Equities Retreat on North Korean Missile Threats

August 14, 2017 – U.S. stocks ended with small gains last Friday, slightly paring a three-day slide to finish a volatile week lower amid North Korean threatened missile attacks and reprisal warnings by President Trump. However, Friday's return to relative calm was not enough to undo market damage from the geopolitical rhetorical furor, with the Dow Industrials and S&P 500 experiencing their worst weekly declines since March. Following North Korea's threat to strike Guam, the VIX Volatility spiked by 56% during the week, with 44% of the rise occurring on Thursday. Tensions eased on Friday, after China issued a stark warning to Kim Jung Un that if North Korea initiates or threatens hostilities against the U.S. with first-launch missiles, China would remain neutral and offer no military assistance, come what may, in reprisals by the United States. Yet the warning was double-edged in that China stated that it *would* intervene if the U.S. strikes first. European and Chinese equity markets also broadly retreated, with the Stoxx Europe 600 down 2.59% and the Shanghai Composite fell 1.61%. The MSCI All-Country World Index lost 1.53%.

Signs of U.S. inflation continue to be soft as the Producer Price Index, the key measure of wholesale price movement, unexpectedly fell 0.1% in July, the first drop in almost a year. The core PPI, which excludes volatile food and energy prices, was unchanged. Consumer Price Index edged 0.1% higher in July, following an unchanged reading the month prior. The core CPI also rose 0.1% and both measures are up 1.7% from a year ago. In other key economic data last week, July small business optimism rose to 105.2 from 103.6 in June, its first increase since January, while Labor Department's JOLTS report showed job openings waiting to be filled surged by 461,000 to a record 6.16 million in June.

For the week, the S&P 500 fell 1.37%, the Dow Industrials declined 1.06% and the NASDAQ Composite sank 1.44%. Within the S&P 500, 10 of its 11 major sector groups ended with declines last week, led by sharp losses in Financials (-2.69%), Energy (-2.58%) and Materials (-2.04%). Utilities (-0.21%) fell the least, while Consumer Staples (+0.13%) posted a fractional gain. West Texas Intermediate (WTI) crude oil futures fell 1.53% to $48.83/barrel, its worst weekly pullback in a month, after compliance with OPEC's output reduction deal faltered. Gold futures advanced to a two-month high amid safer-haven buying, gaining 2.43% last week and 11.90% year-to-date. The U.S. Dollar Index weakened by 0.51% last week, ending at 93.069, while Treasury prices rallied on global tensions. The yield on 10-year Treasury notes fell by 6.4 basis points ending at 2.19%.

What We're Reading

North Korean Tensions Ease ↗

China Warns North Korea ↗

Japan's 2Q GDP Expands ↗

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Week's Economic Calendar

Monday, Aug 14: No major releases;

Tuesday, Aug 15: Retail Sales, Import/Export Prices, Business Inventories, Housing Market Index;

Wednesday, Aug 16: Mortgage Applications, Housing Starts, FOMC Minutes;

Thursday, Aug 17: Jobless Claims, Philly Fed Business Outlook, Industrial Production, eSales, Leading Indicators;

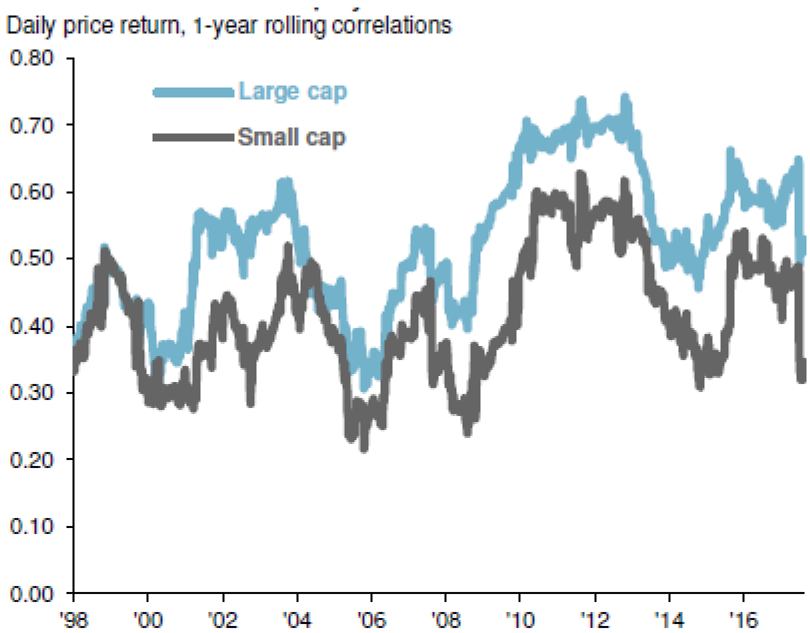
Friday, Aug 18: Consumer Sentiment.

Market Watch

Stocks	1-Week	MTD	3-Month	YTD	1-Year	3-Year
Dow Jones Industrial Avg.	-1.06%	-0.15%	4.49%	10.60%	17.45%	9.67%
S&P 500	-1.37%	-1.06%	2.47%	10.40%	14.04%	10.32%
NASDAQ Composite	-1.44%	-1.37%	2.58%	17.01%	21.06%	13.77%
Russell 3000	-1.52%	-1.34%	2.10%	9.50%	13.86%	9.81%
MSCI EAFE	-1.48%	-0.89%	3.85%	16.05%	15.24%	3.20%
MSCI Emerging Markets	-2.24%	-2.12%	5.38%	22.84%	17.53%	1.78%
Bonds						
Barclays Agg Bond	0.24%	0.41%	1.92%	3.14%	0.27%	2.68%
Barclays Municipal	0.31%	0.47%	2.29%	4.90%	0.79%	3.55%
Barclays US Corp High Yield	-0.75%	-0.71%	1.23%	5.34%	8.89%	5.00%
Commodities						
Bloomberg Commodity	0.52%	-0.79%	0.95%	-3.88%	0.32%	-12.87%
S&P GSCI Crude Oil	-1.23%	-2.39%	1.60%	-8.84%	10.72%	-20.52%
S&P GSCI Gold	2.32%	1.62%	5.40%	12.36%	-4.15%	-0.42%

Chart of the Week: U.S. and International Equity Correlations

Chart 1



Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.

Economic growth across the globe has started to pick up speed, as evidenced by the global manufacturing purchasing manager's index (PMI) hovering near a six-year high. For its part too, the U.S. economy is still slowly picking up steam, but the greatest acceleration in growth is happening in other developed and emerging market countries. Some investors wonder whether the best way to access this improving global growth story is via U.S. companies with a large percentage of revenues coming from abroad, rather than by taking direct equity exposure outside the U.S. While U.S. sectors with large foreign exposure, such as technology, have indeed started to benefit from the improving global backdrop and the weaker-trending U.S. dollar, investors should not forget that there is a diversification benefit from investing directly in international markets as well. As Chart 1 shows, the correlation between U.S. and international stocks has been decreasing significantly since the 2008 global financial crisis. This means, according to J.P. Morgan, that individual markets are increasingly moving based on local, rather than global, factors. This is particularly true when comparing the correlation between small cap U.S. and international companies. With an improving economic backdrop in other parts of the world supported primarily by improving domestic demand, investors should consider whether their portfolios have direct exposure to this aspect via both large and small cap international stocks.

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Glossary

*The **Barclays U.S. Treasury: U.S. TIPS Index** includes all publicly issued, U.S. Treasury inflation-protected securities that have at least one year remaining to maturity, are rated investment grade, and have $250 million or more of outstanding face value.*

*The **Bloomberg Barclays US Aggregate Bond Index**, which was originally called the Lehman Aggregate Bond Index, is a broad based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government–related and corporate debt securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency) debt securities that are rated at least Baa3 by Moody's and BBB- by S&P. Taxable municipals, including Build America bonds and a small amount of foreign bonds traded in U.S. markets are also included. Eligible bonds must have at least one year until final maturity, but in practice the index holdings has a fluctuating average life of around 8.25 years. This total return index, created in 1986 with history backfilled to January 1, 1976, is unhedged and rebalances monthly*

*The **Bloomberg Barclays U.S. Corporate (Investment Grade) Bond Index** measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by U.S. and non-US private-sector industrial, utility and financial issuers. Certificates of deposit are also included. Launched in July 1973, securities included must be rated investment grade (Baa3/BBB-/BBB- or higher). Eligible senior and subordinated corporate securities must have at least one year until final maturity, but in practice the index holdings has a fluctuating average life of around 10.75 years. The index is unhedged and rebalances monthly.*

*The **Bloomberg Barclays US Corporate High Yield Index** measures the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market. 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. Payment-in-kind and bonds with predetermined step-up coupon provisions are also included. Eligible securities must have at least one year until final maturity, but in practice the index holdings has a fluctuating average life of around 6.3 years. This total return unhedged index was created in 1986, with history backfilled to July 1, 1983 and rebalances monthly.*

*The **Bloomberg Barclays US Municipal Bond Index** covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds. Many of the subindicies of the Municipal Index have historical data to January 1980. In addition, several subindicies based on maturity and revenue source have been created, some with inception dates after January 1980, but no later than July 1, 1993. Eligible securities must be rated investment grade (Baa3/BBB- or higher) by Moody's and S&P and have at least one year until final maturity, but in practice the index holdings has a fluctuating average life of around 12.8 years. This total return index is unhedged and rebalances monthly*

*The **Bloomberg U.S. Treasury Floating Rate Bond Index** is a rules-based, market value-weighted index engineered to measure the performance of floating rate U.S. Treasury bonds. The index inception date is January 31, 2014—the first month-end following the U.S. Treasury's issuance of a floating rate bond. Historical performance and characteristics are available from January 31, 2014, when floating rate notes were offered and first traded, the first new Treasury security since the introduction of Treasury-Inflation-Protected Securities (TIPS) in 1997.*

*The **Bloomberg Barclays US Convertible Bond > $500MM Index** is designed to represent the market of US convertible securities, such as convertible bonds, with outstanding issue sizes greater than $500 million.*

*The **Bloomberg Commodity Index** is a broadly diversified index that measures 22 exchange-traded futures on physical commodities in five groups (energy, agriculture, industrial metals, precious metals, and livestock), which are weighted to account for economic significance and market liquidity. No single commodity can comprise less than 2% or more than 15% of the index;*

and no group can represent more than 33% of the index. However, between rebalancings, group weightings may fluctuate to levels outside the limits. The index rebalances annually, weighted 2/3 by trading volume and 1/3 by world production.

*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. Introduced in 1993, the VIX Index has been considered by many to be the world's premier barometer of investor sentiment and market volatility.*

*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 **MSCI ACWI Index** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The SMCI ACWI consists of 46 country indexes comprising 23 developed and 23 emerging market country indexes. The developed country indexes include: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy , Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the United States. The emerging market country indexes included are: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates.*

*The **MSCI EAFE Index** is designed to measure the equity market performance of developed markets (Europe, Australasia, Far East) excluding the U.S. and Canada. The Index is market-capitalization weighted.*

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

*The **MSCI ACWI EX USA Index** is a float-adjusted market capitalization-weighted index that captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 23 Emerging Markets (EM) countries. With 1,852 constituents, the index covers approximately 85% of the global equity opportunity set outside the U.S. The index is reviewed quarterly—in February, May, August and November—with the objective of reflecting change in the underlying equity markets in a timely manner, while limiting undue index turnover. During the May and November semi-annual index reviews, the index is rebalanced and the large and mid capitalization cutoff points are recalculated.*

*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 **NASDAQ-100 Index** includes 100 of the largest domestic and international non-financial companies listed on The NASDAQ Stock Market based on market capitalization.*

*The **Russell 2000 Index** measures the performance of the small-cap segment of the U.S. equity universe and is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.*

*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 **Russell Midcap Index** measures the performance of the mid-cap segment of the U.S. equity universe and is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The Russell Midcap represents approximately 31% of the total market capitalization of the Russell 1000 companies.*

*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 **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.*

***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*

*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 USDX 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*

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