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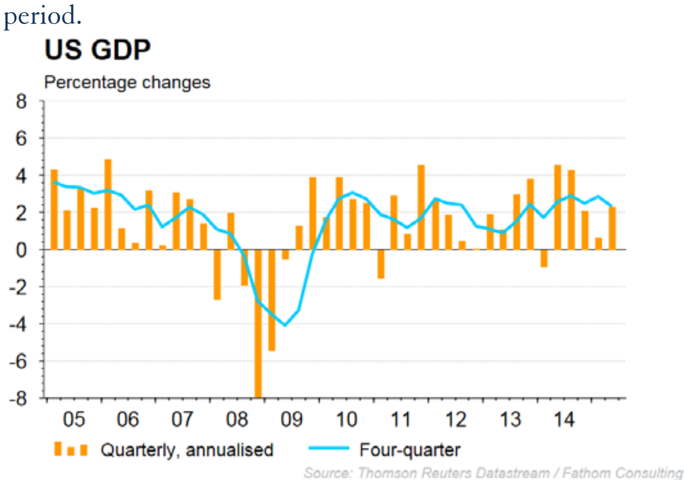
Market Review

July 2015

Economic Review

US second quarter real GDP came in at a 2.3% annualized rate (a.r.), according to the advance estimate released by the Bureau of Economic Analysis (BEA). This was at the lower end of the consensus range of 1.9% to 3.5%. The second quarter real GDP increase reflected positive contributions from personal consumption expenditures (PCE), exports, state and local government spending, and residential fixed investment that were partly offset by negative contributions from federal government spending, private inventory investment, and nonresidential fixed investment. Imports, which are a subtraction in the calculation of GDP, increased.

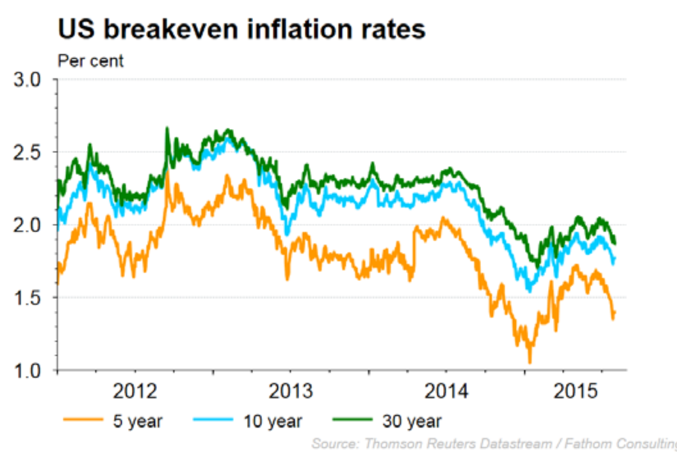
The annual revisions to GDP growth were released with the advance estimate. These revisions largely reflect the incorporation of newly available and revised source data and improvements to estimating methodologies. The revisions span the first quarter of 2012 through first quarter of 2015. The first quarter '15 real GDP was revised to +0.6% from previously reported -0.2%. The first half of 2015 is significantly weaker than the first half of 2014. Last year, first quarter GDP contraction of -0.9% was followed by a second quarter growth of +4.6%. GDP for 2013 was revised lower from 2.2% to 1.5%, and 2012 was revised lower from 2.3% to 2.2%. In total, revision GDP grew at a lower rate than previously reported over the prior three-year period.



The unemployment rate declined 0.2% to 5.3% in June as the civilian labor force declined by 432,000, following an increase of similar magnitude in May. The labor-force-participation-rate declined 0.3% to 62.6% in June. Total nonfarm payroll employment rose by 223,000 in June, compared with an average monthly gain of 250,000 over the prior 12 months. The change in total nonfarm payroll employment for April was revised from +221,000 to +187,000, and the change for May was revised from +280,000 to +254,000. The average workweek for all employees on private nonfarm payrolls was 34.5 hours in June for the fourth month in a row while the average hourly earnings remained unchanged at $24.95.

Housing prices, as measured by the S&P/Case-Shiller Composite Home Price Index, are up 4.9% year-over-year (YoY) through April. Existing home sales increased for the second consecutive month during June, rising +3.2% month-over-month (MoM) to 5.59 million units. Existing home sales are up 9.6% YoY. New home sales fell to the lowest level since November, declining 6.6% MoM to 482,000 units. Housing starts declined 1.1% MoM to 1.04 million. Pending home sales increased 0.9% MoM and are up 8.3% YoY.

June Consumer Price Index (CPI) figures were in line with expectations. CPI rose 0.3% MoM and 0.1% YoY. This is the fifth consecutive monthly increase. Core CPI, excluding food and energy, rose 0.2% MoM and is up 1.8% YoY. The breakeven measures of inflation narrowed in June due to falling commodity prices. The 10-year Breakeven inflation rate fell 14 bps to 1.75%.



The Federal Open Market Committee (FOMC) statement after the July meeting was interpreted by most as increasing the possibility of a rate hike in September. The statement acknowledged the improvement in the labor market and did not highlight any potential deflationary concerns from the recent fall in commodity prices that may delay a rate hike. The FOMC next meets on September 16 and 17.

International economic headlines continued to be dominated by Greece and China. Greek negotiators and the "troika" (the European Commission, the European Central Bank, and the International Monetary Fund) announced an agreement raising hopes of keeping the country in the Euro currency and also temporarily relieving Greece's debt crisis.

The agreement would provide Greece with a $94 billion bailout package in exchange for additional austerity measures. The push for austerity has set Prime Minister Alexis Tsipras (who now supports the measures) against more extreme factions of his leftist Syriza party. Capital controls remained in place in Greece throughout July, and the stock market remained closed throughout the month.

In China, the government continued to take unprecedented action to bolster the country's stock market. In response to a continued slide in Chinese stocks, the China Securities Regulatory Commission (CSRC) has pledged to purchase shares with cash supplied by the People's Bank of China (PBOC). In addition, the PBOC has cut interest rates to a record low and the CSRC has asked brokerage houses for trading records to identify short sellers. The CSRC has threatened "malicious" short sellers with jail time.

Eurostat's flash estimate of July 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%, a 0.2% acceleration from the previous month on a year-over-year basis. In addition, business activity in the Eurozone, as measured by the Purchasing Manager's Index, reached a four-year high in June. The PMI grew to 54.2 from 54.1, well above the 50 threshold between expansion and contraction. Unemployment in the Eurozone remained stable at 11.1% in June. Among the Eurozone states, Greece had the highest unemployment rate at 25.6% and Germany had the lowest rate at 4.7%.

In the UK, the Office of National Statistics' (ONS) estimate of unemployment was 5.6% in May, the first rise in the unemployment rate in two years. Wages rose 3.2%, however, which is the fastest increase in five years.

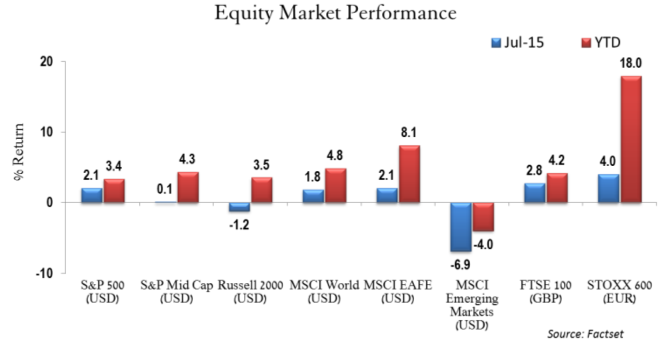
Bank of England (BOE) governor Mark Carney signaled that the BOE will raise interest rates in 2016 for the first time since July 2007. Carney expects that the base rate will rise from 0.50% to 2.5% over the next few years, as Britain's economy gains momentum and inflation normalizes. Inflation in the UK fell from 0.1% in May to 0% in June, driven by falling food and energy prices.

Equity Markets

Global equities mostly rose in July, with the MSCI World Index returning 2.1%. Domestic large cap stocks, as measured by the S&P 500, gained 2.1% in July, and are now up 3.4% in 2015. Domestic mid-cap stocks, as measured by the S&P 400 returned 0.1% and the Russell 2000 small-cap index finished the month down -1.2%. The headline indices for Europe (STOXX 600) and the UK (FTSE 100) returned 4.0% and 2.8%, respectively. At the sector level, Utilities rebounded from a down June to lead the market higher with a 6.1% gain. Energy and Materials lagged the market in July, returning -7.7% and -5.0% for the month, respectively.

The S&P 500 traded choppily throughout the month, with a global commodity rout and persistent fears about Greece introducing some uncertainty into the equity markets. By the end of the month, market volatility, as measured by the CBOE Market Volatility Index (VIX), had collapsed from a spike at the end of June to close July at 12.12. The VIX rose over 22% on July 8 as the New York Stock Exchange halted trading for several hours. The VIX also rose 28% in three days in the middle of the month, as falling oil prices sent stock prices lower. The volatility of European stocks, as measured by the Euro Stoxx 50 VIX Index, fell steadily throughout July, closing the month at 19.29 after spiking to 32.31 at the end of June.

Equity Market Performance

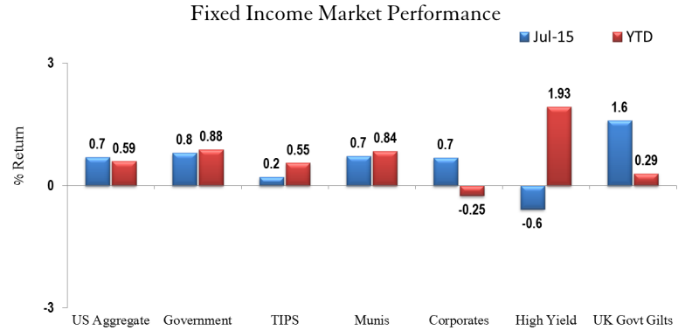


Source: Factset

Bond Markets

Long-term Treasury yields fell back below 3% on headlines out of Greece, the sell-off in Chinese stocks and weakness in commodity markets. Corporate bond issuance remained heavy and credit spreads widened for the third consecutive month. The Option Adjusted Spread on the Barclays Credit Index closed July at 146 bps, the widest since the Fall of 2012.

Fixed Income Market Performance



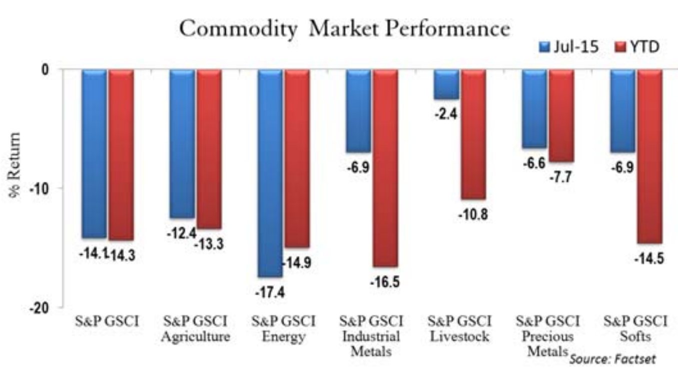
Source: Factset

The yield on the 10-year US Treasury bond declined 8 bps to close July at 2.21%. The yield on the 30-year US Treasury bond fell 17 basis points to close at 2.93%. The UK 10-year benchmark gilt yield declined 13 bps, to close at 1.9%. The yield on German 10-year benchmark bonds dropped 16 basis points to close at 0.61% at the end of July.

Commodities

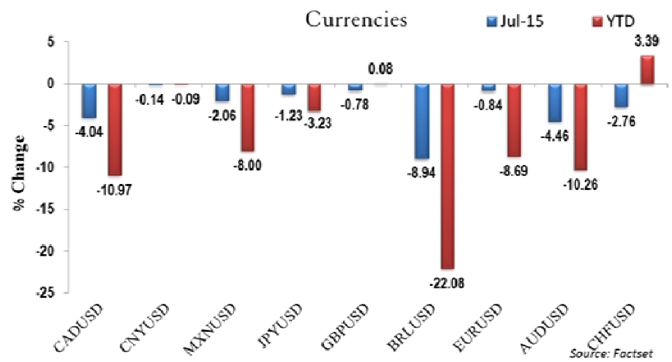
The S&P GSCI Total Return Index, a headline index of 24 commodities, fell 14.1% in July. The index has –lost 14.3% year-to-date, as wild swings in energy, industrial metals, and agricultural commodities persist. The Agricultural sub-index returned -12.4% in July, as the US Dollar strengthened and concerns about the impact of unusual weather on the grain markets have abated. Wheat [-18.9%], Corn [-12.1%], and Sugar [-10.7%] were particularly weak in July. The Industrial Metals sub-index lost 6.9% in July as global growth concerns and a weakening Chinese economy sent Copper [-9.4%] and Nickel [-8.0%] prices lower.

The Energy sub-index dropped 17.4% in July, as energy markets were pressured by rising oil inventories in the United States and the looming threat of increased supply from the end of international sanctions against Iran. The sub-index reversed year-to-date gains and is now down 14.9% in 2015. West-Texas Crude Oil opened the month at $59.47/bbl. and traded nearly straight down throughout the month, closing July at $47.12. Brent Crude, the global benchmark for oil, closed July at $52.21/bbl, down over $11 from the month's open. Oil markets fell sharply in the beginning of July, as the US rig count surprisingly rose to 640, breaking 29 straight weeks of decline. Later in the month, the announcement of a 2.5 million barrel rise in US crude inventories sent WTI prices down 8.5% in 8 days. US refining margins widened slightly in July, as refined products fell but outperformed crude oil.



Currencies

The US Dollar regained momentum versus a basket of major currencies in July, driven by US interest rate expectations and weak commodity markets. The US Dollar Index appreciated 1.74% in July and is up +7.65% for the year. Commodity-based currencies were hurt in July. The Canadian dollar slumped to its lowest levels since 2004 on weak domestic economic performance in recent quarters and declining oil prices.



The Euro weakened 0.8% against the US Dollar to close at 1.10485 USD/EUR in July while the British Pound fell 0.8% to close at 1.5605 USD/GBP.