

# MONTHLY ECONOMIC UPDATE

January 2015

## MONTHLY QUOTE

“Always seek out the seed of triumph in every adversity.”

– *Og Mandino*

## MONTHLY TIP

Own a business? The start of 2015 is the right time to schedule quarterly meetings with your CPA, so you can adjust (or establish) metrics and key performance indicators and review performance as 2015 progresses.

## MONTHLY RIDDLE

Isabella took her two children to a place where stealing was common and everyone wanted to run home. Where did the three of them spend an enjoyable afternoon?

## Last month's riddle:

You saw me where I never was and where I could not be. And yet within that very place, my face you often see. What am I?

## Last month's answer:

A reflection.

## THE MONTH IN BRIEF

December certainly looked like it was going to be a trying month for the market, but then Wall Street got a little help from the Federal Reserve. In its December 17 policy statement, the central bank told the world that it would be “patient in beginning to normalize the stance of monetary policy.” That declaration helped turn stocks around. Oil prices (and retail gas prices) declined further in December; readings on fall consumer spending and Q3 GDP improved. When 2014 ended, the S&P 500 had posted another double-digit yearly gain – and while some foreign economies seemed to be slowing or sputtering, ours looked quite healthy.<sup>1</sup>

## DOMESTIC ECONOMIC HEALTH

Three very positive indicators from the Commerce Department confirmed how well the economy was doing. Third-quarter GDP went in the books at 5.0% (up from 3.9% in the second estimate). Consumer spending rose by a very strong 0.6% in November with consumer wages also rising 0.4%. Cheap gasoline and growing consumer confidence seemed apparent factors in the impressive 0.7% November gain in retail sales.<sup>2,3</sup>

America's two most-watched household sentiment gauges pushed higher in December. The Conference Board's consumer confidence index rose 3.9 points on the month to 92.6, and the University of Michigan's index gain 4.8 points off of its final November mark to reach 93.6.<sup>2,3</sup>

More good news came from the Labor Department: November had been an outstanding month for hiring. Sure, the jobless rate stayed at 5.8% (the U-6 rate encompassing unemployed and underemployed ticked down to 11.4%), but the economy added 321,000 new jobs, 86,000 of them in the professional and business sectors. Additionally, the Labor Department revised the employment gains of September and October upward – 44,000 more people found work across those two months than initially reported.<sup>4</sup>

The Institute for Supply Management announced a slight November downturn in its manufacturing PMI; the 0.3% retreat took it to 58.7, still indicating strong expansion for the sector. (Overall hard goods orders also retreated in November, down 0.7%; economists polled by MarketWatch projected a 3.3% gain.) ISM's service sector PMI jumped 2.2 points north in November to 59.3.<sup>2,3</sup>

Inflation pressure? There wasn't much. The headline Consumer Price Index and Producer Price Index both saw November declines – 0.3% for the CPI, 0.2% for the PPI. Year-over-year, the CPI had only advanced 1.3%, the PPI 1.4%. (The core CPI was up 1.7% yearly, the core PPI up 1.8% in 12 months.)<sup>2,3</sup>

In mid-December, Congress voted to retroactively reinstate more than 50 tax breaks that had expired at the end of 2013. The extenders (which included the tuition & fees deduction, the R&D credit, the state & local sales tax deduction and many others) were all set to sunset at the beginning of 2015 barring further legislative action.<sup>5</sup>

## GLOBAL ECONOMIC HEALTH

December ended with more uncertainty for Greece (and the European Union). The Greek parliament dissolved, unable to select a new president; the Syriza party looked poised to win the resulting national election. It had long protested anti-austerity conditions handed down as part of the bailout offered to Greece by the International Monetary Fund, European Central Bank and European Commission, and had vowed to overturn much of those economic measures if it assumed power. Elsewhere on the continent, Russia's economy looked headed for recession; government economists

put 2014 GDP at 0.6% and projected 2015 GDP at -0.8%. By the end of 2014, the ruble had sunk 50% versus the dollar.<sup>6,7</sup>

As for the broad EU, its jobless rate stood at 10.0% as the year wrapped up (with unemployment in the 18-country euro area at 11.5%), and its annual inflation rate stood at just 0.3% in December. In the U.K., inflation touched a 12-year low last month.<sup>8,9</sup>

Important indicators on foreign factory output and GDP were mostly disappointing. As December ended, the latest HSBC/Markit manufacturing PMI for China came in at 49.5; readings below 50 signal sector contraction. China's State Information Center put the country's Q3 growth at 7.3% (down from 7.5% in Q2) while forecasting 7.0% GDP for 2015. The Markit Composite Flash PMI for the eurozone moved up to 51.7 in mid-December; just prior to that, it had been at 51.1, a 16-month low.<sup>9,10</sup>

## **WORLD MARKETS**

European and Latin American bourses took widespread losses in December. Was it any surprise that Russia's RTS index fell hardest? Its 18.84% monthly drop topped the 14.22% decline of Greece's ATG. Other European losses last month: DAX, 1.76%; CAC 40, 2.67%; IBEX 35, -4.56%; FTSE 100, -2.33%; STOXX 600, -1.36%. Ireland's ISEQ was an exception, up 3.02% last month. Europe's best 2014 performer was Turkey's BIST 100 index, which went +26.43%. Argentina's Merval sank 12.54%, Mexico's IPC All-Share 2.36% and Brazil's Bovespa 8.52%; in Venezuela, the Caracas General index soared exactly 29% in December. The Merval was the top performer for the Americas in 2014, going +59.14%.<sup>11</sup>

The picture in the Asia Pacific region was somewhat better. The winner for the month and the year: the Shanghai Composite. It gained 20.57% in December and 52.87% for the year (its A Shares actually advanced 53.06%). The Sensex lost 4.16% in December, the KOSPI 3.29% and the Hang Seng 1.59%, yet the KSE 100 rose 2.99%, the Jakarta Composite 1.50% and the S&P/ASX 200 1.84%. Japan's Nikkei 225 was virtually flat, losing 0.05%.<sup>11</sup>

Now to the Dow Jones and MSCI benchmarks. The Europe Dow dipped 5.30% in December, the Dow Jones Americas just 0.76%; the Asia Dow was off 2.67%, the Global Dow 2.71%. The twin MSCI indices staged December retreats – the MSCI World lost 1.71%, the MSCI Emerging Markets 4.82%.<sup>11,12</sup>

## **COMMODITIES MARKETS**

Call 2014 the year of the strong dollar and weak oil. The U.S. Dollar Index gained 2.18% more in December, moving up to 90.29 on New Year's Eve. Oil's catastrophic 2014 ended with an 18.25% December loss; WTI crude went -45.42% on the year with a barrel worth just \$53.27 on the floor of the NYMEX as the final trading day of 2014 concluded. Other major energy futures racked up big monthly losses, too. Unleaded gasoline slid 22.17% to bring its 2014 retreat to 47.03%. Natural gas fell 28.65%, heating oil 16.02%. Crops had a mixed month: sugar lost 6.50% and coffee 9.90%, but soybeans rose 0.54%, corn 5.77%, wheat 1.86% and cotton 3.16%.<sup>13,14</sup>

Last month was actually decent for metals. Gold ended 2014 at \$1,184.10 on the COMEX with futures advancing 1.44% in December. Still, it declined 1.23% for the year. Silver rose 1.43% in December, platinum 0.58%; copper futures lost 1.12%.<sup>14</sup>

## **REAL ESTATE**

The housing market lost some momentum in November, even as interest rates for conventional mortgages stayed below 4%. The National Association of Realtors reported existing home sales dropping 6.1% in that month; the Census Bureau found new home sales down 1.6%. It was just the second retreat in eight months for resales, and the first decline in the pace of new house purchases since July. November's 20-city Case-Shiller home price index showed a 4.5% annual advance.<sup>2,3,17</sup>

Looking at the near future, NAR's pending home sales gauge managed to rise 0.8% in November, which was its best performance in 14 months. Groundbreaking tailed off for the first time in three months in the eleventh month of the year: housing starts fell 1.6%, with the issuance of building permits down 5.2%.<sup>15,16</sup>

Freddie Mac's last 2014 Primary Mortgage Market Survey (December 31) showed the average interest rate for the 30-year FRM at 3.87%, a tenth of a percent below where it was in the November 26 edition of the survey. Between those two dates, mean rates on 15-year FRMs declined from 3.17% to 3.15% and mean rates for 1-year ARMs declined from 2.44% to 2.40%. Average rates on 5/1-year ARMs were unchanged at 3.01%.<sup>17</sup>

### LOOKING BACK...LOOKING FORWARD

The Dow, S&P 500 and NASDAQ all posted slight December declines. Closing values from December 31 for the big three: DJIA, 17,823.07; NASDAQ, 4,736.05; S&P, 2,058.90. Oil's winter tumble helped the CBOE VIX advance hugely – it ended the year at 19.20, with a monthly gain of 44.04% and a yearly gain of 39.94%. The Russell 2000 settled at 1,204.70 on December 31, rising 2.68% on the month and gaining 3.53% for 2014.<sup>11</sup>

% CHANGE	2014	1-MO CHG	5-YR AVG	10-YR AVG
DJIA	+7.52	-0.03	+14.18	+6.53
NASDAQ	+13.40	-1.16	+21.74	+11.77
S&P 500	+11.39	-0.42	+16.93	+6.99
REAL YIELD	12/31 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.49%	0.80%	1.48%	1.68%

Sources: online.wsj.com, bigcharts.com, treasury.gov - 12/31/14<sup>11,18,19,20</sup>  
 Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends. 10-year TIPS real yield = projected return at maturity given expected inflation.

For the last couple of years, stocks have surpassed expectations. Will they do so this year? Will corporate earnings be strong enough to generate another double-digit advance for the S&P? If the Fed times its moves right, the bull market could hold up nicely. Oil and Russia present two wild cards for the coming quarters. What if the world's need for oil has peaked, and demand is never as high as it once was? What if the plummeting ruble and the seeming freefall of oil futures send Russia (in the worst-case scenario) toward a debt default? Can U.S. equities adequately withstand such potential shocks? Major questions, but it is worth reflecting on the major economic and geopolitical question marks confronting stocks in the past few years – all of which the bulls eventually ran past. Perhaps 2015 will surprise the analysts once again.

**UPCOMING ECONOMIC RELEASES:** 2015 kicks off with the following slate of economic announcements and reports: the December ISM factory PMI (1/2), December's ISM service sector PMI and November factory orders (1/6), ADP's employment change report for December and the December 17 Federal Reserve policy meeting minutes (1/7), December's Challenger job-cut report (1/8), the Labor Department's December employment report and November wholesale inventories (1/9), a new Fed Beige Book, November business inventories and December retail sales (1/14), the December PPI (1/15), the initial January consumer sentiment index from the University of Michigan, December industrial output and the December CPI (1/16), December housing starts and building permits (1/21), the Conference Board's December leading indicator index and December existing home sales (1/23), the November Case-Shiller home price index, December hard goods orders, the Conference Board January consumer confidence index and December new home sales (1/27), a Federal Reserve policy statement (1/28), December pending home sales (1/29), and lastly the University of Michigan's final January consumer sentiment index and the federal government's first estimate of Q4 GDP (1/31).

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The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. It is not possible to invest directly in an index. The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. The CBOE Volatility Index® (VIX®) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. NYSE Group, Inc. (NYSE:NYX) operates two securities exchanges: the New York Stock Exchange (the "NYSE") and NYSE Arca (formerly known as the Archipelago Exchange, or ArcaEx®, and the Pacific Exchange). NYSE Group is a leading provider of securities listing, trading and market data products and services. The New York Mercantile Exchange, Inc. 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The FTSE 100 Index is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. 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 ISEQ Overall Index is a capitalization-weighted index of all official list equities in the Irish Stock Exchange, excluding U.K.-registered companies. The Borsa Istanbul 100 Index is a capitalization-weighted index composed of National Market companies except investment trusts. The Merval Index (MERcado de VALores, literally Stock Exchange) is the most important index of the Buenos Aires 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 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 IBC Index from the Caracas Stock Exchange (Venezuela), also known as the General Index, is a capitalization-weighted index of the 15 most liquid and highest capitalized stocks traded on the Caracas Stock Exchange (Bolsa de Valores de Caracas). The SSE Composite Index is an index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. 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 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 Hang Seng Index is a freefloat-adjusted market capitalization-weighted stock market index that is the main indicator of the overall market performance in Hong Kong. Karachi Stock Exchange 100 Index (KSE-100 Index) is a stock index acting as a benchmark to compare prices on the Karachi Stock Exchange (KSE) over a period. The IDX Composite or Jakarta Composite Index is an index of all stocks that are traded on the Indonesia Stock Exchange (IDX). The S&P/ASX 200 measures the performance of the 200 largest index-eligible stocks listed on the ASX (Australian Stock Exchange) by float-adjusted market capitalization. Nikkei 225 (Ticker: ^N225) is a stock market index for the Tokyo Stock Exchange (TSE). The Nikkei average is the most watched index of Asian stocks. The S&P/ASX 200 is Australia's "premier" share market index. The Europe Dow measures the European equity markets by tracking 30 leading blue-chip companies in the region. The Dow Jones Americas Index measures the Latin American equity markets by tracking 30 leading blue-chip companies in the region. The Asia Dow measures the Asia equity markets by tracking 30 leading blue-chip companies in the region. 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. 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