Financial Services, LLC

Frank DeMaio Presents:

QUARTERLY ECONOMIC UPDATE

A review of 1Q 2016

QUOTE OF THE QUARTER

"The grass is not, in fact, always greener on the other side of the fence. Fences have nothing to do with it. The grass is greenest where it is watered."

– *Robert Fulghum*

QUARTERLY TIP

When is the ideal time to talk to a tax professional? Late April, May, or June. You can discuss your financials and map out a long-run plan for tax savings, apart from the hubbub that precedes the federal tax deadline.

THE QUARTER IN BRIEF

In investing, patience is often a virtue. For an illustration of why it matters, simply look at the opening quarter of 2016. Stocks plunged in January and fell further in early February, and a bear market seemed a possibility. Then, Wall Street turned around. The Dow staged its greatest quarterly comeback in 83 years, rising more than 7% in March alone and ending March slightly positive YTD. The S&P 500 and Nasdaq Composite each gained more than 6.5% in March. It was a quarter marked by rebounds; in stock indexes, in some key economic indicators, in oil prices, in bullish sentiment. Even terrorist attacks could not deter the bulls, and the central bank decisions of the quarter only helped them.[1]

DOMESTIC ECONOMIC HEALTH

Arguably the most reassuring development of the quarter for Wall Street occurred in March, when the Federal Reserve not only refrained from raising interest rates, but also scaled back its forecast for rate hikes across the rest of the year. A revised dot-plot issued by the central bank showed a consensus forecast for two rate increases rather than the previously assumed four. The Federal Open Market Committee also lowered its median projection of where the federal funds rate would be at the end of 2016 to 0.9%.[2]

The Labor Department's March employment report showed net job gains of 168,000 for January, 245,000 for February, and 215,000 for March. As labor force participation rose during Q1, the unemployment rate did tick up a tenth of a percent in March to 5.0%, and the U-6 jobless rate (counting the underemployed as well as the unemployed) also rose a tenth of a percent to 9.8%. Hourly wages were up 2.3% year-over-year in March.[3]

Improvement occurred in the Institute for Supply Management's closely watched factory PMI. The ISM manufacturing index jumped 2.3 points in March to 51.8, its highest reading since July. ISM's non-manufacturing PMI spent January and February well above 50, with successive readings of 53.5 and 53.4.[4,5]

Household optimism wavered in early 2016. The Conference Board's consumer confidence poll ended the quarter at 96.2, and the University of Michigan's household sentiment index recorded a final March reading of 91.0. Those indices respectively ended 2015 at 96.3 and 92.6.[6,7]

Consumer spending received no great boost in Q1 either. Commerce Department reports showed personal spending up only 0.1% in February, replicating the increase seen in both January and December. Retail purchases tailed off 0.4% in January and another 0.1% in February.[8,9]

The federal government's two major price indices again showed tolerable consumer and wholesale inflation. As of February, the headline Consumer Price Index was up just 1.0% in 12 months, though core consumer prices had risen 2.3% in that interval (they were up 0.3% in February). Both the Consumer Price Index and Producer Price Index retreated 0.2% in the year's second month.[9]

Economists have been a bit pessimistic about Q1 GDP, given the relatively weak Q4 GDP assessment from the Bureau of Economic Analysis. In March, the BEA closed the book on Q4 growth with a final 1.4% estimate.[9]

Hard goods orders, which were up 4.2% in January, were off 2.8% in February. The same pattern was seen for industrial output, which rose 0.8% in January, but fell 0.5% a month later.[9]

GLOBAL ECONOMIC HEALTH
While the Fed was tightening, other central banks were easing. After years of battling deflation pressures and an unsuccessful 3-year asset-buying campaign, the Bank of Japan made an unprecedented monetary policy move in January and cut a benchmark interest rate below zero. Two months later, the European Central Bank ramped up its stimulus efforts: it slashed all of its key interest rates; expanded the scope of its bond buying; and announced a new round of targeted loans to banks beginning in June. Deflation was real in the eurozone, with consumer prices down 0.2% annually of March; ECB economists see only 0.1% inflation for 2016.[10,11]

As Q1 ended, a look at Markit's March manufacturing PMIs for various countries reveals some encouraging numbers. While Japan's PMI sank to a 3-year low of 49.1, Markit's eurozone PMI advanced to 51.6. Mexico's factory PMI ticked up to 53.2, while Canada's reached 51.5, indicating manufacturing growth for the first time in eight months. Indonesia's manufacturing PMI reached 50.6, which, in its factory sector, ended 17 months of contraction. Even the PMI in beleaguered Brazil rose a point-and-a-half to 46.0. Most notable was the rebound in China: its stock market may have fallen in Q1, its factory PMIs rose. The reading on the nation's official manufacturing PMI improved to 50.2, the first sign of sector expansion since July. The Caixin/Markit factory PMI for China nearly reached growth territory last month at 49.7. As for China's GDP, Standard and Poor's projects at least 6% growth for the PRC during the next three years; the nation's newest 5-year plan has set a 6.5% GDP target.[12,13]

WORLD MARKETS
Stock benchmarks in the Americas fared best in Q1. Besides small gains for our own Dow and S&P 500, the quarter also saw advances of 15.47% for the Bovespa, 3.72% for the TSX Composite, 6.76% for the IPC All-Share, and 1.44% for the Dow Jones Americas. Russia's RTS was the only notable gainer in Europe, rising 15.74%. In the Asia Pacific region, the Asia Dow rose 0.39% for Q1; the Jakarta Composite gained 5.49%; the Kospi, 1.76%; and the Manila Composite, 4.46%. The MSCI Emerging Markets index rose 5.37%.[14,15]

Aside from those gains, there was a plethora of quarterly losses. The Shanghai Composite fell 15.12%; the Nikkei 225, 11.95%; the Sensex, 2.97%; the ASX 200, 4.02%; the Hang Seng, 5.19%; the Europe Dow, 3.74%; the IBEX 35, 8.60%; the DAX, 7.24%; the FTSE MIB, 15.41%; the FTSE 100, 1.08%; the CAC 40, 5.43%; and the STOXX 600, 7.73%. The Global Dow gave back 0.92% in the quarter; the MSCI World index fell 0.88%.[14,15]

COMMODITIES MARKETS
The first quarter of 2016 was a great quarter for gold, which jumped 16.4%. (Gold had not had a quarter like that in 20 years.) Platinum rose 9.5%; silver, 11.9%; and palladium, a mere 0.4%. Among the base metals, tin gained 16.1%; zinc, 10.9%; and copper, 2.7%. Lead fell 4.7%; aluminum, 0.8%; and nickel, 3.9%. Gold ended Q1 at $1,232.50 on the COMEX; silver, at $15.44.[16,17]

Light sweet crude advanced 3.5% on the NYMEX during Q1. It was oil's first positive quarter since Q2 2015. While natural gas futures dove 16.2% for Q1, heating oil futures rose 5.5% and unleaded gasoline futures, 13.8%.[1,16]

The biggest commodity winners in Q1 were iron ore, up 24%, and thinly traded lumber, up 21.4%. Besides natural gas, notable first-quarter losses came for oats (14.6%), rice (16.2%), cocoa (8.1%), and cotton (7.7%). Soybeans and soybean oil, on the other hand, posted Q1 gains of 4.7% and 12.0%, respectively. The U.S. Dollar Index slipped 4.1% in its poorest quarter since Q3 2010.[16]

REAL ESTATE
How well did homes sell in Q1? The data currently on hand shows some significant fluctuations. Existing home sales, according to National Association of Realtors reports, were up 0.4% in January and then down 7.1% a month later. The Census Bureau, on the other hand, recorded a 2.0% February rise in new home sales after a 7.0% fall for January.[9]

The 20-city Case-Shiller home price index displayed a 5.7% annual increase in existing home values in its January edition, and the NAR reported a 3.5% boost in housing contract activity for February after a 3.0% January dip. Groundbreaking lessened 3.4% in January, then accelerated 5.2% in February according to the Census Bureau (building permits were down 0.2% in January and another 3.1% in February).[9,18]

Mortgage rates declined markedly during the quarter. Comparing Freddie Mac's December 31 and March 31 Primary Mortgage Market Surveys, we see the following chronological movements: 30-year FRM, 4.01% to 3.71%; 15-year FRM, 3.24% to 2.98%; 5/1-year ARM, 3.08% to 2.90%.[19,20]

LOOKING BACK…LOOKING FORWARD
A lengthy winning streak was snapped in Q1; the Nasdaq Composite had its first down quarter since 2009. The Russell 2000 also lost ground in Q1, retreating 1.92%. The Dow and S&P finished Q1 a bit ahead of where they began the year, and two stateside indices in particular had remarkably great quarters: the Dow Jones Utility Average climbed 15.71% and the PHLX Gold/Silver index jumped 53.45%. Three indices sank more than 20% in the quarter: the Nasdaq Biotech (22.98%), the NYSE Arca Biotechnology (22.42%), and the CBOE VIX (23.39%). The DJIA ended the quarter at 17,685.09; the NASDAQ, at 4,869.85; the S&P, at 2,059.74; and the RUT, at 1,114.03.[1,14]

% CHANGE	Q1 CHG	Q4 CHG	1-YR CHG	10-YR AVG
DJIA	+1.49	+7.00	-0.51	+5.92
NASDAQ	-2.75	+8.38	-0.63	+10.81
S&P 500	+0.77	+6.45	-0.39	+5.91
REAL YIELD	3/31 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.16%	0.18%	0.99%	2.35%

Sources: wsj.com, bigcharts.com, treasury.gov – 3/31/16[1,14,21,22,23]
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
These returns do not include dividends.

Could the second quarter of 2016 be calmer and better than the first? Stock market performance seemed remarkably tied to the fall and rise of oil prices in Q1, and perhaps that will prove far less true in Q2. Appetite for risk appears to have returned, and investors are again focusing on market fundamentals. Nothing suggests this next earnings season will be a good one (Thomson Reuters IBIS data projects a 6.9% Q1 dip in earnings per share for S&P 500-listed companies), but employment and manufacturing indicators been encouraging and inflation is still tame. If stocks did in fact find a floor in Q1, they certainly did not leave volatility behind; some major downside risks lurk, from the ISIS terrorist threat to weak corporate profits to the possibility of the United Kingdom exiting the European Union. Still, an investor could reasonably believe that the next three months might contain more positives than negatives for the economy, and perhaps also for the markets.[24]

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Citations.

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