MARKET UPDATE
INTELLIGENCE MATTERS

Monthly Market Recap 2016

August 2016

World markets resilient in August

Global markets ended August slightly positive, as early gains were partially offset by volatility toward month-end. U.S. equity markets posted small increases in August. The S&P 500 Index closed the period up 0.14 percent, the Dow Jones Industrial Average was up 0.26 percent, and the Nasdaq led the way with a gain of 1.18 percent.

The positive market performance was supported by better-than-expected corporate earnings. With 98 percent of S&P 500 companies reporting second-quarter results by the end of August, 71 percent had beaten earnings expectations and 53 percent had reported sales above expectations. The overall blended earnings decline of 3.2 percent was disappointing, though it was significantly better than the 5.5-percent decline anticipated as of the end of June or the 3.8-percent decline forecast at the end of July. Unfortunately, only 5 of 10 sectors showed earnings growth for the quarter. This weakness should be monitored, as earnings drive market performance in the long run and continued declines could pressure markets going forward.

Technicals stayed positive in August. All three major U.S. indices finished the period above their 200-day moving averages, and all three remained comfortably above the trend line throughout the month. Positive technical factors help increase confidence in continued equity market performance.

Developed international markets also showed small gains, with the MSCI EAFE Index up 0.07 percent for the month. The index dipped below its 200-day moving average at the beginning of August but quickly recovered to end the period well above the average level, suggesting that technical factors remain supportive as well. Developed market performance was driven by slow but real growth in the European Union (EU), as well as better-than-expected performance by the British economy in the aftermath of the Brexit vote.

Emerging markets did best of all, as the MSCI Emerging Markets Index ended August with a 2.52-percent gain. The four largest emerging market countries—Brazil, Russia, India, and China—all posted positive returns, which led to the sizeable uptick for the index.

Technicals also continued positive, as the emerging markets index stayed above its 200-day moving average support level throughout the month. But the strong August performance notwithstanding, risks remain, particularly because of potential Federal Reserve (Fed) action, which could lead to a stronger dollar and therefore have a negative impact on this volatile sector.

Fixed income had mixed results in August. The Barclays Capital Aggregate Bond Index ended the month down 0.11 percent, in large part due to rising interest rates. The yield on the 10-year Treasury increased from 1.46 percent at the beginning of the period to 1.58 percent by month-end.

Much of the rise in rates was engendered by increasing confidence in the U.S. economy— supported by positive comments from Fed Chair Janet Yellen at the annual Jackson Hole Economics Policy Symposium. The Barclays Capital U.S. Corporate High Yield index, which is less influenced by interest rates, ended August with a positive 2.09-percent return, driven by a rally in lower-rated market investments.

U.S. economic data continues to improve

Fundamental domestic economic data remained strong in August. Although second-quarter 2016 gross domestic product growth was revised down from 1.2 percent to 1.1 percent, this was in line with expectations and reflected old data. Though the figure was disappointing, data for most other economic reports released during the month was quite positive and supportive of faster growth for the second half of the year.

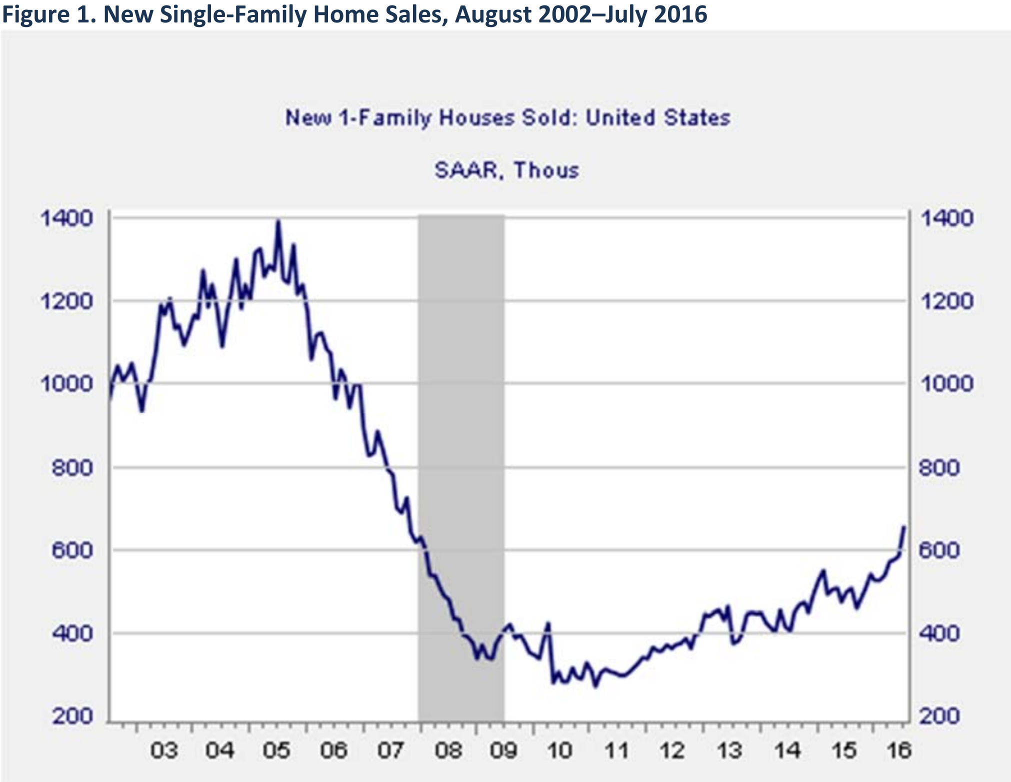
Key to that potential growth was a very strong jobs report released at the start of August, as the increase of 255,000 jobs in July marked two months in a row of robust nonfarm payroll numbers. The underlying data was positive as well, with wage growth beating expectations and remaining near post-recession highs on a year-over-year basis. In addition, despite the slowdown in the recent August jobs report, overall the still-positive jobs data supports the continuing U.S. economic recovery and helps alleviate lingering concerns over the dismal May report.

Business confidence continued positive, albeit at levels slightly lower than those reported in July. Both the ISM Manufacturing and Non-Manufacturing indices showed expansion during August, indicating that businesses anticipate growth ahead. Additionally, August's increases in industrial production and manufacturing, which exceeded expectations, highlight the improvement in the manufacturing sector. Finally, a rebound in durable goods orders in August signals that businesses are translating steady confidence into increased spending.

Data surrounding consumers was more mixed. Retail sales were flat in August, largely due to a slowdown in auto sales growth. But this followed three months of strong growth in retail sales and could point to more of a pause in consumer spending growth than a full stop. A surprisingly strong uptick in consumer confidence and a strong increase in consumer spending overall at month-end lend support to the notion that the August retails sales number reflects a slowdown rather than a trend change.

Housing was also strong in August. Both housing starts and new home sales substantially beat expectations, indicating continued and perhaps increasing growth. As illustrated in Figure 1, even though new home sales have climbed to post-recession highs, there is still some way to go before they approach the all-time high achieved before the recession.

Figure 1. New Single-Family Home Sales, August 2002–July 2016



Source: U.S. Census Bureau/Haver Analytics

International risks were muted but remain
After a string of headline-grabbing events earlier in the summer, international risks were subdued in August. Although uncertainty remains—especially in Europe and the Middle East because of the ongoing refugee crisis and fallout from the Brexit vote—there were no major market-moving events from overseas during the month.

Despite the general tranquility, however, a handful of developments could impact U.S. markets going forward. The EU's ruling that Apple owes it roughly $14 billion in back taxes could lead to more friction with the U.S. In addition, China remains a concern, as it continues to hold its currency near four-year lows against the dollar, even as that nation faces sizeable headwinds to growth in the second half of 2016.

All eyes on central banks

In the face of global risks, central banks have been active. Janet Yellen's speech at the annual Jackson Hole conference gave a positive take on the U.S. economy, and the market reacted to her speech by increasing the odds for at least one rate hike in 2016. Any action taken by the Fed will be felt by global markets; consequently, the upcoming Fed meetings will be closely watched for changes.

Even as the Fed mulls over raising rates, the European Central Bank and Bank of Japan continue to increase their asset-purchasing programs. This policy divergence could have a negative effect on domestic and international markets.

Uncertainty remains heading into the fall

Although August was quite calm, September may show more activity, as the approach of fall brings a set of potentially destabilizing events. Risks to monitor around the globe include the ongoing Brexit process, uncertainty surrounding China's growth, and continuing conflict in Syria. Here in the U.S., the possibility of future rate hikes, the upcoming presidential election, and the lack of quality earnings growth could increase market volatility. All of these risks—both foreign and domestic—could become causes for concern.

Nevertheless, despite the real risks, the fundamentals of the U.S. economy are healthy, and any potential volatility will be cushioned by that reality. Over time, such short-term risks have always passed. As always, a well-diversified portfolio, combined with a perspective that maintains the long view, presents the best means for accomplishing financial goals, even in the face of short-lived volatility.

All information according to Bloomberg, unless stated otherwise.

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