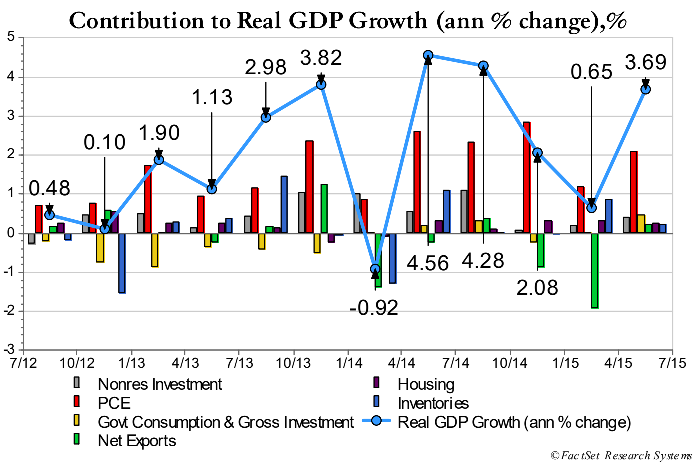
# Market Review

August 2015

## *Economic Review*

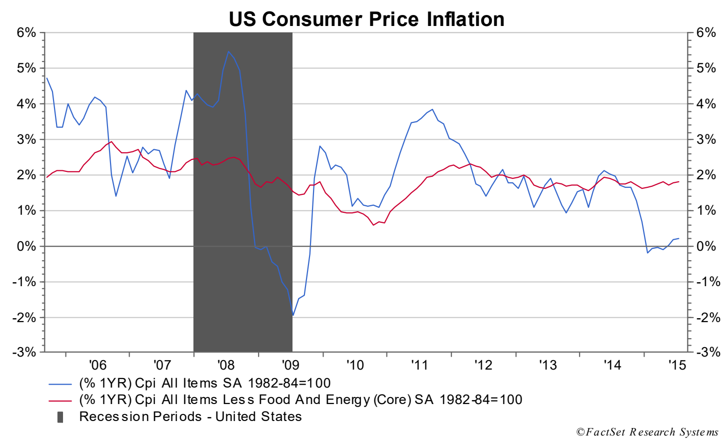
US economic reports in August were generally strong. Second quarter real GDP growth was revised from a 2.3% to a 3.7% annualized rate (a.r.). The revision in real GDP primarily reflected upward adjustments to Personal Consumption Expenditures (PCE), nonresidential fixed investment, state and local government spending and private inventory investment, but downward revision to imports.




The unemployment rate remained unchanged at 5.3% in July according to the US Bureau of Labor Statistics. The unemployment rate has declined 0.9% over the past 12 months. Total nonfarm payroll employment rose by 215,000 in July, compared with an average monthly gain of 246,000 over the prior 12 months. Wage growth continues to be weak in relation to the labor market performance. The second quarter year-over-year (YoY) Employment Cost Index data were disappointing, while monthly hourly earnings remained steady. Real average hourly earnings for all employees increased by 1.9%, seasonally adjusted, year-over-year. This increase in real average hourly earnings combined with a 0.3% increase in the average workweek, resulted in a 2.2% increase in real average weekly earnings over this period.

Housing prices fell for the second consecutive month as the S&P Case-Shiller Home Price Index declined 0.12% month-over-month (MoM) in June. The Index is up nearly 5% in the first six months of the year. Existing home sales increased 2% in July, the third consecutive positive month, to an annualized rate (a.r.) of 5.59 million. New home sales increased 5.4% in July after declining 7.7% in June. New home inventory stands at 218,000 houses, translating to a 4.5 month supply based on the current sales rate. Housing starts increased 0.2% to an a.r. of 1.21 million during July. Building permits fell 16.3% to an a.r. of 1.12 million.

Inflation numbers continue to indicate benign price pressures. The Consumer Price Index (CPI) rose 0.1% MoM in July and 0.2% for the year. Core CPI, which excludes food and energy, increased 0.1% MoM and 1.8% YoY. Persistently low inflation has caused increased speculation about the likelihood of a move by the Federal Reserve to raise interest rates.




The discussion at the Fed's annual Jackson Hole symposium did little to shed light on the timing of a possible rate hike. Fed speakers noted potential downside risks from the recent developments in international/emerging markets and acknowledged the moderate economic growth and low inflation. The FOMC next meets on September 16 and 17. A stronger US dollar, weaker than expected emerging market growth and weak commodity prices are also weighing on the Fed's decision to tighten.

In Europe, the Eurozone registered 0.3% real GDP growth in the second quarter, led by a 0.8% growth rate in Greece. Eurostat's flash estimate of August inflation in the Eurozone was 0.2% on a year-over-year basis, as falling energy prices dragged down the consumer price index. The core inflation rate, which strips out food and energy prices, was up 1.0%-unchanged from the previous month on a year-over-year basis. In addition, business activity, as measured by the manufacturing Purchasing Manager's Index, in the Eurozone was unchanged at 52.4 and slightly higher than economists' 52.2 estimate. Unemployment in the Eurozone dropped to 10.9% in July. Improvement in the rate was driven by falling unemployment in Italy, Spain, and Portugal, though France showed a slight uptick to 10.4% from 10.3%. Among the Eurozone states, Greece had the highest unemployment rate at 25% and Germany had the lowest rate at 4.7%.

In the UK, the Office of National Statistics' (ONS) estimated that the number of unemployed workers was 1.85 million in June, a rise of 25,000. This is the first time in over two years that the UK has experienced a rising unemployment count in two consecutive months. Wage growth, previously a source of strength in the UK, showed some signs of slowing in June. Wages rose 2.4% year-over-year in June, compared with a 3.2% rise in the previous month. Inflation in the UK unexpectedly rose in July, and the core inflation rate registered a five-month high of 1.2%. Bank of England (BOE) Governor Mark Carney, speaking at the Fed's Jackson Hole symposium, signaled that market turmoil and China's deteriorating economy will not change the BOE's plan to raise interest rates in 2016.

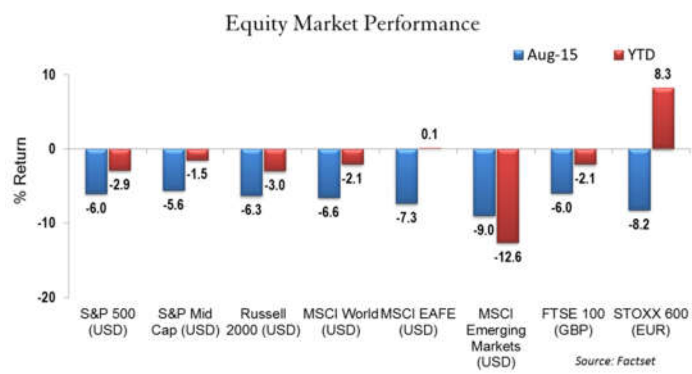
In China, the government continued to take unprecedented action to bolster the country's stock market and softening economy. China reported an 8.3% decline in exports in July and producer prices hit a six-year low. In response, the People's Bank of China (PBOC) devalued the Chinese yuan 1.9% to a three-year low against the US dollar. After a short pause in large-scale share purchases, the China Securities Regulatory Commission (CSRC) resumed buying stocks through state-owned investment funds ahead of a nationalist holiday celebrating the end of World War II.

The slowdown in China has taken a toll on other Asian economies, most notably Japan. Japan's economy contracted 1.6% in the second quarter, driven lower by a 16.5% contraction in exports. According to the Japan External Trade Organization (JETRO), Japan's exports to China fell 11% in the first half of the year. Similarly, the Reserve Bank of Australia (RBA) cut the country's GDP forecast to 2.5% from 3.5%; China accounts for one-third of all Australian exports, largely in commodities and raw materials. It remains to be seen how the Chinese slowdown will impact frontier markets, where China is a disproportionately large trading partner. For example, China is responsible for more than 1/8 of trade in sub-Saharan Africa, though this activity is mostly concentrated in five countries: Angola, Congo, the Democratic Republic of the Congo, Equatorial Guinea, and South Africa.

## *Equity Markets*

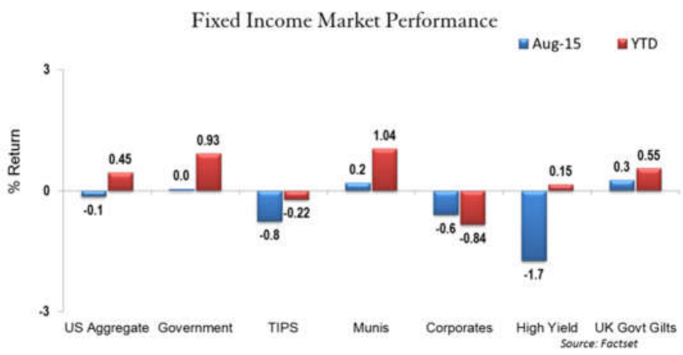
Global equity markets fell sharply in August, with the MSCI World Index returning -6.6%. Domestic large cap stocks, as measured by the S&P 500, fell 6.0% in August, and are now down 2.9% in 2015. Domestic mid-cap stocks, as measured by the S&P 400 returned -5.6% and the Russell 2000 small-cap index finished the month down 6.3%. The headline indices for Europe (STOXX 600) and the UK (FTSE 100) returned -8.2% and -6.0%, respectively. Emerging Markets lagged the developed world, as the MSCI Emerging Markets index lost 9.0% in August, and is now down 12.6% in 2015. At the sector level, previous leaders Health Care and Consumer Discretionary led the market lower with losses of 7.9% and 6.4%, respectively. Utilities was the strongest performing sector, albeit losing 3.4% on the month.

The -6.0% monthly performance for the S&P 500 was the worst month since September 2011, when US sovereign debt was downgraded by Standard & Poor's and Europe was in the throes of a banking crisis in several peripheral nations. The S&P 500 opened the month flat, before losing 11% in six trading sessions in the middle of the month. Market volatility, as measured by the CBOE Market Volatility Index (VIX), spiked from a low of 12.12 to close the month at 28.43. The VIX rose over 200% during the six-day downturn and recorded an intraday high over 53.29 a level not seen since the depths of the financial crisis. The volatility of European stocks, as measured by the Euro Stoxx 50 VIX Index, also spiked in August, closing the month at 31.07, up from July's 19.29 close.




## *Bond Markets*

August was a roller coaster month for financial assets as volatility climbed in all asset classes due to global deflationary concerns and devaluation of Chinese currency. Credit spreads closed the month at the widest levels in three years with the Option Adjusted Spread on the Barclays Credit Index closed at 155 bps. Despite all the volatility, long term Treasury bond yields ended the month nearly unchanged.



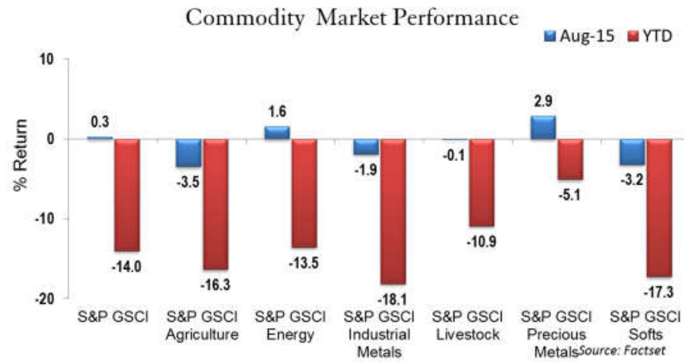

The yield on the 10-year US Treasury bond was flat and closed August at 2.2%. The yield on the 30-year US Treasury bond was also flat to close at 2.93%. The UK 10-year benchmark gilt yield declined 5 bps, to close at 1.85%. The yield on German 10-year benchmark bonds increased from 0.61% at the end of July to 0.73% at the end of August.

## *Commodities*

The S&P GSCI Total Return Index, a headline index of 24 commodities, returned 0.3% in August. The index has fallen 14.0% in 2015, as wild swings in energy, industrial metals, and agricultural commodities persist. The Agricultural sub-index returned -3.5% in August, as pressure in the emerging markets continues and previous concerns about unusual weather patterns have abated. Soybeans [-5.6%], Sugar [-4.0], and Cocoa [-3.9%], led the index lower.

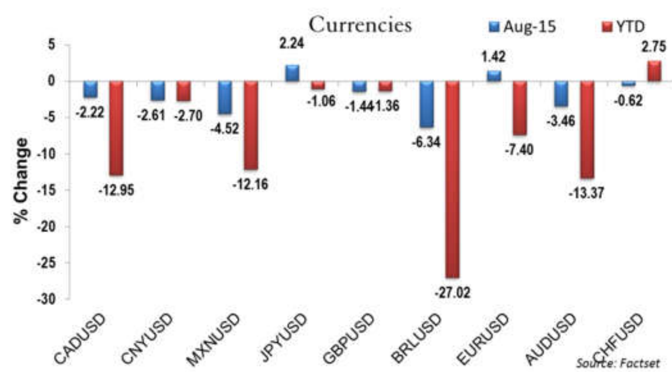
The Energy sub-index returned 1.6% in August, as markets paused from July's dizzying decline in energy related commodities. West-Texas Crude Oil opened the month at $47.12/bbl. and traded straight down throughout the month, before rallying over 27% in the final three days of August to close the month at $49.20/bbl. Brent Crude, the global benchmark for oil, traded similarly to WTI throughout the month, closing August at $55.80, up slightly from July's $54.25 close. Refining margins contracted sharply in August, as Gasoline [-4.9%] significantly underperformed crude.

The Precious Metals sub-index rallied 2.9% in August, as a risk-off trade in global equity markets and commodities pushed investors into safe-haven assets. Gold opened August at $1,095/oz., and rallied throughout the month, closing at $1,132/oz. Gold is down roughly 40% from 2011 highs of $1,900/oz., and has fallen approximately $52/oz. so far in 2015.




## *Currencies*

The US dollar weakened versus a basket of major currencies amidst the volatility in August. The US dollar Index fell 1.3% and is up +6.25% for the year. Commodity based currencies were hurt in July.




The Euro strengthened 1.4% against the US dollar to close at 1.1205 USD/EUR in August while the British pound weakened -1.4% to close at 1.538 USD/GBP.