MARKET UPDATE
INTELLIGENCE MATTERS

Monthly Market Recap 2017

August 2017

Strong August for global markets
August was a solid month for global markets, and all three major U.S. indices ended the period on a positive note. Despite political risk in the U.S., as well as worrisome geopolitical events, the S&P 500 Index gained 0.31 percent and the Dow Jones Industrial Average rose 0.65 percent. The Nasdaq led the way, up 1.43 percent.

Fundamentals drove the positive equity performance, as corporate earnings and sales results supported markets. According to FactSet, as of September 1, 73 percent of S&P 500 companies had announced higher-than-expected earnings and 70 percent had reported higher-than-expected sales. This led to a blended earnings growth rate of 10.3 percent for the second quarter—well above the 9.1 percent predicted at the end of July.

The positive performance was widespread, with better-than-expected results in 10 of 11 sectors. Because fundamentals drive long-term performance, the strong second-quarter results are welcome signs.

International markets were a bit more mixed in August. The MSCI EAFE Index had a small decline of 0.04 percent. A larger decline mid-month, driven by political concerns and a robust euro, was offset by a strong final week that brought the index back close to its monthly starting point. Economic data from developed international markets remained positive, so the slight decline may prove transitory.

The MSCI Emerging Markets Index had a very strong month, ending with a gain of 2.27 percent—the best result among the major indices. A decline in the strength of the U.S. dollar and cheap oil for most of August bolstered emerging market returns. Both international indices stayed above their technical trend lines in August, which is a positive sign.

Fixed income markets also had a solid month. The Bloomberg Barclays Aggregate Bond Index was up a very respectable 0.90 percent, as the yield on the 10-year Treasury declined from 2.26 percent at the start of August to 2.12 percent by month-end. The decline was due to a flight to safety because of geopolitical risks and continued weak inflation data.

The Bloomberg Barclays U.S. Corporate High Yield Index fared slightly worse in August, as it was down 0.04 percent. But this was the index's first decline in four months, and it is up 6.05 percent year-to-date. So the decrease may represent a normal pullback rather than a change in trend.

Growth faster than expected
The economic news in August was good and pointed to faster growth ahead. Gross domestic product growth for the second quarter was much better than initial estimates. The figure was revised upward, from 2.6 percent to 3 percent on an annualized basis. Higher consumer spending led to the revision, which suggests that high consumer confidence is finally translating into faster spending.

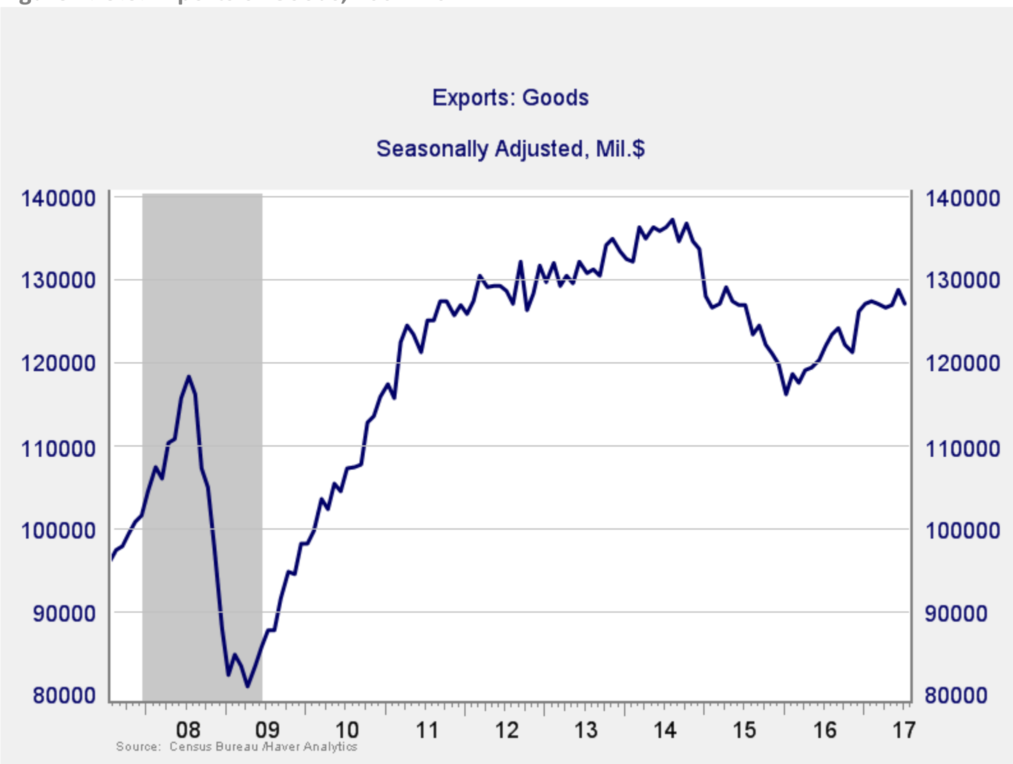
In fact, according to the July Conference Board survey, consumer confidence continues to be healthy and is now at the second-highest level since 2001. Personal spending was up 0.3 percent in August, and the July figure was revised upward. Increases in consumer confidence and personal spending have historically been consistent with faster economic growth.

Retail sales data, which has lagged consumer confidence growth, rose 0.6 percent in July. Seeing the hard data start to converge with positive soft data is very encouraging.

Consumers are not alone in translating increased confidence into higher levels of spending. Business confidence continues to improve, with the most recent Institute for Supply Management Manufacturing survey rising to a six-year high in August and manufacturers adding more jobs and producing more goods.

Manufacturing benefits from a weaker dollar. As U.S. exports become less expensive, they are more attractive to foreign buyers. The August U.S. International Trade in Goods and Services report showed that the U.S. trade deficit had narrowed, primarily due to an increase in exports. After a steady decline in 2014 and 2015 and a recent low in January 2016, the export of U.S. goods has been on the rise (Figure 1).

Figure 1. U.S. Exports of Goods, 2007–2017



But not all business investment numbers have been rosy. Headline durable goods orders data for August was disappointing, down 6.8 percent. The headline number is volatile, however. It depends on airplane orders, which bounce around from month to month. The core durable goods number—which excludes airplane orders—was up a solid 0.5 percent in August compared with July. This kind of growth is what you would expect if businesses were confident in the current expansion. The headline miss may represent normal volatility rather than something worse.

Job growth disappoints, but trends remain strong

One area of concern for August was the jobs report, which came in below expectations. Only 156,000 new jobs were added—below the 180,000 expected and down from the 189,000 new jobs created in July. Worse, jobs data for the work week declined. Wage growth also disappointed, suggesting even more weakness in labor demand.

Although this was a weak jobs report, it was not a disaster. And it comes after a strong run. A review of jobs data for past years suggests that August employment figures often come in weak only to be revised upward later. This year, supply issues are a factor, with strong hiring demand affected by an inability to find appropriate workers to fill openings.

The recent weakness is worth noting, but it is more likely noise than a change in trend. Given the strong business confidence reported in the surveys, the positive signals elsewhere in the economy, and the healthy long-term employment trends, it is not an immediate risk. Still, we will be watching this.

Politics, in the U.S. and abroad, is the real risk

As August came to a close, the real risks to the economy came from politics. In the U.S., the next major political event is the debt ceiling vote.

With the government expected to run out of funds by the end of September, the failure to raise the debt limit could disrupt financial markets. There is uncertainty surrounding when and how a bill to increase the debt ceiling will pass. Based on past history, an agreement and vote will come only at the last minute. So, despite potential risk, Congress will likely act to avert a crisis. Expect to hear quite a bit about this issue throughout September.

The other major potential risk arises from geopolitics. The launch of North Korean ballistic missiles over Japan near month-end came amid ongoing tensions between the U.S. and North Korea. The event caused markets in Asia and Europe to drop before recovering. Further developments may lead to more volatility.

Falling into faster growth

As summer wanes, the U.S. economy appears to be in good shape. Strong fundamental and technical support for equity markets, combined with solid economic data, paints the picture of an economy that continues to move forward.

In the short term, the principal risks are political and have the potential to cause more market volatility. But should situations worsen, the U.S. and global economy are solid and well positioned to weather most problems. As always, a well-diversified portfolio focused on the long term is the best way to meet financial goals.

All information according to Bloomberg, unless stated otherwise.

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