

MONTHLY ECONOMIC UPDATE

January 2016

MONTHLY QUOTE

“We can draw lessons from the past, but we cannot live in it.”

– Lyndon Johnson

MONTHLY TIP

The new year may be the right time to rebalance your portfolio, so that your asset allocation can stay aligned with your risk tolerance and investment objectives. During 2015, some of your asset categories may have shifted away from your target allocations.

MONTHLY RIDDLE

It can make food for the whole world, but it does not eat and will never spend time on this planet. What is it?

Last month's riddle:
Which side of an ocelot has the most fur?

Last month's answer:
The outside.

THE MONTH IN BRIEF

Stocks limped to the finish in December. The S&P 500 slumped 1.75% during the month and lost 0.73% for the year. The market rallied when the Federal Reserve raised interest rates for the first time in nearly a decade, but it retreated repeatedly during the month as oil prices continued to fall. Payrolls expanded nicely, consumer confidence improved, and most of the housing market news was positive. In the wake of the Federal Reserve interest rate decision, Wall Street seemed ready to focus on 2016 and forget a weak year for equities.¹

DOMESTIC ECONOMIC HEALTH

On December 16, U.S. monetary policy changed course. The Federal Reserve raised the benchmark interest rate a quarter-point, the central bank's first upward move since 2006. The Federal Open Market Committee's updated dot-plot forecast projected four rate hikes during 2016, with a median projection of 1.4% for the federal funds rate at the end of this year.^{2,3}

December saw the Conference Board consumer confidence index advance 3.9 points to a mark of 96.5. The University of Michigan's household sentiment index ended the month at 92.6, slightly improved from its initial December reading of 91.8.^{4,5}

Commerce Department data showed both consumer spending and consumer incomes rising 0.3% in November. Core retail sales (minus auto buying) improved 0.4% in that month as headline retail sales increased 0.2%; October had seen both indicators rise just 0.1%.^{5,6}

The Labor Department's December jobs report showed wages up 2.3% through the 12 months ending in November – in the eyes of some analysts, a statistic contributing to the Fed's decision to hike. Payrolls swelled with 211,000 new hires in November, and September and October job gains were revised up to leave the average monthly hiring total at 218,000 for that 3-month period. The headline unemployment rate stayed at 5.0% in November, but the U-6 total unemployment rate ticked up to 9.9%.⁷

November's Consumer Price Index was flat, with core consumer prices increasing 0.2%; that left the headline CPI up 0.5% and the core CPI up 2.0% year-over-year. Both the headline and core Producer Price Indexes rose 0.3% in November, offsetting a 0.4% dip for the headline PPI and an 0.3% fall for the core PPI in the prior month.^{6,8}

December also brought the last estimate of Q3 growth from the Bureau of Economic Analysis. It was an unexceptional 2.0%, down from 2.1% in the previous estimate. In November, the Institute for Supply Management's factory PMI came in at 48.6, falling an alarming 1.5 points from October and indicating sector contraction. ISM's service sector PMI also fell sharply, losing 3.2 points for November but remaining in good shape at 55.9. Industrial output had declined 0.6% in November and was 1.2% underneath the level of a year ago according to the Federal Reserve; durable goods orders were flat for November, core durable orders down 0.1%.^{5,8,9}

GLOBAL ECONOMIC HEALTH

The European Central Bank cut its already negative deposit rate further to -0.3% in early December, but the markets were assuming a deeper cut to -0.4%. ECB president Mario Draghi did announce a 6-month extension of the central bank's quantitative easing campaign (to March 2017) and a pledge to buy a wider range of assets from banks, with proceeds from maturing bonds being reinvested in new debt

instruments. As the year drew to a close, the euro area had almost no inflation (0.2%) and more than twice the unemployment of the United States (10.7%).^{10,11}

Manufacturing PMIs from the eurozone and China were in marked contrast. The Markit eurozone PMI came in at 53.1 for December, up 0.3 points from its November level. China's official PMI showed sector contraction for a fifth straight month in December at 49.7, and the private-sector Caixin manufacturing PMI was lower at 48.9. China's official service sector PMI reached a 16-month peak of 54.4 last month, however, corresponding to the nation's effort to transition from an economy rooted in manufacturing and investment to one driven by consumer spending and service industries.^{12,13}

WORLD MARKETS

The important regional and multi-regional equity indices lost ground in December. The month saw descents of 1.87% for the MSCI World Index, 2.48% for the MSCI Emerging Markets Index, and 2.29% for the Global Dow. The Asia Dow fell 1.32% in December, but the Europe Dow and Stoxx 600 respectively dropped 3.47% and 5.09%; the Dow Jones Americas gave back 2.38%.^{1,14}

Europe saw some major retreats last month. Italy's FTSE MIB slipped 5.72%, Russia's RTS 10.63%, France's CAC 40 6.47%, Spain's IBEX 35 8.11%, and Germany's DAX 5.62%. The United Kingdom's FTSE 100 gave back but 1.79%.¹

Around the rest of the world, there were mixed gains and losses: Nikkei 225, -3.61%; Kospi, -1.54%; Shanghai Composite, +2.72%; Manila Composite, +0.36%; Jakarta Composite, +3.30%; Hang Seng, -0.37%; ASX 200, +2.50%; KSE 100, +1.74%; Sensex, -0.11%; TSX Composite, -3.41%; IPC All-Share, -1.02%; Bovespa, -3.92%. Among consequential indices, the notable 2015 performers per region were the Shanghai Composite at +9.41%, Argentina's Merval at +36.09%, and Ireland's ISEQ at +30.00%.¹

COMMODITIES MARKETS

Gold futures had another down month in December. The yellow metal lost 0.50% to end the year at \$1,060.50 on the COMEX. Gold lost 10.53% for the year. A 1.21% December slip left silver futures at \$13.82 on December 31; silver notched an 11.69% loss for 2015. Platinum and copper both posted impressive December gains, the former rising 7.25%, the latter 4.14%.¹⁵

December saw the U.S. Dollar Index decline 1.50%, but fuels and crops benefitted little from that descent. With OPEC nations declining to reduce production, NYMEX crude futures lost another 11.06% for the month, finishing 2015 at just \$37.07 a barrel. Oil fell hard on the year, sinking 30.98%. Unleaded gasoline gave back 5.30% in December, heating oil 14.49%. Natural gas futures rose 5.38%. Coffee was December's best performer among major crops, advancing 7.42%; sugar was next, up 3.98%. Smaller gains came for wheat (2.23%) and cotton (1.02%). Soybeans lost 1.19%, corn 1.92%, and cocoa 3.57%.^{15,16}

REAL ESTATE

An unexpected slip in existing home sales occurred in November, according to the National Association of Realtors. The new "Know Before You Owe" closing rule may have contributed to the 10.5% slide, as it lengthened some closings. That left resales down 3.8% year-over-year, but analysts still anticipated an annualized rise. NAR said that the median existing home sale price had increased 3.8% in the 12 months ending in November. (October's 20-city S&P/Case-Shiller Home Price Index had shown a yearly gain of 5.5% in home values.) New home sales advanced 4.3% during November, bringing their year-over-year gain to 9.1%.^{4,17}

Mortgage rates climbed appreciably during December. In Freddie Mac's November 25 Primary Mortgage Survey, the average interest rate on the 30-year fixed rate mortgage was 3.95%; by December 31, it was 4.01%. The average interest rate on the

15-year FRM was 3.24% at year's end, up from 3.18% on November 25. In the same interval, average rates on 5/1-year ARMs went from 3.01% to 3.08% and average rates for 1-year ARMs rose from 2.59% to 2.68%.¹⁸

Looking at indicators geared toward the near future, the pending home sales index maintained by the NAR fell 0.9% for November. That negative was offset by two positives: a 11.0% climb in building permits and a 10.5% surge in housing starts in the year's eleventh month.^{4,19}

LOOKING BACK...LOOKING FORWARD

The year's final settlements: DJIA, 17,425.03; NASDAQ, 5,007.41; S&P, 2,043.94; RUT, 1,135.89; VIX, 18.21. Out of all five, only the NASDAQ managed to ascend in 2015 – it rose 5.73%. The Russell lost 5.71% and even the VIX fell 5.16%; the Dow merely lost 2.23% for the year, the S&P just 0.73%. Four U.S. equity indices realized double-digit gains in 2015: the Dow Jones Internet Index at +28.79%, the Ocean Tomo Growth index at +18.93%, the NASDAQ Biotech Index at +11.42%, and the NYSE Arca Biotechnology Index at +10.90%. For December, the CBOE VIX jumped 12.90%.¹

% CHANGE	2015	1-MO CHG	5-YR AVG	10-YR AVG
DJIA	-2.23	-1.66	+10.10	+6.26
NASDAQ	+5.73	-1.98	+17.75	+12.71
S&P 500	-0.73	-1.75	+12.50	+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^{1,20,21,22}

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends. 10-year TIPS real yield = projected return at maturity given expected inflation.

As January begins, investors are wondering how much strength remains in the bull market. Was 2015 just a pause? The month began with the S&P 500 trading at 22.5x reported earnings, higher than at the conclusion of nine of the past ten bull markets. Is there more room to run? Some analysts are marveling how well equities held up last year in the wake of plummeting oil prices, terrorism shocks, and the volatility in Chinese stocks. Given that wage growth is picking up, hiring is strong, and many economic indicators are decent-to-positive, the hope is that a resilient U.S. economy can weather any prolonged slowdown in the emerging markets, and that higher interest rates exert little drag on stocks in the months ahead. Will the first month of the year show renewed strength and confidence from the bulls? With little if any hints of a downturn on the horizon, we can hope to see just that.²³

UPCOMING ECONOMIC RELEASES: The rest of January unfolds as follows in terms of news items: the minutes from the December Federal Reserve policy meeting, the December ADP employment change report, the December ISM service sector PMI and November factory orders (1/6), the December Challenger job-cut report (1/7), the Labor Department's December employment report (1/8), a new Federal Reserve Beige Book (1/13), December retail sales and industrial output, December's PPI, November business inventories and the preliminary January University of Michigan household sentiment index (1/15), December's CPI and December housing starts and building permits (1/20), the December Conference Board leading indicators index and December existing home sales (1/22), a new Conference Board consumer confidence index and the November S&P/Case-Shiller home price index (1/26), a Federal Reserve interest rate decision and December new home sales (1/27), December durable goods orders and pending home sales (1/28), and to close out the month, the University of Michigan's final January household sentiment index and the first estimate of Q4 GDP from the Bureau of Economic Analysis (1/29). The December personal spending report will arrive February 1.

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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 Dow Jones Americas Index measures the Latin American equity markets by tracking 30 leading blue-chip companies in the region. The FTSE MIB (Milano Italia Borsa) is the benchmark stock market index for the Borsa Italiana, the Italian national stock exchange. 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 CAC-40 Index is a narrow-based, modified capitalization-weighted index of 40 companies listed on the Paris Bourse. The IBEX 35 is the benchmark stock market index of the Bolsa de Madrid, Spain's principal stock exchange. 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. 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 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 SSE Composite Index is an index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. The Philippine Stock Exchange PSEi Index is a capitalization-weighted index composed of stocks representative of the Industrial, Properties, Services, Holding Firms, Financial and Mining & Oil Sectors of the PSE; it was formerly named the PSE Composite. The IDX Composite or Jakarta Composite Index is an index of all stocks that are traded on the Indonesia Stock Exchange (IDX). 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 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. Karachi Stock Exchange 100 Index (KSE-100 Index) is a stock index acting as a benchmark to compare prices on the Karachi Stock Exchange (KSE) over a period. 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 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 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 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 Merval Index (MERcado de VALores, literally Stock Exchange) is the most important index of the Buenos Aires Stock Exchange. 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 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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