

MONTHLY ECONOMIC UPDATE

October 2014

MONTHLY QUOTE

“He that is of the opinion money will do everything may well be suspected of doing everything for money.”

– *Ben Franklin*

MONTHLY TIP

The end of the year is a good time to review (and adjust) the asset allocation of your portfolio. When you see a big difference between stock market performance and bond market performance in a given year, this is especially sensible.

MONTHLY RIDDLE

You have two twins, three triplets and four quadruplets in a room; how many total people do you have in the room?

Last month's riddle:

What may contain hundreds or thousands of wheels yet never moves or rises above the land?

Last month's answer:

A parking lot.

THE MONTH IN BRIEF

Bullish sentiment certainly waned in September – when the month was over, the Dow, Nasdaq, S&P 500 and Russell 2000 had all retreated to varying degree. Troubling headlines from Asia, the Middle East and Eastern Europe weighed on Wall Street's collective mind, as did some unexpectedly weak U.S. economic signals. While the Federal Reserve maintained its outlook on interest rates, investors were acknowledging the looming end of QE3. The dollar got even stronger, and the broad commodities market took a severe hit. Housing news was mixed. The S&P notched a new record close of 2,011.36 during the month, then lost 1.8% between that peak and the start of October.¹

DOMESTIC ECONOMIC HEALTH

The latest consumer indicators were mostly encouraging. Personal spending – which had declined 0.1% in July – rose 0.5% for August. Year-over-year, the increase was 4.1%. (The Commerce Department also noted 0.3% wage growth in August.)^{2,3}

Household sentiment, as measured by the University of Michigan's index, also improved: the index's final September reading was 84.6 (up from 82.5 at the end of August, and the highest reading since late April). On the other hand, the Conference Board's consumer confidence index sank a troubling 7.4 points, falling to 86.0.^{2,4}

Shoppers were opening their wallets a bit more as inflation remained benign. Retail sales were up 0.6% in August following the 0.3% gain the Commerce Department recorded for July. August's headline Consumer Price Index showed a 0.2% retreat, taking the annualized rise in consumer prices down to 1.7%. The core CPI was flat for August.⁴

Wall Street was disappointed in the August employment report. The Labor Department announced just 142,000 new hires, representing the smallest monthly net job gain since December. Unemployment ticked down to 6.1% and the U-6 rate (including the underemployed) dipped 0.2% to 12.0%.⁵

Factory activity had surged in July with aircraft orders being the big influence, but that all seemed to reverse in August. Factory orders dropped 10.1% in the eighth month of the year according to the Commerce Department, and August brought 0.1% and 0.4% respective declines in factory and manufacturing production. Durable goods orders fell 18.2% in August. Producer prices were flat in August and up 1.8% in a year.^{2,4}

Given all that, the August drop in the Institute for Supply Management's factory PMI wasn't surprising. It came in at 56.6 as opposed to 59.0 for July – still strong, just less so. ISM's service sector PMI had gained 0.9 points in August, reaching 59.6.^{2,6}

As the month and quarter wound down, the Commerce Department revised Q2 GDP north again, from 4.2% to 4.6%. Investors were pleased by that and by the Fed's September policy statement, which again said that interest rates would likely not be adjusted for “a considerable time” after the end of quantitative easing.^{4,7}

GLOBAL ECONOMIC HEALTH

Investors watched fluid geopolitical situations on multiple continents. The U.S. led air strikes against ISIS positions in Syria, including oil refineries ISIS had captured. A truce in Ukraine seemed shaky at best: the month ended with Russian separatists killing seven Ukrainian soldiers. Pro-democracy protests in Hong Kong escalated into a blockade and raised fears of violence.^{3,8}

Speaking of China, its latest official factory PMI came in flat for September at 51.1, indicating mild sector expansion; HSBC's factory PMI for the country was also unchanged at 50.2. The PRC also announced economic initiatives to encourage home buying and assist real estate developers.⁹

Other key manufacturing gauges were largely unimpressive. The Markit factory PMI for Germany showed sector contraction for the first time in 15 months in September; Markit's manufacturing PMI for France showed contraction for the fifth month in a row. The eurozone factory PMI came in at 50.3 in September, the poorest reading in 14 months. In a Reuters poll late last month, economists put the chance of the European Central Bank initiating a quantitative easing campaign at 40%; the ECB followed through with that move in early October.¹⁰

WORLD MARKETS

There were benchmarks that rose in September. Take China's Shanghai Composite, with its 6.62% gain. Or the Nikkei 225, which advanced 4.86%, or Pakistan's KSE Composite, up 4.06%. Not all Asia Pacific indices were so fortunate: the Kospi lost 2.34%, the Sensex 0.03%, the ASX 200 5.92% and the Hang Seng 7.31%. In Europe, the CAC 40 gained 0.80% and the DAX 0.04% while the FTSE 100 slipped 2.89%. Ireland's ISEQ rose 1.91% and Italy's FTSE MIB advanced 2.16%.¹¹

In the Americas, the Bovespa sank 11.70%, the IPC All-Share 1.41% and the TSX Composite 4.26%. Overseas indices in the Dow Jones family suffered a rough month – the DJ Americas lost 2.89%, the Asia Dow 7.04%, the Europe Dow 4.10% and the Global Dow 3.29%. The STOXX 600 gained 0.32% last month; the MSCI World Index dipped 2.88% while the MSCI Emerging Markets Index slid 7.59%.^{11,12}

COMMODITIES MARKETS

September saw a 3.85% rise for the U.S. Dollar Index – the DXY closed out the month at 85.94. That factor alone meant rough going for many commodity futures. Important metals all pulled back: COMEX gold fell 5.98% for the month to close at \$1,212.80 on September 30; platinum dropped 8.99%, copper 4.07% and silver 12.40%. Silver futures ended September down at \$17.06.^{13,14}

Crop futures also had a trying September, with major losses for soybeans (16.35%), corn (10.80%), cotton (9.22%) and wheat (13.25%). Sugar retreated just 0.06%, coffee gained just 0.03%. Cocoa actually advanced 1.35%.¹⁴

Did air strikes on ISIS-controlled refineries put any real pressure on oil prices? No. NYMEX crude lost 4.72% last month and ended September at \$92.00. Unleaded gasoline sank 7.23% and heating oil fell 7.24%. Natural gas futures, partly reflecting fears over security of Ukraine pipelines, rose 1.10%.¹⁴

REAL ESTATE

Existing home sales had slipped 1.8% in August, in the first decline the National Association of Realtors had measured since March. Year-over-year, the sales pace had decreased by 5.3%. NAR also reported pending home sales down 1.0% for August, a switch from July's 3.2% gain. The Census Bureau, on the other hand, reported new home sales up 18.0% in August. It noted an 8.0% annualized rise in new home prices and a 33.0% yearly improvement in new home buying.^{2,15}

At the jobsite, the August numbers were negative. Construction spending was down 0.8% for the month, housing starts 14.4% and building permits 5.6%. A falloff in multi-family projects accounted for much of those retreats. Groundbreaking for single-family homes was up 4.2% year-over-year as of August.^{2,16}

September saw mortgages grow more expensive. By the time Freddie Mac's September 25 Primary Mortgage Market Survey rolled around, the average interest rate on a 30-year fixed loan was up to 4.20%. Rates on the refiner's favorite, the 15-year fixed, were averaging 3.36%. Average rates on the 5/1-year ARM and 1-year ARM respectively reached 3.08% and 2.43%. Back on August 28, mean interest rates

on mortgage types were estimated as follows: 30-year FRM, 4.10%; 15-year FRM, 3.25%; 5/1-year ARM, 2.97%; 1-year ARM, 2.39%.¹⁷

LOOKING BACK...LOOKING FORWARD

Well, the CBOE VIX certainly had a fine month. It gained 36.14% to close at 16.31 on September 30. Small caps were battered last month – the Russell 2000 fell 6.19%. The big three retreated far less than that – the Dow lost 0.32%, the Nasdaq 1.90% and the S&P 1.55%. At September's end, here was where the key U.S. indices finished: DJIA, 17,042.90; S&P, 1,972.79; NASDAQ, 4,493.39; RUT, 1,101.68.¹¹

| % CHANGE | Y-T-D | 1-YR CHG | 5-YR AVG | 10-YR AVG |
|------------|-----------|----------|-----------|------------|
| DJIA | +2.81 | +12.65 | +15.10 | +6.91 |
| NASDAQ | +7.59 | +19.14 | +22.34 | +13.69 |
| S&P 500 | +6.70 | +17.32 | +17.33 | +7.70 |
| REAL YIELD | 9/30 RATE | 1 YR AGO | 5 YRS AGO | 10 YRS AGO |
| 10 YR TIPS | 0.55% | 0.45% | 1.56% | 1.77% |

Sources: online.wsj.com, bigcharts.com, treasury.gov - 9/30/14^{11,18,19}
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
These returns do not include dividends.

October has been a famously either/or month for stocks (plenty of big ascents, descents and swings over the years), and equities are being subjected to major volatility as the month opens thanks to recent world events. Unhappily, October 1 saw a correction in the Russell 2000. In the best-case scenario, better-than-expected earnings take center stage for the bulk of the month, complemented by upbeat economic indicators (manufacturing expansion, net job gains above the 200,000 level, a good initial reading on Q3 growth, solid fall consumer spending). The Fed's longstanding asset purchase program is about to end; Wall Street is hopefully ready to accept that. October may throw more challenges at stocks than we have seen in several months. At junctures like these, hanging on and settling in for the ride often ends up being a wise move.²⁰

UPCOMING ECONOMIC RELEASES: Here is the rollout of important economic indicators and reports for the rest of this month: the Labor Department's September jobs report and the September ISM services PMI (10/3), the release of the minutes from the Fed's most recent policy meeting (10/8), August wholesale inventories (10/9), September retail sales, a new Beige Book from the Fed and September's PPI (10/15), September industrial output (10/16), the initial University of Michigan consumer sentiment index for October and the numbers on September housing starts and building permits (10/17), September existing home sales (10/21), September's CPI (10/22), the Conference Board's September leading indicators (10/23), September new home sales (10/24), September pending home sales (10/27), the Conference Board's October consumer confidence index, the August Case-Shiller home price index and September hard goods orders (10/28), a Fed policy announcement (10/29), the first estimate of Q3 GDP from the federal government (10/30), and lastly the personal spending report for September and the final October University of Michigan consumer sentiment reading (10/31).

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The BSE SENSEX (Bombay Stock Exchange Sensitive Index), also-called the BSE 30 (BOMBAY STOCK EXCHANGE) or simply the SENSEX, is a free-float market capitalization-weighted stock market index of 30 well-established and financially sound companies listed on the Bombay Stock Exchange (BSE). 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 S&P/ASX 200 is Australia's "premier" share market index. The CAC-40 Index is a narrow-based, modified capitalization-weighted index of 40 companies listed on the Paris Bourse. The DAX 30 is a Blue Chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The FTSE 100 Index is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. 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 FTSE MIB (Milano Italia Borsa) is the benchmark stock market index for the Borsa Italiana, the Italian national 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 Mexican IPC index (Indice de Precios y Cotizaciones) is a major stock market index which tracks the performance of leading companies listed on the Mexican 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 Dow Jones Americas Index measures the Latin American equity markets by tracking 30 leading blue-chip companies in the region. 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 Global Dow is a 150-stock index of corporations from around the world created by Dow Jones & Company. 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. 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. 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