Market Commentary | Q3 2016

Quarterly Review

The Markets (as of market close September 30, 2016):

The third quarter provided a bumpy ride for investors. Following the upheaval caused by the Brexit vote in June, July kicked off the third quarter by ending the month in favorable fashion led by the Russell 2000 (5.90%) and the NASDAQ (6.60%). Stocks held their own for July, despite falling energy shares, as crude oil prices (WTI) sank from around $49 per barrel to under $42 by the close of July. As money moved into equities, bond yields remained on the low side as the yield on 10-year Treasuries remained below 1.60%, closing July at just about where it started at 1.45%.

The dog days of summer saw light trading in August, but that didn't stop the markets from moving sharply. By the middle of the month, the Dow, S&P 500, and NASDAQ had surged to all-time highs — the first time since 1999 that all three indexes reached a new high at the same time. Yet by the end of August, many indexes saw their values fall back to about where they were at the beginning of the month. The large-cap Dow and S&P 500 fell ever so slightly from July's closing values, while the Russell 2000 and Global Dow posted modest gains for the month. Crude oil fell below $40 per barrel during the month, but rebounded to close the month at about $45 per barrel. Bond prices fell as the yield on 10-year Treasuries reached 1.60%.

For the month, September ended about where it began for equities. Overall, the third quarter proved to be a good month for stocks. Long-term bond yields measured by 10-year Treasuries hovered around 1.60% for September, closing the month and quarter at 1.59% — just about where they ended the second quarter. Gold lost value, closing the second quarter at $1,318.80, down from its June closing value of 1,324.90. Crude oil (WTI) ended the second quarter at about $48.59 per barrel, just about the same price it ended the third quarter ($48.05).

The Quarter in Review

Employment: The employment sector slowed a bit in August, but remained steady with 151,000 new jobs added for the month, compared to 275,000 new jobs added in July. The unemployment rate remained at 4.9% in August — the same as July. There were 7.8 million unemployed persons. Both the unemployment rate and the number of unemployed persons have shown little movement. Interestingly, the unemployment rate for adult men and adult women was the same — 4.5%. The labor force participation rate remained at 62.8% as did the employment/population ratio, which was 59.7%. According to the latest figures from the Bureau of Labor Statistics, the average workweek decreased by 0.1 hour to 34.3 hours, while average hourly earnings rose to $25.73 compared to $25.59 at the end of July.

FOMC/interest rates: The Fed did not raise interest rates in September, keeping the federal funds target rate at the 0.25%-0.50% range. Following its September meeting, The FOMC's Chair Janet Yellen noted that while a case for a rate increase has strengthened based on overall economic strengthening, consumer price inflation continues to run at a rate that is under the Committee's target of 2.0% and labor market slack is being taken up at a somewhat slower pace than in previous years. Nevertheless, it appears more likely that the Fed will increase rates by the end of the year.

Oil: The price of crude oil (WTI) fluctuated some during September, hovering between $43 and $45 per barrel, finally settling at $48.05 per barrel by the end of the month. The national average retail regular gasoline price was $2.224 on September 26, down from the August 29 selling price of $2.237.

GDP/budget: The U.S. economy is expanding, but at a slow pace. According to the Bureau of Economic Analysis, the final estimate of the second quarter 2016 gross domestic product grew at an annualized rate of 1.4%, compared to the first quarter, which grew at an annual rate of 0.8%. The primary positives driving the upward movement of the GDP were nonresidential (e.g., business) fixed investment, private inventory investment, and exports. An indicator of inflationary trends, the price index for gross domestic purchases increased 2.1% in the second quarter, compared to an increase of 0.2% in the first quarter. As to the government's budget, the federal deficit for August was $107 billion, as total receipts came in at about $231 billion and total outlays were $338 billion. The deficit at the end of July was about $113 billion. Through the first 10 months of the fiscal year, the deficit sits at $620.8 billion, compared to $530 billion over the same period last year. The government's fiscal year ends in October.

Inflation/consumer spending: The U.S. economy is expanding, but at a slow pace. According to the Bureau of Economic Analysis, the final estimate of the second quarter 2016 gross domestic product grew at an annualized rate of 1.4%, compared to the first quarter, which grew at an annual rate of 0.8%. The primary positives driving the upward movement of the GDP were nonresidential (e.g., business) fixed investment, private inventory investment, and exports. An indicator of inflationary trends, the price index for gross domestic purchases increased 2.1% in the second quarter, compared to an increase of 0.2% in the first quarter. As to the government's budget, the federal deficit for August was $107 billion, as total receipts came in at about $231 billion and total outlays were $338 billion. The deficit at the end of July was about $113 billion. Through the first 10 months of the fiscal year, the deficit sits at $620.8 billion, compared to $530 billion over the same period last year. The government's fiscal year ends in October.

Housing: The housing market definitely slowed in August. Higher home prices and a lack of available homes for sale are the main reasons given for the drop in the housing sector. Existing home sales fell 0.9% to a seasonally adjusted annual rate of 5.33 billion, down from July's downwardly revised annual rate of 5.38 billion, according to the National Association of Realtors®. However, existing home sales are slightly ahead of last year's rate of 5.29 billion. The median sales price for existing homes was $240,200 — up 5.1% from August 2015. Total housing inventory at the end of August fell 3.3% to 2.04 million existing homes available for sale, and is now 10.1% lower than a year ago (2.27 million) and has declined year-over-year for 15 straight months. The Census Bureau's latest report reveals a fall in new home sales as well. Sales of new single-family homes fell 7.6% in August to an annual rate of 609,000 — down from July's rate of 659,000. The median sales price of new houses sold in August was $284,000, while the average sales price was $353,600. Available inventory of new homes for sale did expand slightly from July. The seasonally adjusted estimate of new houses for sale at the end of August was 235,000. This represents a supply of 4.6 months at the current sales rate, which is up from 231,000 homes available (supply of 4.2 months) in July.

Manufacturing: One of the reasons the Fed has held off on raising interest rates is the continued weakness in the manufacturing and industrial production sectors. The Federal Reserve's monthly index of industrial production (which includes factories, mines, and utilities) fell 0.4% in August after rising 0.6% in July. Manufacturing output also declined 0.4% for the month. At 104.4% of its 2012 average, total industrial production in August was 1.1% lower than its year-earlier level. Capacity utilization for the industrial sector decreased 0.4 percentage point in August to 75.5%, a rate that is 4.5 percentage points below its long-run (1972-2015) average. The latest report from the Census Bureau shows new orders for all durable goods (expected to last at least three years) fell $0.1 billion in August from the prior month. Excluding the volatile transportation segment, new orders fell a disappointing 0.4%. Orders for capital goods dropped 4.4%, while shipments fell 0.4%.

Imports and exports: The advance report on international trade in goods revealed that the trade gap narrowed by 0.6% in August. The overall trade deficit was $58.4 billion in August, down $0.4 billion from July. Exports rose 0.7% to $124.6 billion, $0.9 billion more than July exports. Imports jumped 0.3% to $183.0 billion, $0.5 billion more than July imports. The prices for U.S. imports (goods purchased here but produced abroad) fell for the first time since February, primarily driven by lower fuel prices. August imports sank 0.2% following a 0.1% gain in July. The prices for exports declined 0.8% following four consecutive months of increases. Year-on-year, import prices are down 2.2% and export prices have fallen 2.4%.

International markets: According to the World Trade Organization, world trade will grow more slowly than expected in 2016, expanding by just 1.7%, well below the April forecast of 2.8%. With expected global GDP growth of 2.2% in 2016, this year would mark the slowest pace of trade and output growth since the financial crisis of 2009. The WTO warned that long-term economic growth could be weakened if growing antiglobalization continues to slow trade. The Bank of Japan maintained its stimulus policy, hoping to rally equities and spur inflation. Great Britain is still trying to stem its economic slowdown following voters' decision to leave the European Union. More stimulus measures from the Bank of England are expected, including further interest rate decreases.

Consumer sentiment: Despite several weakening economic indicators, consumer confidence gained some momentum in August. The Conference Board Consumer Confidence Index® for August rose 4.5 points to 101.1. On the other hand, the Surveys of Consumers of the University of Michigan Index of Consumer Sentiment dipped from 90.4 in July to 89.8 in August.

Market Performance

Index Performance for Period Ending 9/30/2016

US Equity Markets	Index	Quarter	YTD	One Year	3 Year	5 Year	10 Year
US Small Growth	Russell 2000 TR Growth	9.22%	7.48%	12.12%	6.58%	16.15%	8.29%
US Small Value	Russell 2000 TR Value	8.87%	15.49%	18.81%	6.77%	15.45%	5.78%
US Small Blend	Russell 2000 TR	9.05%	11.46%	15.47%	6.71%	15.82%	7.07%
US Mid Growth	Russell Mid Cap TR Growth	4.59%	6.84%	11.24%	8.90%	15.85%	8.51%
US Mid Value	Russell Mid Cap TR Value	4.45%	13.72%	17.26%	10.49%	17.38%	7.89%
US Mid Blend	Russell Mid Cap TR	4.52%	10.26%	14.25%	9.70%	16.67%	8.32%
US Large Growth	Russell 1000 TR Growth	4.58%	6.00%	13.76%	11.83%	16.60%	8.85%
US Large Value	Russell 1000 TR Value	3.48%	10.00%	16.20%	9.70%	16.15%	5.85%
US Large Blend	Russell 1000 TR	4.03%	7.92%	14.93%	10.78%	16.41%	7.40%
S&P 500	S&P 500 TR USD	3.85%	7.84%	15.43%	11.16%	16.37%	7.24%

US Fixed Income Markets	Index	Quarter	YTD	One Year	3 Year	5 Year	10 Year
US Multisector Bond	Barclays US Agg Bond TR USD	0.46%	5.80%	5.19%	4.03%	3.08%	4.79%
Intermediate	Barclays US Govt/Credit Interm TR U	0.16%	4.24%	3.52%	2.80%	2.45%	4.17%
Short Term Bond	Barclays US Govt/Credit 1-3 Yr TR U	0.02%	1.68%	1.31%	1.09%	1.05%	2.59%

International Markets	Index	Quarter	YTD	One Year	3 Year	5 Year	10 Year
Emerging Markets	MSCI EM PR USD	8.32%	13.77%	14.07%	-2.92%	0.52%	1.50%
Foreign Large Blend	MSCI EAFE PR USD	5.80%	-0.85%	3.48%	-2.18%	4.38%	-1.02%
World Bond	Barclays Global Aggregate TR USD	0.82%	9.85%	8.83%	2.13%	1.74%	4.26%

Allocation Portfolios	Index	Quarter	YTD	One Year	3 Year	5 Year	10 Year
Balanced	DJ Moderate TR USD	3.53%	8.36%	10.98%	5.55%	8.66%	5.69%
Target Date 2046-2050	S&P Target 2050 TR USD	4.17%	7.44%	12.08%	6.67%	12.13%	5.53%
Target Date 2036-2040	S&P Target 2040 TR USD	3.87%	7.35%	11.56%	6.46%	11.55%	5.48%
Target Date 2026-2030	S&P Target 2030 TR USD	3.39%	7.08%	10.70%	6.10%	10.57%	5.37%
Target Date 2016-2020	S&P Target 2020 TR USD	2.79%	6.68%	9.50%	5.63%	9.05%	5.20%
Target Date Income	S&P Target Today TR USD	1.66%	5.81%	7.02%	4.27%	5.67%	4.31%

Key Takeaways

► World Trade Organization says world trade will grow more slowly than expected in 2016, expanding by just 1.7% vs. April forecast of 2.8%. Expected global GDP growth of 2.2% in 2016 would mark the slowest pace of trade and output growth since the financial crisis of 2009.

►FOMC recognizes U.S. economic strengthening, but declines to raise the Fed Funds Rate due to labor market slack and low inflation. However, one indicator of inflationary trends, the price index for gross domestic purchases, increased 2.1% in the second quarter, compared to an increase of 0.2% in the first quarter.

►Continued weakness in U.S. manufacturing and industrial production sectors.

► Through the first 10 months of the fiscal year, the U.S. Federal deficit sits at $620.8 billion, vs. $530 billion over the same period last year.

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