reserve seemed committed to raising interest rates before the end of the year, even as it lowered its 2015 economic forecast. Spring brought more home buying, higher oil prices, improved hiring, and a number of encouraging signs that the economy was pulling out of a winter slump. Even with all those positives, the headwinds in the stock market were too strong to allow a broad advance.^{1,2}

DOMESTIC ECONOMIC HEALTH

The second quarter saw the Federal Reserve revise its projections for 2015 GDP downward; the spring forecast of 2.3-2.7% growth was reduced to 1.8-2% growth. Its June 17 policy statement also signaled at least one interest rate hike later this year – but perhaps only one, as more Fed officials now believed the central bank should raise rates only once in 2015 with two calling for no move until 2016. It has long been thought that the Fed might raise rates starting in September, but futures markets disagreed as the quarter ended, envisioning the first move coming in December.³

With revisions included, Labor Department reports showed the economy adding 187,000 jobs in April, 254,000 jobs in May, and 223,000 jobs in June. The unemployment rate fell to 5.3% in June, a low unseen since April 2008; the U-6 rate measuring the unemployed and underemployed declined to 10.5% in June, down half a percent from a year earlier. Wages were up 2% in a year as of June.⁴

Two other key indicators showed continued growth for America’s factory and services sectors. While the Institute for Supply Management’s manufacturing PMI slipped to a 2-year low of 51.5 in April, it rose to readings of 52.8 and 53.5 in May and June. The ISM service sector PMI (which has averaged a robust 57.2 in the last 12 months) showed readings of 57.8 for April, 55.7 for May and 56.0 for June.^{5,6}

Consumer confidence readings were higher by the quarter’s end. The University of Michigan’s consumer sentiment index posted final April, May, and June marks of 95.9, 90.7, and 96.1; that June reading was the best since January. The Conference Board’s respected survey jumped to 101.4 in June after coming in at 94.3 in April and 94.6 in May.^{7,8}

Consumer inflation remained but a minor threat, even as the Consumer Price Index put up its largest monthly gain since February 2013 in May. (The 0.4% May rise was largely due to a 10.4% increase in retail gas prices.) Year-over-year, the headline CPI was flat while the core CPI was up just 1.7%.⁹

Personal spending was up just 0.1% in April, then soared 0.9% for May. Retail sales experienced the same “spring thaw,” advancing 0.2% in April and 1.2% in May.^{10,11}

Headline durable goods orders sank 1.5% in April, then 1.8% in May; without volatile transportation orders, there was an 0.3% April loss and an 0.5% May gain. Producer prices jumped 0.5% in May after a 0.4% dip for April.^{10,12}

As Q2 went on, the Bureau of Economic Analysis improved what was a dismal Q1 GDP reading. In the second BEA Q1 GDP estimate, the economy contracted 0.7%; in its third and final estimate, the contraction was 0.2%.¹⁰

Finally, Puerto Rico Governor Alejandro García Padilla told the world on June 28 that the commonwealth could not pay its \$72 billion in public debt, shocking many investors but not many economists. Padilla's administration is exploring a Chapter 9 bankruptcy as an option, but under current federal law that option is only available to U.S. cities, not territories.¹³

GLOBAL ECONOMIC HEALTH

As early as April, there were indications that Greece might default on its debt. Then it missed a June 30 deadline on a €1.5 billion debt repayment, triggering a global stock selloff as investors glimpsed a crack in the framework of the European Union. The quarter ended with Prime Minister Alexis Tsipras and the ruling Syriza party announcing a July 5 national vote on whether Greece should accept further austerity measures as a condition of additional financial aid; 61% of the electorate voted no, opening the door to Greece's exit from the EU and leaving EU leaders with a hard choice for July – either play hardball with Greece and risk a humanitarian crisis, or play softball with Greece and placate its people in a last-ditch effort to keep it in the eurozone. On July 6, the *Guardian* reported that the Greek banking system held only about €500 million, or about €45 per person. This was the last development the eurozone needed as it tried to mount an economic recovery from its recent recession.^{14,15}

The Greek debt crisis did not wholly distract investors from troubles in China – namely, the panic in its stock market. The Shanghai Composite fell 24% between June 12 and July 4 (prior to that, it was up 149% YTD). More than \$2.4 trillion in wealth evaporated in this sudden bear market. China's major brokerages actually formed a \$19.4 billion rescue fund to buy up shares in major companies listed in the index, while the Chinese government encouraged its citizens to purchase stock. China's annualized growth slowed to 7.0% in Q1, its poorest GDP reading since 2009; on June 29, the People's Bank of China made its fourth interest rate cut in eight months.^{16,17}

WORLD MARKETS

While many European indices suffered heavy Q2 losses, the picture was a bit brighter in other parts of the world. The damage in Europe was certainly severe: the CAC 40 sank 4.84%, the FTSE MIB 3.01%, the DAX 8.53%, the IBEX 35 6.52%, and the FTSE 100 3.72%. Russia's RTS index and Ireland's ISEQ were notable exceptions, posting respective quarterly gains of 6.76% and 2.42%.²

In the Asia Pacific region, the Shanghai Composite went +14.12% for the quarter even after all that slipping and sliding. Pakistan's KSE 100 rivaled that performance, going +13.78%. Other quarterly gains and losses from the east: Sensex, -0.63%; Nikkei 225, +5.36%; Kospi, +1.63%; S&P/ASX 200, -7.34%; Hang Seng, +5.42%; Jakarta Composite, -11.02%. Looking at the Americas, we see gains of 7.56% for Argentina's Merval, 3.04% for Mexico's IPC All-Share, and 3.77% for Brazil's Bovespa; Q2 brought a loss of 2.34% for Canada's TSX Composite.²

The major multi-country benchmarks all went red in the quarter, registering the following losses: Global Dow, 0.19%; Asia Dow, 0.54%; Europe Dow, 1.95%; Dow Jones Americas, 0.38%; STOXX 600, 4.02%; MSCI World Index, 0.30%; MSCI Emerging Markets Index, 0.24%.^{2,18}

COMMODITIES MARKETS

The second quarter of 2015 was noticeably better than the first in the commodities sector: the Thomson Reuters/Jefferies CRB Index rose 7.23% as the U.S. Dollar Index fell 2.92%.^{19,20}

Oil staged a major rally in the quarter, rising 24.9% on the NYMEX as it rebounded from a 6-year low. WTI crude settled at on \$59.04 on June 30. Cocoa futures also had a fine quarter, gaining 21.3%. Sugar futures rose 2.9%, lumber futures 3.6%.^{21,22}

Metals, on the other hand, did not gain ground in Q2. Gold wrapped up June at a COMEX price of \$1,171.80, down 1.0% for the quarter and 1.0% YTD. After

stumbling 6.7% for June, silver settled at \$15.58 on the COMEX June 30 yet was just -0.1% YTD. Platinum fell 5.6% in Q2 and palladium sank 8.5%; the end of Q2 found platinum at -10.8% YTD, palladium -15.8% YTD. A dip in demand from China influenced copper's 4.5% Q2 loss.^{21,23}

REAL ESTATE

What had been a lukewarm housing market transformed into a hot one. The National Association of Realtors provide ready evidence of that: after slipping 3.3% in April, existing home sales improved 5.1% in May to a seasonally adjusted annual rate of 5.35 million, the best pace in almost six years and up 9.2% year-over-year. New home sales rose 8.1% in April and another 2.2% in June according to the Census Bureau; that put their annualized sales rate at 546,000 (the best in seven years) and their year-over-year increase at 19.5%.^{24,25}

This happened even with mortgage rates on the way up. In the March 26 Freddie Mac Primary Mortgage Market Survey, interest rates on assorted mortgages were as follows: 30-year FRM, 3.69%; 15-year FRM, 2.97%; 5/1-year ARM, 2.92%; 1-year ARM, 2.46%. By June 25, those percentages had changed markedly: 30-year FRM, 4.02%; 15-year FRM, 3.21%; 5/1-year ARM, 2.98%; 1-year ARM, 2.50%.²⁶

Now to the other key real estate indicators during the quarter. Housing starts climbed 22.1% in April, then faltered 11.1% during May; they were still up 5.1% annually after the May drop. With an 11.8% May boost, building permits hit their highest level in almost eight years and registered a 25.4% 12-month gain by Census Bureau calculations. The overall April S&P/Case-Shiller home price index displayed a yearly gain of 4.2% in housing values, ticking down from 4.3% in March. The NAR's pending home sales index rose but 0.9% in May after an April advance of 2.7%.^{27,28}

LOOKING BACK...LOOKING FORWARD

As the quarter ended, the four most important U.S. indices settled as follows: DJIA, 17,619.51; NASDAQ, 4,986.87; S&P, 2,063.11; RUT, 1,253.95. June was the worst month for both the Dow and the S&P since January, and that is reflected in the Q2 performance noted below. Like the Nasdaq, the Russell 2000 advanced for Q2, albeit just 0.09%. The quarter's best-performing stateside index was the CBOE VIX: ending June at 18.23, it advanced 19.23% in three months. The Nasdaq Bank Index finished second with a gain of 7.57%, the Nasdaq Biotechnology Index third with a rise of 7.44%.²

% CHANGE	Y-T-D	Q2 CHG	1-YR CHG	10-YR AVG
DJIA	-1.14	-0.88	+4.71	+7.15
NASDAQ	+5.30	+1.75	+13.13	+14.24
S&P 500	+0.20	-0.23	+5.25	+7.32
REAL YIELD	6/30 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.48%	0.27%	1.15%	1.67%

Sources: wsj.com, bigcharts.com, treasury.gov - 6/30/15^{2,29,30}
 Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
 These returns do not include dividends.

In July, we have some relative calm on Wall Street; at this writing, the selloff of June 29 has fortunately not been replicated. It looks as though Greece's creditors may just have to take a haircut – since Greece cannot hope to function without access to credit, negotiations to either restructure its debt repayments or lessen the principal seem a given. So far, U.S. stocks have come through this crisis with far less damage than European shares – and hopefully that continues with eurozone finance ministers seeking an expedient solution and a new earnings season providing a diversion. Perhaps the third quarter will bring relative calm and renewed confidence for consumers and investors.³¹

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The FTSE MIB (Milano Italia Borsa) is the benchmark stock market index for the Borsa Italiana, the Italian national stock exchange. The DAX 30 is a Blue Chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The IBEX 35 is the benchmark stock market index of the Bolsa de Madrid, Spain's principal stock exchange. The FTSE 100 Index is a share index of the 100 most highly capitalized companies listed on the London Stock Exchange. The RTS Index (abbreviated: RTSI, Russian: Индекс PTC) is a free-float capitalization-weighted index of 50 Russian stocks traded on the Moscow Exchange. The ISEQ Overall Index is a capitalization-weighted index of all official list equities in the Irish Stock Exchange, excluding U.K.-registered companies. The SSE Composite Index is an index of all stocks (A and B shares) that are traded at the Shanghai Stock Exchange. 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. BSE Sensex or Bombay Stock Exchange Sensitivity Index is a value-weighted index composed of 30 stocks that started January 1, 1986. 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. 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 is Australia's "premier" share market index. 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 IDX Composite or Jakarta Composite Index is an index of all stocks that are traded on the Indonesia Stock Exchange (IDX). The Merval Index (MERCado de VALores, literally Stock Exchange) is the most important index of the Buenos Aires Stock Exchange. The Mexican IPC index (Indice de Precios y Cotizaciones) is a capitalization-weighted index of the leading stocks traded on the Mexican Stock Exchange. 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 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 Global Dow (GDOW) is a 150-stock index of corporations from around the world, created by Dow Jones & Company. The Asia Dow measures the Asia equity markets by tracking 30 leading blue-chip companies in the region. The Europe Dow measures the European 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 Dow Jones STOXX 600 Index captures more than 90% of the aggregate market cap of European-based companies. The MSCI World Index is a free-float weighted equity index that includes developed world markets, and does not include emerging markets. The MSCI Emerging Markets Index is a float-adjusted market capitalization index consisting of indices in more than 25 emerging economies. The US Dollar Index measures the performance of the U.S. dollar against a basket of six currencies. Additional risks are associated with international investing, such as currency fluctuations, political and economic instability and differences in accounting standards. This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. 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