

MONTHLY ECONOMIC UPDATE

August 2014

MONTHLY QUOTE

“For one human being to love another; that is perhaps the most difficult of all our tasks, the ultimate, the last test and proof, the work for which all other work is but preparation.”

– *Rainer Maria Rilke*

MONTHLY TIP

If a consumer debt burden bothers you, think twice about turning to a debt settlement company. Their ideal customers are consumers who can access big lump sums of cash. If that isn't you, negotiating with creditors yourself may prove cheaper.

MONTHLY RIDDLE

Never resting, never still. Moving silently over the hill. It can't walk, run or trot. All is cool where it is not. What is it?

Last month's riddle:

A farmer feeds a total of ten goats and dogs with 56 biscuits. The dogs each eat six biscuits and the goats each eat five biscuits. So how many goats and how many dogs does he have?

Last month's answer:

4 goats and 6 dogs. $4 \times 5 = 20$, $6 \times 6 = 36$, $20 + 36 = 56$ biscuits.

THE MONTH IN BRIEF

Stocks seemed set for just a slight July loss until developments on the last day of the month rattled Wall Street. Argentina effectively defaulted on its debt (for the second time in the past 13 years), and new data out of Washington showed that wages were finally on the way up (a caution flag for higher interest rates). The blue chips lost 317 points on July 31 (the Dow's worst day since February 3) while the S&P 500 sank 39 points. The S&P lost 1.51% in an eventful month in which the Fed set an exit plan for QE3, a pair of geopolitical events troubled global markets, and U.S. economic indicators looked pretty good even as earnings were mediocre.^{1,2}

DOMESTIC ECONOMIC HEALTH

July's Conference Board consumer confidence index came in at 90.9, a major leap from the (upwardly revised) June reading of 86.4. The University of Michigan's consumer sentiment index, on the other hand, only reached 81.8 (0.7 points beneath the forecast of economists polled by Briefing.com). Consumer spending and incomes were both up 0.4% in June, and retail sales advanced another 0.2% in that month, with the Commerce Department revising May's gain north to 0.5%.^{3,4}

As for employment, the Labor Department noted a sixth consecutive month of job creation above the 200,000 level – something that hadn't occurred since 1997. Employers added 209,000 non-farm jobs in July, 47,000 in the professional & business services category. Unemployment crept up to 6.2% and underemployment (the U-6 rate) ticked up to 12.2% last month, but that was a consequence of more participants in the labor market.⁵

On the factory front, the Institute for Supply Management's July manufacturing PMI read 57.1, up 1.8 points from June. U.S. industrial output had risen 0.2% in June, a Federal Reserve report noted. Buoyed by demand for aircraft, durable goods orders advanced 0.7% in June after a 1.0% retreat in May.^{3,4,6}

Annualized consumer inflation remained at 2.1% in June, even with a 0.3% monthly rise in the Consumer Price Index. (Yearly inflation was only at 1.1% in February.) Wholesale prices were up 1.9% in 12 months as of June, with the Producer Price Index showing a monthly gain of 0.4%. At month's end, Wall Street noticed that the Bureau of Labor Statistics employment cost index rose 0.7% in Q2, its largest quarterly jump since 2008. Employment costs include wages, and this signaled wage growth at last. Investors fretted that the rising indicator might offer further grounds for hiking interest rates sooner than anticipated.^{7,8}

On July 9, the Fed solidified its endgame for QE3: reductions to monetary stimulus would continue as scheduled, concluding with a last \$15 billion cut to zero at the October Federal Open Market Committee meeting. The economy was certainly over the winter doldrums: in the federal government's initial estimate, Q2 brought 4.0% growth. The abysmal first quarter number was revised again: Q1 2014 GDP now goes in the books at -2.1% rather than -2.9%.^{3,9}

GLOBAL ECONOMIC HEALTH

In 2001, Wall Street hedge fund managers bought inexpensive debt from Argentina only to see that nation stop the bond payments and record the worst sovereign default in history. As July ended, Argentina stared into the maw of a second default related to the first. U.S. district courts were blocking payments to the nation's other bondholders until Argentina finally paid interest on the debt payments it had owed the American hedge funds for 13 years. The crisis triggered a major global selloff, but that wasn't the only anxiety putting pressure on stock market indices in July.¹⁰

After the downing of Malaysia Airlines Flight 17 in Ukraine at the apparent hands of Russian separatists, investors worried that the U.S. and eurozone would tighten economic sanctions on Russia. Israel launched a ground offensive into Gaza in response to Hamas missile attacks, and attempts at cease fires were short-lived. In mid-month, the parent firm of major Portuguese lender Banco Espirito Santo failed to make payments on commercial paper – and the bank still appeared shaky as July ended.^{1,11}

China offered better news. In July, its official PMI rose 0.7 points to a 26-month peak of 51.7. China's GDP was 7.4% for the first half of 2014, but its government still predicted its economy reaching the 7.5% target for the year. Markit's eurozone PMI topped the Reuters forecast of 52.8 for July, reaching a 3-month peak of 54.0. Factory sectors in France and Germany were heading in opposite directions – France's Markit PMI was at 49.4 in July, Germany's at 55.9. Markit projections showed eurozone GDP growing at about 0.4% per quarter.^{12,13}

WORLD MARKETS

For the second month in a row, emerging market indices largely outpaced benchmarks in Europe and the U.S. Witness these July performances: Hang Seng, +6.75%; Kospi, +3.69%; Nikkei 225, +3.03%; Sensex, +1.89%; Jakarta Composite, +4.31%; Bovespa, +5.01%; IPC All-Share, +2.53%; Merval, +3.81%; Shanghai Composite, +7.48%; ASX 200, +4.40%; MSCI Emerging Markets, +1.43%; Asia Dow, +1.59%. (The Dow Jones Americas index did pull back 1.71%).^{2,14}

Major European indices were mostly in the red in July. Losses came to the DAX (4.33%), the CAC 40 (4.00%), the RTS (10.74%), the FTSE 100 (0.21%), the Europe Dow (4.05%) and the STOXX 600 (1.72%). To round out the scorecard, the MSCI World Index fell 1.67% in July, the Global Dow 1.02%.^{2,14}

COMMODITIES MARKETS

In the big picture, futures struggled. Energy futures certainly didn't have a good month: July brought losses of 14.04% for natural gas, 9.16% for unleaded gasoline, 2.68% for heating oil and 7.22% for oil, with NYMEX crude ending the month at \$98.17. Some marquee crops descended, too: cotton went -15.39% last month, soybeans -12.54%, wheat -5.97%, sugar -0.99% and corn -15.57%. Cocoa and coffee proved exceptions; the former gained 2.13% and the latter jumped 13.49%.¹⁵

How did key metals do? Not too well. Copper futures rose 1.00% last month, but July saw COMEX gold lose 3.43%, silver 2.76% and platinum 1.57%. At the close on July 31, COMEX gold was valued at \$1,281.30 an ounce. The U.S. Dollar Index gained 2.11% for July.^{15,16}

REAL ESTATE

Housing indicators presented a mixed bag as the data stream went from the prime home buying season of spring into summer. Existing home sales, according to the National Association of Realtors, rose 5.3% in June. That increase sent the yearly sales pace up to 5.04 million; October was the last month in which it was that high. New home sales plummeted 8.1% for June, and the Census Bureau noted 5.8 months of new home inventory on the market – the most since October 2011. Pending home sales were down 1.1% for June, NAR noted, a sea change from the 6.0% gain noticed in May.^{3,17}

As for yearly home price gains, there was a major slip for the S&P/Case-Shiller index in May – the annualized overall price gain across 20 metro markets was 9.3%, down markedly from 10.8% in the April edition. The Census Bureau found a 5.3% annualized increase in new home prices. Building permits for new construction were down 4.2% for June, and housing starts down 9.3% in that month.^{3,7,17}

Home loans? On July 31, Freddie Mac published the following average interest rates in its Primary Mortgage Market Survey: 30-year FRM, 4.12%; 15-year FRM, 3.23%; 5/1-year ARM, 3.01%; 1-year ARM, 2.38%. Here were the average rates on June 26: 30-year FRM, 4.14%; 15-year FRM, 3.22%; 5/1-year ARM, 2.98%; 1-year ARM,

2.40%.¹⁸

LOOKING BACK...LOOKING FORWARD

At the close on July 31, the Dow settled at 16,563.30, the S&P at 1,930.67, the Nasdaq at 4,369.77 and the Russell 2000 at 1,120.07. Small caps also took a beating in July, with the RUT diving 6.11%. The jump in the CBOE VIX exceeded 30% in the last trading week of the month, which left the fear index with a July gain of 46.50%. The VIX ended July at 16.95.^{2,21}

% CHANGE	Y-T-D	1-MO CHG	1-YR CHG	10-YR AVG
DJIA	-0.08	-1.56	+6.86	+6.34
NASDAQ	+4.63	-0.87	+20.50	+13.15
S&P 500	+4.45	-1.51	+14.53	+7.52
REAL YIELD	7/31 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.29%	0.38%	1.71%	2.01%

Sources: online.wsj.com, bigcharts.com, treasury.gov - 7/31/14^{2,19,20}
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
These returns do not include dividends.

After the fall stocks took at the end of last month, analysts are again wondering if a correction is near. (For the record, the July 31 selloff left the S&P 500 just 3.1% down from its record high.) If a correction is coming – and Argentina, Russia and Portugal aren't the only possible worries that might unnerve Wall Street – there is always the silver lining of being able to pick up quality shares for less, an opportunity some investors have awaited. There is certainly more to worry about than there was three months ago. Global investors do take many cues from the U.S., however, and our hiring and our GDP look very, very good right now. How much attention will the (presumably positive) indicators from America command over the next several weeks? Markets may be more volatile this month than we've been accustomed to during a mostly placid 2014.²¹

UPCOMING ECONOMIC RELEASES: The roll call of releases for the rest of August: June wholesale inventories (8/8), June business inventories and July retail sales (8/13), July's PPI and July industrial output and the University of Michigan's initial August consumer sentiment index (8/15), the July CPI plus July housing starts and building permits (8/19), the minutes of the July Fed policy meeting (8/20), July existing home sales and the Conference Board's July index of leading indicators (8/21), July new home sales (8/25), the Conference Board's August consumer confidence index, July durable goods orders and June's Case-Shiller home price index (8/26), the federal government's second reading of Q2 GDP and NAR's July pending home sales report (8/28), and then July personal spending and the final University of Michigan August consumer sentiment index (8/29).

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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 IDX Composite or Jakarta Composite Index is an index of all stocks that are traded on the Indonesia Stock Exchange (IDX). 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 Merval Index (MERCado de VALores, literally Stock Exchange) is the most important index of the Buenos Aires Stock 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 S&P/ASX 200 is Australia's "premier" share market index. The Asia Dow measures the Asia equity markets by tracking 30 leading blue-chip companies in the region. The DAX 30 is a Blue Chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The CAC-40 Index is a narrow-based, modified capitalization-weighted index of 40 companies listed on the Paris Bourse. 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 FTSE 100 Index is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. The Europe Dow measures the European equity markets by tracking 30 leading blue-chip companies in the region. 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 Global Dow is a 150-stock index of corporations from around the world created by Dow Jones & Company. 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. 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. 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