Monthly Economic Update

February 2015

MONTHLY QUOTE

"It still holds true that man is most uniquely human when he turns obstacles into opportunities."

– *Eric Hoffer*

MONTHLY TIP

If you want to leave some of your IRA to your children, a Roth IRA conversion may be a great idea: the IRA they inherit could realize further tax-free growth.

MONTHLY RIDDLE

It begins and ends with E yet it may contain only one letter. What is it?

Last month's 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 answer: A baseball game.

THE MONTH IN BRIEF

Assumptions of a global slowdown sent stocks further down in January. The blue chips and the small caps both fell more than 3% on the month. Gold and the dollar got off to a hot start for 2015, as did many foreign stock markets; energy and crop futures mostly extended losing streaks. Housing indicators were mixed, and the latest data on consumer spending, inflation and retail sales raised some questions. The big economic news came from overseas as the European Central Bank announced a long-awaited easing effort; stateside, the Federal Reserve seemed to hint that it was still considering raising interest rates this year.[1]

DOMESTIC ECONOMIC HEALTH

If institutional investors had felt as confident as American households last month, stocks might have performed better. January saw the Conference Board's consumer confidence index reach an impressive 102.9, and the University of Michigan's consumer sentiment index ended the month at 98.1.[2]

While consumer confidence was rising, consumer spending abruptly tailed off. Commerce Department data showed it retreating 0.3% in December. Retail sales also dropped 0.9% in the same month after two months of solid gains.[2,3]

On the upside, personal wages grew 0.3% in December, and the federal government announced that Q4 personal spending had advanced 4.3%, becoming the major factor in the 2.6% initial estimate of Q4 GDP released in late January.[2,4]

The latest Labor Department report showed more improvement. December saw the jobless rate dip another 0.2% to 5.6%; the overall U-6 rate, which measures the marginally employed as well as the unemployed, also decreased to 11.2%. Thanks to 252,000 more Americans finding employment in December, 2014 became the nation's best year for hiring since 2000.[5]

Looking at another key economic barometer, we see remarkably little inflation pressure stateside. The Consumer Price Index dipped 0.4% in December following a 0.3% retreat in November. That meant the country experienced just 0.8% inflation for 2014. The core CPI was flat in December, so its year-over-year change was 1.6%. As for the Producer Price Index, it pulled back 0.3% for December and rose just 1.1% for 2014; the core PPI rose 0.3% for December, taking its 2014 gain to 2.1%.[3]

December saw a 0.3% rise in manufacturing production and a 0.1% dip in industrial output according to the Federal Reserve, but durable goods orders slipped 3.4% (they were also down 2.1% in November). The twin PMIs maintained by the Institute for Supply Management disappointed Wall Street: ISM's December service sector PMI came in 3.1 points lower at 56.2, and its manufacturing PMI read 55.1 for December and 53.5 for January. These readings were solid, but decidedly beneath previous editions.[2,3]

In the face of this mixed bag of indicators, the Fed sounded pretty bullish. Its latest policy statement (January 28) noted the economy expanding "at a solid pace" as opposed to the "moderate pace" noted in prior Federal Open Market Committee reflections. Nothing in the statement gave off impressions that the Fed would delay a rate hike until 2016.[6]

GLOBAL ECONOMIC HEALTH

In late January, the European Central Bank unveiled a money-purchase program of proportions to rival QE3. The ECB announced it would buy €60 billion in bonds each month through September 2016. By weakening the euro, the central bank is aiding the economies of most eurozone countries, which are pegged heavily to exports.[7]

The ECB had to do something; annualized eurozone inflation reached -0.2% in December, the European Commission forecasts it at -0.6% for January, and it is projected to stay at +0.5% or less through 2020. For 2015, the eurozone economy is expected to expand only 1.2%; the euro area jobless rate was 11.4% in December, and that was a 2-year low.[7,8]

Did China's economy rev up a bit in January? No. January's "official" China factory PMI dipped 0.3 points to 49.8 (meaning contraction) and its "official" service sector PMI dropped 0.4 points to 53.7. The HSBC/Markit China PMI stayed below 50 for another month (49.7). South Korea's key manufacturing PMI had improved 1.5 points to 51.1 in December, and Indonesia's rose 0.9 points to 48.5; India's factory PMI fell 1.6 points to 52.9.[9]

WORLD MARKETS

Indices in Europe and Asia mostly rose. Look at some of the progress made last month: FTSE 100, +2.79%; CAC 40, +7.76%; DAX, +9.06%; FTSE MIB, +7.84%; STOXX 600, +7.16%; Sensex, +6.12%; Hang Seng, +3.82%: Nikkei 225, +1.28%; S&P/ASX 200, +3.28%. Another glance reveals a few notable retreats – January losses of 0.75% for the Shanghai Composite, 6.20% for Brazil's Bovespa, 6.75% for the Russian RTS, 5.09% for Mexico's IPC All-Share.[1]

January saw the MSCI World Index fall 1.88%; the MSCI Emerging Markets Index gained 0.55%. The month saw losses of 3.32% for the Dow Jones Americas index, 1.76% for the Europe Dow and 2.41% for the Global Dow; the Asia Dow, on the other hand, improved 2.73%.[1,10]

COMMODITIES MARKETS

Gold had a tremendous month, with futures rising 8.38% on the COMEX to settle at $1,279.20 on January 30. Its ascent was mirrored by a 9.24% climb for silver, with an ounce of that commodity being worth $17.21 at January's end. Platinum rose 2.38% on the month; copper dropped 10.91%. The U.S. Dollar Index surged north another 5.02% in January to end the month at 94.80.[11,12]

Apart from the greenback and precious metals, the commodities sector didn't really offer much to cheer about. Light sweet crude fell further in New York: a barrel was worth just $48.24 on the NYMEX when the month ended. January also saw heating oil futures sink another 7.43% and natural gas futures give up another 8.20%. Crops mostly descended as well, with cotton losing 1.51%, coffee 3.80%, cocoa 8.12%, soybeans 5.79%, corn 7.23% and wheat 15.27%. It wasn't all bad, as unleaded gasoline did rise 0.61% and sugar gained 1.79%.[11]

REAL ESTATE

Mortgages got even cheaper last month: the interest rate for the 30-year fixed averaged only 3.66% according to the January 29 Freddie Mac Primary Mortgage Market Survey. That was down from 3.87% on December 31. Between the two surveys, average interest rates on the key mortgage types declined as follows: 15-year FRM, 3.15% to 2.98%; 5/1-year ARM, 3.01% to 2.86%; 1-year ARM, 2.40% to 2.38%.[13,14]

New home sales soared in December: they were up 11.6% according to the Census Bureau, coming off a (revised) 6.7% drop in November. Existing home sales improved slightly in December as well – the National Association of Realtors found them rising 2.4%, much better than the (revised) 6.3% fall of a month before. NAR's pending home sales index, on the other hand, fell 3.7% for December after a November gain of 0.6%.[2,3]

As for home prices, NAR said that the national median resale price was $208,500 in December – the best median price in six years, and up 5.8% from a year earlier. That year-over-year improvement surpassed the 4.3% gain in the 20-city Case-Shiller home price index for December.[2,15]

As for new projects, the Census Bureau noted a 1.9% decline in applications for building permits in December, but a 4.4% increase in groundbreaking which put total U.S. housing starts over 1 million for the first time since 2005. Last year saw an 8.8% increase in housing starts.[15,16]

LOOKING BACK...LOOKING FORWARD

Here was where things settled on January 30, the month's last market day: DJIA, 17,164.95; NASDAQ, 4,635.24; S&P, 1,994.99; Russell 2000, 1,165.39 (the RUT was down 3.26% YTD when January ended). The CBOE VIX was one of the best performers in January, gaining 9.22% on the month to 20.97. Bond yields went lower worldwide after the ECB easing announcement, and investors really ran to Treasuries – look at that real yield for the 10-year note as January ended.[1]

% CHANGE	Y-T-D	2014	5-YR AVG	10-YR AVG
DJIA	-3.69	+7.52	+14.10	+6.36
NASDAQ	-2.13	+13.40	+23.17	+12.47
S&P 500	-3.10	+11.39	+17.16	+6.89
REAL YIELD	1/30 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.03%	0.57%	1.30%	1.65%

Sources: online.wsj.com, bigcharts.com, treasury.gov - 1/30/15[1,17,18,19,21]
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.

Is downside risk increasing as we get into February? Could a correction happen? Market analysts aren't ruling it out, as U.S. stocks didn't especially get a sustained lift from the latest Fed policy statement or the ECB's announcement of its stimulus. Still, what happens in January does not necessarily foretell what will happen during the rest of the year. Pessimists should note that January 2014 was even worse for the blue chips: the Dow lost more than 5%, but it gained more than 13% over the ensuing 11 months. Oil prices have been rebounding of late; earnings have been decent. Those two factors alone may give investors a bit more optimism as February unfolds.[20]

UPCOMING ECONOMIC RELEASES: Here is what is on tap for the rest of February: the January ISM service sector PMI and ADP employment change report (2/4), the January Challenger job-cut report (2/5), the Labor Department's January jobs report (2/6), January wholesale inventories (2/10), December business inventories and January retail sales (2/12), February's preliminary consumer sentiment index from the University of Michigan (2/13), January's PPI, industrial output, housing starts and building permits and the January 28 Fed policy meeting minutes (2/18), the Conference Board's latest leading indicator index (2/19), January existing home sales (2/23), the Conference Board's February consumer confidence index and the December Case-Shiller home price index (2/24), January new home sales (2/25), January's CPI and hard goods orders (2/26), and then the federal government's second estimate of Q4 GDP, January pending home sales and the University of Michigan's final February consumer sentiment index (2/27).

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