Commentary

September 7, 2015

**The Markets**

Who's the culprit?

Speculating on who or what is to blame for recent market weakness is a popular pastime right now. Last week, *Barron's* said the search for someone to blame is a lot like a game of Clue. So far, the most common conclusions are "the People's Bank of China with a devalued currency in Beijing," and "Janet Yellen with a potential interest-rate hike in Washington."

The article pointed out those theories might be flawed. After all, China's slowdown wasn't a surprise. Analysts have been factoring slower growth into their calculations for some time. U.S. rate hikes are highly anticipated and, even though some fear they could tip the American economy into recession (and argue recent stock price movement supports the claim), relatively strong economic data casts doubt on the idea. Some analysts believe the stock market can help predict where a country's economy is headed. A significant drop in stock prices could be indicative of a future recession and a significant increase could suggest future economic growth.

So, why have markets headed south? *Barron's* offered an alternative answer: Investors with volatility trading strategies (and/or a case of nerves) across the globe. The article pointed out the CBOE Volatility Index (VIX), a.k.a. the fear gauge, popped from a low of 13 to a high of 53 between August 18 and August 24:

"That's higher than when Standard & Poor's cut the credit rating of the United States in 2011, or at the peak of the European debt crisis in 2010, and seems extreme given the evidence. But volatility isn't simply a measure of fear. It has been used to manage risk in portfolios that employ sophisticated trading schemes… Although each type of fund adjusts to market changes at a different speed, they all respond in the same way – by selling stocks… Don't just blame the professionals. For months now, there have been warnings about overcrowding in the market's best-performing stocks. And, when the market started to tumble in August, these stocks were among the hardest hit…"

So, who caused the market downturn? Take your pick.

| Data as of 9/4/15 | 1-Week | Y-T-D | 1-Year | 3-Year | 5-Year | 10-Year |
|---|---|---|---|---|---|---|
| Standard & Poor's 500 (Domestic Stocks) | -3.4% | -6.7% | -3.8% | 11.0% | 12.0% | 4.5% |
| Dow Jones Global ex-U.S. | -4.1 | -8.8 | -17.0 | 2.3 | 1.0 | 1.0 |
| 10-year Treasury Note (Yield Only) | 2.1 | NA | 2.5 | 1.6 | 2.6 | 4.1 |
| Gold (per ounce) | -1.5 | -6.8 | -12.1 | -13.0 | -2.2 | 9.6 |
| Bloomberg Commodity Index | -1.0 | -15.2 | -29.0 | -15.5 | -8.2 | -6.4 |
| DJ Equity All REIT Total Return Index | -4.6 | -9.0 | -3.0 | 6.5 | 10.6 | 6.0 |

S&P 500, Dow Jones Global ex-US, Gold, Bloomberg Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT Total Return Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.
Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.
Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable.

**THE TRAVAILS OF EMERGING MARKETS.** Just a few years ago, emerging markets were the toast of the town. In general, emerging countries recovered much faster than developed countries following the financial crisis and global recession. The MSCI Emerging Markets Index delivered pretty remarkable (and highly volatile) performance during the past decade. According to the *MSCI fact sheet*, annual returns have ranged from down 53.33 to up 78.51:

| Annual Returns (%) | |
|---|---|
| 2005 | 34.00 |
| 2006 | 32.14 |
| 2007 | 39.42 |
| 2008 | -53.33 |
| 2009 | 78.51 |
| 2010 | 18.88 |
| 2011 | -18.42 |
| 2012 | 18.22 |

| | |
|---|---|
| 2013 | -2.60 |
| 2014 | -2.19 |

Through September 4, the Emerging Markets Index was down 17.54 percent. While that's a significantly smaller swing than some we've experienced during the past 10 years, any double-digit dip demands attention. *The Wall Street Journal* explained the downturn like this:

"China's economic slowdown is having broad implications, hitting regional economies like Taiwan, Malaysia, and Vietnam where manufacturing data showed declines for August. Emerging markets are also nervous about the possibility of an interest-rate increase in the United States, which would encourage global investors to invest more there. China's Shanghai Composite Index is down 39 percent after hitting a seven-year high in June."

Indeed, money is moving back into the United States. Experts cited by *The Economist* said about $44 billion has been pulled from emerging markets since mid-July.

Christine Lagarde, Managing Director of the International Monetary Fund (IMF), indicated the IMF's outlook for global growth was likely to be revised downward, in part, because emerging economies are at risk of being negatively affected by commodity price weakness, China's slowdown, and America's monetary policy.

How bad will it get in emerging markets? The IMF's July projection was that emerging market and developing countries would grow by 4.2 percent in 2015 and 4.7 percent in 2016. Developed economies, on the other hand, were expected to grow by 2.1 percent in 2015 and 2.4 percent in 2016.

**Weekly Focus – Think About It**

"I never blame myself when I'm not hitting. I just blame the bat and if it keeps up, I change bats. After all, if I know it isn't my fault that I'm not hitting, how can I get mad at myself?"

*--Yogi Berra, Baseball player*

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* Government bonds and Treasury Bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.
*Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features.
* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. You cannot invest directly in this index.
* The Standard & Poor's 500 (S&P 500) is an unmanaged index. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.
* The Dow Jones Global ex-U.S. Index covers approximately 95% of the market capitalization of the 45 developed and emerging countries included in the Index.
* The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.
* Gold represents the afternoon gold price as reported by the London Bullion Market Association. The gold price is set twice daily by the London Gold Fixing Company at 10:30 and 15:00 and is expressed in U.S. dollars per fine troy ounce.
* The Bloomberg Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14, 1998.
* The DJ Equity All REIT Total Return Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones.
* Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.
* Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.
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* Past performance does not guarantee future results. Investing involves risk, including loss of principal.
* You cannot invest directly in an index.
* Consult your financial professional before making any investment decision.
* Stock investing involves risk including loss of principal.

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