

QUARTERLY ECONOMIC UPDATE

A review of 4Q 2015

QUOTE OF THE QUARTER

“Facing it, always facing it, that's the way to get through. Face it.”

—Joseph Conrad

QUARTERLY TIP

Retired? Retiring soon? A tax-efficient withdrawal strategy is vital. Which accounts should you draw from first, or last? Take time to review your options and determine the proper order of distributions.

THE QUARTER IN BRIEF

Thanks to a great October offsetting a flat November and a down December, U.S. stock indices posted sizable gains during the fourth quarter. The Dow Jones Industrial Average rose 7.00% in Q4, but even so, the blue chips lost 2.23% for the year. In the last quarter of 2015, the Federal Reserve finally raised interest rates, the slowdown in global manufacturing spread to America, and oil prices fell on the NYMEX. Hiring totals were impressive, housing indicators mostly positive. Terrorism, ongoing weakness in Chinese manufacturing, the oil supply glut, and declining corporate profits and dollar strength all bred considerable anxiety among investors.¹

DOMESTIC ECONOMIC HEALTH

The quarter's biggest financial story was the Federal Reserve's big move – its December 16 decision to raise the federal funds rate by a quarter of a point. Investors widely expected a December rate hike, so the focus quickly turned to what the Fed might do in 2016. Its December dot-plot chart showed a median projection of 1.4% for the federal funds rate at the end of this year, 2.4% at the end of 2017, and 3.3% at the end of 2018.^{2,3}

In November, annualized core consumer inflation was right at the central bank's 2.0% target. The headline Consumer Price Index had risen just 0.5% in a year. Both the headline and core CPI advanced 0.2% for October; in November, the core CPI maintained that pace while the headline CPI was flat. The headline and core Producer Price Indexes both rose 0.3% in November; they had respectively retreated 0.4% and 0.3% for October.^{4,5}

Annualized wage growth had improved slightly to 2.3% by November, another development likely influencing the timing of the Fed's upward move. Employers added 298,000 new jobs in October and 211,000 in November; by the eleventh month of the year, the headline unemployment rate stood at 5.0% while the U-6 rate tracking “total” unemployment stood at 9.9%.⁶

Personal spending was up 0.3% in November after a flat October; personal incomes rose 0.4% in October, 0.3% in November. Retail sales merely inched up 0.1% in October, 0.2% in November; minus auto buying, sales were actually up 0.4% for November. As for consumer confidence, the Conference Board's index went north again, reaching 96.5 in November after a 92.6 reading in October. The University of Michigan's index ended November at 92.6.^{4,5}

How much had the economy grown in the third quarter? As Q4 drew to a close, we received the final answer from the Bureau of Economic Analysis: 2.0%, far from the 3.9% expansion in Q2. Indicators from the fall months made analysts wonder if GDP would even reach 2% in Q4. The manufacturing PMI from the Institute for Supply Management slipped lower and lower as the quarter went on – 50.1 in October, 48.6 in November, and 48.2 in December. So by ISM's measure, the year ended with two months of contraction in the U.S. factory sector. (In December 2014, the ISM manufacturing PMI was at 55.1.) In contrast, ISM's non-manufacturing PMI was holding up well as 2015 ended, at 59.1 in October and 55.9 in November (though the November reading was the lowest since May). Total durable goods orders were up 2.9% in October but flattened a month later. U.S. industrial output fell 0.4% for October and 0.6% for November.^{4,7,8}

GLOBAL ECONOMIC HEALTH

Leaders of China, the second-largest economy in the world, claimed that economy would meet its 7% growth target for 2015, but their claims were met with some

skepticism. China's manufacturing sector appeared to be firmly in contraction territory, with the nation's official factory PMI at 49.7 when the quarter ended, barely better than the 49.6 November reading that represented a 3-year low. The Caixin manufacturing PMI for China was at 48.6 in October, a 6-month peak of 48.9 for November, and 48.2 for December; it was last above 50 in February. Economists polled by Bloomberg see 6.9% GDP for China for 2015, 6.5% for 2016, and 6.3% for 2017. China's official service sector PMI did reach 54.4 in December, its best mark since August 2014. At quarter's end factory PMIs in Japan (52.6), South Korea (50.7), and Taiwan (51.7) were all showing sector expansion.^{9,10}

The eurozone manufacturing sector seemed in good shape. Markit's manufacturing PMI for the euro area came in at 53.1 in December; manufacturing output had accelerated at the fastest pace in 20 months. The European Central Bank expanded the scope of its economic stimulus as the year ended, as the deflation threat to the eurozone remained – annualized consumer inflation was at 0.2% the entire quarter, and yearly core inflation was just 0.9% in December, nowhere near the ECB target of 2.0%.^{11,12}

WORLD MARKETS

Gains outnumbered losses in Q3. China's Shanghai Composite jumped 15.93%, Germany's DAX rose 11.21%, and Argentina's Merval surged 18.96%. Other gains: The U.K.'s FTSE 100, 2.98%; Australia's ASX 200, 5.46%; Hong Kong's Hang Seng, 5.12%; Indonesia's Jakarta Composite, 8.74%; Japan's Nikkei 225, 9.46%; Ireland's ISEQ, 10.12%; France's CAC 40, 4.08%. The major regional indices also advanced in Q3: the Asia Dow rose 3.35%, the Global Dow 4.03%, the Stoxx 600 5.19%, the Europe Dow 1.32%, the Dow Jones Americas 4.98%, the MSCI World Index 5.11%, and the MSCI Emerging Markets Index 0.26%.^{1,13}

Fourth quarter retreats varied from major to minor. Russia's RTS lost 4.14%; Brazil's Bovespa 3.79%, Spain's IBEX 35 0.16%, Canada's TSX Composite 2.23%, India's BSE Sensex 0.14%, and South Korea's Kospi 0.08%.¹

COMMODITIES MARKETS

The Thomson Reuters/Core Commodity CRB Index fell another 9.09% in Q4 and sank 23.40% for the year. As for the U.S. Dollar Index, it logged a 2.37% Q4 advance and gained 9.26% for 2015.^{14,15}

Crude oil sank 17.85% during the quarter on NYMEX, ending the year at \$37.04 after cresting the \$50 level in early October. Unleaded gasoline futures fell 12.11% in 2015, which paled compared to the 20.55% descent for natural gas and the 37.12% drop taken by heating oil.^{16,17}

As Q4 concluded, gold settled at \$1,060.50 per ounce on the COMEX, retreating 10.53% for 2015. Silver ended the year at \$13.82, slipping 11.69% in 2015. Platinum and copper fell harder: platinum lost 26.00% for the year, copper 25.09%.¹⁷

Soft commodities fared best in the quarter. In fact, the five-commodity block of Cocoa, cotton, coffee, sugar, and frozen concentrated orange juice rose 12.64% in Q4, with sugar alone up 18.32%. It only gave back 0.74% on the year. Coffee certainly had a rough year, slipping 21.54%; corn lost 9.36% in 2015, soybeans 13.07%, and wheat 18.88%. Cocoa futures advanced 9.07% in 2015, cotton futures 6.21%, and sugar futures 6.87%.^{17,18}

REAL ESTATE

New home sales kept rising during the fall: up 10.7% in October, another 4.3% in November according to the Census Bureau. Resales went in the opposite direction. The National Association of Realtors recorded a 4.1% drop in October, then a 10.5% plunge in November, possibly influenced by new home financing regulations that delayed some closings. This development may have also affected NAR's pending home sales index, which fell 0.9% in November after a 0.2% October gain.⁴

Looking at some other key housing market indicators, October's Case-Shiller Home Price Index rose 0.1% and displayed a year-over-year increase of 5.5% (this is the 20-city composite). U.S. housing starts declined 12.0% for October, but groundbreaking picked up 10.5% in November. October saw a 4.1% increase in building permits, and November brought an 11.0% gain in that category.⁴

When the quarter started (October 1), Freddie Mac measured the following average interest rates on home loans in its Primary Mortgage Market Survey: 30-year FRM, 3.85%; 15-year FRM, 3.07%; 5/1-year ARM, 2.91%; 1-year ARM, 2.53%. On December 31, everything was higher: 30-year FRM, 4.01%; 15-year FRM, 3.24%; 5/1-year ARM, 3.08%; 1-year ARM, 2.68%.¹⁹

LOOKING BACK...LOOKING FORWARD

Along with the Q4 gains for the three major indices, the Russell 2000 improved 3.20% in the last three months of 2015. The CBOE VIX, the "fear index," lost 25.67% for the worst Q4 performance of any U.S. benchmark. Rising 17.83%, the Dow Jones Internet index was the quarter's top performer. On December 31, the most-watched U.S. indices settled as follows: DJIA, 17,425.03; NASDAQ, 5,007.41; S&P, 2,043.94; RUT, 1,135.89; VIX, 18.21. The 2015 performances of the "big three" are noted just below; the RUT lost 5.71% on the year, the VIX 5.16%.¹

% CHANGE	2015	Q4 CHG	1-YR CHG	10-YR AVG
DJIA	-2.23	+7.00	-2.23	+6.26
NASDAQ	+5.73	+8.38	+5.73	+12.71
S&P 500	-0.73	+6.45	-0.73	+6.37
REAL YIELD	12/31 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.73%	0.49%	1.00%	2.06%

Sources: wsj.com, bigcharts.com, treasury.gov – 12/31/15^{1,20,21}
 Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
 These returns do not include dividends.

How will stocks fare in the first quarter of 2016? They certainly fared poorly on the year's first trading day, when another global selloff prompted by a poor factory PMI reading in China sent equity indices on three continents down 2-8%. One bad day need not foretell the whole quarter, however. For stocks to regain momentum in this and subsequent quarters, oil prices have to rebound at least slightly, corporate profits have to rise (Thomson Reuters data shows they were flat last year, in contrast to 8.3% improvement in 2014), Wall Street has to accept the long-planned slowdown in China's economy, and the dollar needs to be a little less dominant – a rather long wish list. Even if the Fed winds up making just one or two upward moves in 2016, the bulls will have some formidable challenges to overcome. Stocks advanced nicely in the previous decade when monetary policy was tightened; with luck, perhaps they will do just that this quarter, and this year.^{22,23}

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The DAX 30 is a Blue Chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The MERVAL Index (MERcado de VALores, literally Stock Exchange) is the most important index of the Buenos Aires Stock Exchange. The FTSE 100 Index is a share index of the 100 most highly capitalized companies listed on the London Stock Exchange. The S&P/ASX 200 index is a market-capitalization weighted and float-adjusted stock market index of Australian stocks listed on the Australian Securities Exchange from Standard & Poor's. 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 IDX Composite or Jakarta Composite Index is an index of all stocks that are traded on the Indonesia Stock Exchange (IDX). Nikkei 225 (Ticker: ^N225) is a stock market index for the Tokyo Stock Exchange (TSE). The Nikkei average is the most watched index of Asian stocks. 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 CAC-40 Index is a narrow-based, modified capitalization-weighted index of 40 companies listed on the Paris Bourse. The Asia Dow measures the Asia equity markets by tracking 30 leading blue-chip companies in the region. The Global Dow (GDOW) is a 150-stock index of corporations from around the world, created by Dow Jones & Company. The Dow Jones STOXX 600 Index captures more than 90% of the aggregate market cap of European-based companies. The Europe Dow measures the European equity markets by tracking 30 leading blue-chip companies in the region. The Dow Jones Americas Index measures the Latin American equity markets by tracking 30 leading blue-chip companies in the region. 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 RTS Index (abbreviated: RTSI, Russian: Индекс РТС) is a free-float capitalization-weighted index of 50 Russian stocks traded on the Moscow 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 IBEX 35 is the benchmark stock market index of the Bolsa de Madrid, Spain's principal 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. BSE Sensex or Bombay Stock Exchange Sensitivity Index is a value-weighted index composed of 30 stocks that started January 1, 1986. The Korea Composite Stock Price Index or KOSPI is the major stock market index of South Korea, representing all common stocks traded on the Korea Exchange. 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. This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. Past performance is no guarantee of future results. Investments will fluctuate and when redeemed may be worth more or less than when originally invested. All information is believed to be from reliable sources; however we make no representation as to its completeness or accuracy. All economic and performance data is historical and not indicative of future results. 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