Market Update

September 30, 2015

The third calendar quarter of 2015 exhibited the greatest volatility in equity markets in at least the last three years. Virtually all equity indices we follow were down roughly 10%, with the exception of emerging economy equity markets which were down 20-25%. The S&P 500 and the Dow Jones Index were both down roughly 9%, NASDAQ was down 9.5%, and small and mid-cap stocks were down 10-12%. Some industry groups that had been up more than 25% through mid-July, like biotech, reversed course in late September to wind up slightly negative in year to date returns.

The cause of this market correction (the negative volatility) was not the overall U.S. economy, which produced a better than expected growth of 3.9% during the second quarter. Corporate profits, excluding the energy sector, continued to grow at a 5-6% rate. Interest rates, as indicated by the 10 year U.S. Treasury yield, declined from 2.4% to 2.1%.

The more likely cause of this global market correction was concern over China's growth slowdown and its consequential effect on worldwide growth. In addition to that the Chinese government's attempts to stimulate its equity markets was executed badly. This produced a sharp downward correction in the Shanghai market which was a great concern to global investors.

The Federal Reserve again declined to raise the Federal Funds interest rate in September by the expected 0.25%. This time they cited instability in international markets, both for securities and currencies. Subsequent speeches by Janet Yellen, Chairman of the Federal Open Market Committee, indicated that the U.S. economy was "on track" for a rate increase sometime later this year. The market reaction to the Federal Reserve's decision was a small one, certainly much less than that caused by the Federal Reserve's decision two years ago to phase out direct purchases of Treasury and Agency bonds.

Looking ahead, the overall U.S. economy looks likely to continue its relatively sluggish 2% growth. Corporate profits, excluding the energy sector, will do slightly better. It is not surprising that corporations are reluctant to commit to large new capital expansion programs, as demand growth is so slow. Consequently, stock buy backs and dividend increases remain significant uses of corporate funds generated through operating profits.

We believe these current trends within the economy and within corporations will continue and will consequently produce positive, although modest, equity market returns.

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