Monthly Market Commentary

August, 2017

US Economy

The US economy continued its modest expansion during the month of August. The Commerce Department reported that US GDP (Gross Domestic Product) increased at a 3.0% annual rate during the second quarter of 2017, up from their initial estimate of a 2.6% increase. In addition, the Atlanta Federal Reserve Board is projecting a 3.3% growth rate for the third quarter of 2017.

The Labor Department reported that 156,000 new jobs were created in August, well below the consensus estimate of 180,000. The unemployment rate ticked up to 4.4% from July's 4.3% reading. Finally, according to the National Association of Realtors, there has been a slight slowdown in pending home sales this summer. Interestingly, they attribute this slowdown to a lack of available supply. While this could be a short-term negative, in the medium-term, this could bode well for homebuilders who will need to build to keep pace with demand.

US Markets

Despite ending roughly flat, market volatility picked up during the month of August. We believe tensions surrounding North Korea's nuclear program and seasonal factors are to blame for this recent spate of volatility. As of this writing, tensions with North Korean have slightly diminished, which has had a calming effect on the markets. That being said, additional missile launches and/or nuclear tests could add to market volatility moving forward. As for the seasonal factors, as we have mentioned in the past, summer and early autumn tend to be a choppier time for the markets. We attribute much of this is to so many market participants taking vacations during the summer time. That is, if there are fewer market participants, it becomes easier for markets to swing both to the upside and to the downside.

Fixed Income

As we have mentioned in past monthly commentaries, the Fed likely will initiate its plans to reduce the assets held on its balance sheet later this year (possibly as early as September). According to the New York Fed, as of July 17, 2017, the total value of assets on the Fed's balance sheet stood at $4.2 trillion. This translates to 22.6% of the US GDP, more than four times its level at the beginning of the financial crisis in 2007. Today, the Fed is not the only central bank with a historically high level of balance sheet assets. Several other major central banks, including the Bank of Japan (BOJ) and the European Central Bank (ECB), also have increased their total central bank assets since the Great Recession. By contrast, China has provided its stimulus in a different way. The People's Bank of China (PBOC) holds large USdollar reserves and has sold off a significant portion to provide important liquidity to the economy, but actually reduced the size of its balance sheet in the process.

Of the 10 largest economies (including the Eurozone as a whole), the US likely will be the only country to experience multiple rate hikes in 2017. Therefore, while most other central banks continue with additional stimulus packages, the Fed is pursuing a tightening monetary policy through a reduction of its balance sheet and an increase in its federal funds target rate. As such, the attractive differences in yields between US Treasury securities and many other sovereign (i.e. government-issued) bonds are likely to support demand for US-government fixed income securities.

International Markets

To some market participants, investing in the Asia-Pacific region might mean gaining exposure to China, Japan, or South Korea. However, the Asia-Pacific region encompasses 33 countries and territories, represents one-fifth of global landmass, and houses **half** of the world's population. For perspective on the geographic expansiveness of the region, it takes roughly the same amount of time to fly between Hong Kong and Sydney, Australia as it does to fly between New York City and Sao Paulo, Brazil. In terms of economic output, China and Japan are Asia-Pacific's two largest economies, yet the other economies in the region combined are twice the size of Japan's, and nearly equivalent to China's. In total, the region accounts for one-third of global economic output.

In terms of broad long-term trends, the Asia-Pacific region has been a growth market for foreign multinational companies over the past two decades. We continue to believe that the Asia-Pacific region is a key growth market, yet expect large Chinese, Japanese, Korean, and even Taiwanese multinational companies to play a more influential investment role in countries like India, Indonesia, and Thailand. A key reason being that technological and infrastructure advancements have increased entrepreneurial know-how and eased the movement of people and ideas across the region.

Commodities

After gaining nearly 18% in 2016, copper is up an additional 15% in 2017 to $2.90/pound (as of this writing). Copper hit its most recent highs in 2011 (near $4.50/pound) due to Chinese spending on capital expenditures (capex) hitting its zenith. Despite the recent rise in prices, we do not believe that this is the beginning for a new bull super-cycle for copper.

China consumes roughly 50% of the world's copper. Much of that comes from inside China, but a decent amount comes from outside the country. However, since 2011, the growth in China's need for outside copper has stalled. This is because the Chinese government, around 2011, changed its GDP growth targets as it began to favor consumer-led GDP (i.e. led by consumer spending) over capex-fueled GDP (i.e. dependent on driving growth from building roads, bridges, etc.). For much of the past six years, the impact of this change has been slowing metals-consumption growth. For copper to see $4.50/pound prices, like in 2011, we believe that China would need to revert to 2011-like copper buying. We do not see this happening anytime soon. We suspect that copper prices have little upside from here.

What Does This Mean To Me?

Despite the recent market volatility and the potential for more volatility in early autumn, we still believe that the US economy will continue to expand, which should be positive for the US equity markets. As we look into 2018, barring a major geopolitical event, we are not forecasting a US recession. In addition, as we look globally, we continue to be encouraged by positive economic momentum in Asia-Pacific and Europe. This leads us to believe the global economy could continue to expand for the foreseeable future, which should bode well for diversified portfolios. Despite the bellicose rhetoric and rising tensions with North Korea, we believe that diplomacy will ultimately prevail. As such, we continue to recommend that clients stick with their long-term investment plans.

If you have any questions or concerns, please do not hesitate to reach out to us at any time.

Sincerely,

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