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ECONOMIC UPDATE — MARCH 2016

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We began February continuing the selloff in stocks that started January 4. However, over the past 3 weeks we've seen the S&P 500 rally 9% and finish the month within 4% of the beginning of the year. For February, the S&P 500 index finished the month almost flat, down -0.13%. The Small Cap Russell 2000 index virtually matched the S&P 500 down -0.14%. International stocks didn't fare quite as well with the MSCI ACWI Ex US down -1.78%. The Ten year US Treasury yield finished the month lower at 1.83%

The start of the rally seemed to coincide with an announcement of an agreement by OPEC to freeze oil production at current levels. That announcement sparked a rebound in oil prices and a rally in junk bonds as investors believed this agreement would put a floor under oil prices that would thereby enable stressed oil companies to avoid eventual bankruptcy. Time will tell if these assumptions prove correct but for now the market found the catalyst it needed to halt the slide in stocks.

Prior to the market reversal in February, economic analysts and market pundits seemed to be quite negative on the outlook for the economy with many beginning to predict a recession in the next year. This week, though, the sentiment seems much more positive, and only a few are still talking about recession. Ah… the power of momentum.

We have seen modest signs of acceleration emerge in recent weeks. Retail sales rose in January despite a 3.1% decline in gas station sales due to lower prices at the pump. If you remove the impact of gas sales, retail sales have risen seven months in a row and are up 4.5% from a year ago. The employment picture continues to show improvement as well with unemployment now at 4.9%. In 2015, private payrolls grew at an average monthly rate of 216,000 and these were overwhelmingly full-time jobs. Earned income also made good progress in 2015 as hourly earnings rose by 2.7%. These are not the numbers we generally associate with recession.

Not all the news is good however. With nearly all of the S&P 500 companies reporting Fourth Quarter earnings, reports have been disappointing. Earnings have now declined 3 quarters in a row and unfortunately it appears that First Quarter 2016 earnings will decline further.

So far this election cycle has proven to be interesting to say the least. One thing that is clear is that primary voters have been rejecting the "establishment candidate", especially in the Republican Party but to some extent in the Democratic Party as well. The market generally doesn't like this much uncertainty but so far has focused on more pressing issues.

Most analysts now believe that the Fed will remain on hold this month and wait until later this year before raising rates again. This Fed has proven to be quite cautious so we tend to agree that a March rate increase is now unlikely given the volatility we've seen so far this year.

Volatility is likely to continue and after a sharp run-up in stocks we may very well retrace some of the recent gains. Bonds have held on to much of their recent gains indicating that bond investors are currently more cautious than stock investors. Diversification continues to be prudent. If you have questions regarding the strategy in your account, please do not hesitate to contact your advisor.

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