

# MONTHLY ECONOMIC UPDATE

July 2014

## MONTHLY QUOTE

“If we are to learn to improve the quality of the decisions we make, we need to accept the mysterious nature of our snap judgments.”

– *Malcolm Gladwell*

## MONTHLY TIP

As you plan to pay for your child’s college education, think about breaking the effort into thirds. A third of projected college costs could come from your savings, another third from family or student loans, and the last third from your current income plus financial aid.

## MONTHLY 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 riddle:

An ancient invention (still used the world over) permits people to see right through walls. What is it?

### Last month’s answer:

A window.

## THE MONTH IN BRIEF

A geopolitical crisis in the Middle East didn’t halt the advance of U.S. stocks in June. Indicators did much to bolster investor confidence – the housing market seemed to have pulled out of its winter slump, manufacturing PMIs for the U.S. and China were reassuring, and consumer confidence improved even as consumer prices increased. Gold and oil futures pushed north during the month while mortgage rates more or less stayed put. Again, the bull market found some fresh legs.

## DOMESTIC ECONOMIC HEALTH

Households felt better about the economy in June. The month saw a 3-point rise in the Conference Board’s consumer confidence index (to a mark of 85.2) and also an advance for the University of Michigan’s consumer sentiment index (a final reading of 82.5).<sup>1</sup>

Consumer spending held up as inflation pressure increased. The Federal Reserve’s PCE index showed yearly inflation hitting 1.8% in May, a 19-month peak; the May Consumer Price Index recorded a 1-month advance of 0.4% and a 12-month increase of 2.1%. The Commerce Department measured a 0.2% gain in personal spending for May (along with 0.4% wage growth). Retail sales improved 0.3% for May, and the Commerce Department revised the April increase to 0.5%.<sup>2,3,4</sup>

On the factory front, the Institute for Supply Management’s June manufacturing PMI came in at a solid 55.3 (it was at 55.4 for May), indicating continued sector expansion. ISM’s service sector PMI had displayed a 56.3 May reading. Headline durable goods orders slipped 1.0% for May (but just 0.1% with transportation orders removed). Wholesale inflation actually declined 0.2% in May (the biggest dip since October), even as the Producer Price Index showed a 2.0% yearly advance.<sup>1,5,6</sup>

Further evidence emerged of the U.S. economic recovery. Labor Department data showed 217,000 new hires in May, marking the fourth straight month in which payrolls expanded by 200,000 or more. By May, the economy had gained back 100% of the 8.7 million jobs lost during the recession.<sup>4</sup>

In the federal government’s final estimate, Q1 GDP was even poorer than previously thought. The economy shrank 2.9% in the opening three months of 2014, with consumer spending rising only 1%. Still, economists widely projected Q2 growth between 3-4%.<sup>2</sup>

## GLOBAL ECONOMIC HEALTH

The Islamic State in Iraq & Syria (ISIS), a militant Sunni faction set on creating a new nation, captured key cities in northern and western Iraq and part of Syria in June on its way to declaring a caliphate (and shortening its name to the Islamic State). As peace in Iraq came undone, the bulk of the country’s oil supplies had yet to be threatened: the majority of oil production in Iraq happens in its southern half, and its northern regions haven’t exported oil since March. Still, the ambition of ISIS and its fast conquest of so much territory sent oil prices higher in June and bred worries about the fighting quickly spreading into neighboring nations.<sup>7,8</sup>

In more positive news, global manufacturing seemed in decent shape. China’s official factory PMI stood at 51.0 for June, and June’s eurozone manufacturing PMI

had a decent 51.8 reading. The United Kingdom's June factory PMI was up at 57.5 and Germany's reached 52.0; France's official PMI showed sector contraction with a mark of 48.2.<sup>9</sup>

Deflation was a growing concern in the euro area: the European Central Bank measured yearly inflation at just 0.5% in June. The ECB's annual inflation target is currently 2.0%, and its deposit rate is at -0.10%, which essentially punishes banks for parking euros. The latest data from China showed yearly inflation running at 2.5% in May, relatively high in current global terms but relatively placid in historical terms (it contended with 28.4% inflation in 1989 and 2.2% deflation in 1999).<sup>10,11</sup>

## **WORLD MARKETS**

Generally speaking, stocks did better in the Far East and in the Americas than they did in Europe. The Sensex went +4.94%, the Hang Seng +0.47%, the Shanghai Composite +0.45%, the Nikkei 225 +3.62%, the Manila Composite +2.96% and the Kospi +0.36%; the Asia Dow went +1.90%. Australia's ASX 200 fell 1.76%. Canada's TSX Composite rose 3.71% for June, Mexico's IPC All-Share 3.32% and Brazil's Bovespa 3.76%.<sup>12</sup>

On the other hand, the Europe Dow lost 0.45% in June and the STOXX 600 retreated 0.69%; Germany's DAX pulled back 1.11%, France's CAC 40 slipped 2.14% and Ireland's ISEQ lost 4.06%. The United Kingdom's FTSE 100 declined 1.47% on the month. Russia's RTS was an exception, recording a 5.43% June climb. The Global Dow advanced 1.58% for June, while the MSCI World Index rose 1.65% and the MSCI Emerging Markets Index gained 2.25%.<sup>12,13</sup>

## **COMMODITIES MARKETS**

Oil futures closed out the month at \$105.37 a barrel in New York, going +2.46% for June. Natural gas futures fell exactly as much as oil rose, but unleaded gasoline advanced 1.49% and heating oil 2.98% for the month.<sup>14</sup>

Gold rallied to \$1,322.00 on the COMEX at month's end, rising an impressive 6.23% in 30 days. Silver soared 12.05% for the month, settling at \$21.01 on June 30. Copper futures gained 1.43% in June, platinum futures 2.30%. The U.S. Dollar Index dipped 0.73% on the month, ending June at 79.78.<sup>14,15</sup>

Ag futures were up and down for June, as follows: coffee, -2.68%; wheat, -9.92%; cocoa, +2.75%; corn, -9.25%; soybeans, -5.89%; cotton, -14.94%; sugar, +1.55%.<sup>14</sup>

## **REAL ESTATE**

The May home sales data was terrific, wiping away anxieties about the real estate market stalling out. The fifth month of the year saw a 4.9% improvement in existing home sales according to the National Association of Realtors, plus an 18.6% leap in new home buying. Census Bureau data showed new home sales were at their hottest pace since May 2008.<sup>16</sup>

Associated real estate statistics also brought some reassurance. NAR said that pending home sales improved a whopping 6.1% in May; analysts at Briefing.com thought they would rise but 0.5%. Home prices were up 10.8% year-over-year through April, as measured by the 20-city S&P/Case-Shiller index. The one sour note concerned builders: the Census Bureau measured a 6.5% May drop in housing starts, along with a 6.4% reduction in building permits.<sup>1,3,5</sup>

Mortgage interest rates barely budged during June. Freddie Mac's Primary Mortgage Market Survey recorded the following movements in average interest rates on these home loan types from May 29 to June 26: 30-year FRM, 4.12% to 4.14%;

15-year FRM, 3.21% to 3.22%; 5/1-year ARM, 2.96% to 2.98%; 1-year ARM, 2.41% to 2.40%.<sup>17</sup>

## LOOKING BACK...LOOKING FORWARD

Bearish analysts have contended for months that the bull market is due to end. In June, their case looked weak.

June ended with the S&P 500 at 1,960.23; it rose 1.91% for the month. The Nasdaq pulled off a 3.90% June gain, and the Dow advanced another 0.65%; at the close on June 30, the Nasdaq stood at 4,408.18, the Dow at 16,826.60. Small caps did much better than the blue chips in June – the Russell 2000 gained 5.15% for the month to go +2.52% YTD. While the crisis brewing in Iraq pushed gold and energy futures higher in June, it only took the CBOE VIX up 1.49%; the “fear index” closed June at 11.57, down 15.67% on the year. The Nasdaq Biotech index rose 7.30% in June while the Dow Jones Utility Average gained 5.69%; after two quarters of 2014, those indices were respectively up 13.37% and 17.41% YTD.<sup>12</sup>

% CHANGE	Y-T-D	1-YR CHG	5-YR AVG	10-YR AVG
DJIA	+1.51	+12.36	+19.84	+6.12
NASDAQ	+5.54	+28.35	+28.04	+11.53
S&P 500	+6.05	+21.38	+22.65	+7.18
REAL YIELD	6/30 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.27%	0.48%	1.78%	2.10%

Sources: online.wsj.com, bigcharts.com, treasury.gov - 6/30/14<sup>12,18,19</sup>

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.

Bullish sentiment certainly hasn't evaporated this year, even as YTD stock market performance has moderated to something more akin to the status quo. The S&P entered July having gone more than 1,000 days without a correction, one of the more astonishing market statistics of late. That's 33 months without a 10% drop. (If you're curious, the record is seven years. The S&P went 2,553 days without a correction across 1990-97.) Even the unrest in Iraq hasn't rattled U.S. markets to any lasting degree; lately, investors have seemed almost as focused on economic developments in America and China. Things could certainly change, and change for the worse, but for the moment little seems to be impeding U.S. stock gains.<sup>20</sup>

**UPCOMING ECONOMIC RELEASES:** Here's the schedule for the balance of July: the June jobs report from the Labor Department and the ISM June service sector PMI (7/3), the June 18 FOMC minutes (7/9), May wholesale inventories (7/10), May business inventories and June retail sales (7/15), a new Federal Reserve Beige Book, June industrial output and the June PPI (7/16), June housing starts and building permits (7/17), the Conference Board's June leading indicator index and the University of Michigan's initial July consumer sentiment index (7/18), June existing home sales and the June CPI (7/22), June new home sales (7/24), June durable goods orders (7/25), June pending home sales (7/28), the Case-Shiller home price index for May and the Conference Board's July consumer confidence index (7/29), a Fed policy statement, the first Q2 GDP estimate from the Bureau of Economic Analysis, and the July ADP employment change report (7/30) and the July Challenger job cuts report (7/31). August 1 sees the release of the June personal spending report and the final University of Michigan July consumer sentiment index.

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The Nikkei average is the most watched index of Asian stocks. 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 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 Asia Dow measures the Asia equity markets by tracking 30 leading blue-chip companies in the region. The S&P/ASX 200 is Australia's "premier" share market index. 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 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 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 ISEQ Overall Index is a capitalization-weighted index of all official list equities in the Irish Stock Exchange, excluding U.K.-registered companies. The FTSE 100 Index is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. 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 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. 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