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summaries

SIGMA INVESTMENT COUNSELORS

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# 3rd Quarter Market Perspective

The 3rd quarter of 2015 proved to be a challenging period for investors. Global equity markets have been quite volatile in response to a number of items, which include but are not limited to; a slowdown in the growth rate of China's economy, the Federal Reserve nearing an increase in their benchmark rate for the first time in nine years, currency fluctuations, a material drop in the price of oil, and a general concern about the overall level and sustainability of global growth. Notwithstanding the heightened level of volatility and aforementioned areas of concern, we do not believe that drastic, defensive measures need to be taken in client portfolios.

The U.S. equity market, as represented by the S&P 500 has experienced its first correction in four years. A correction is defined as a drop in asset prices from peak to trough in excess of 10%. From the peak of May 21st to the lows of August 25th of this year, the S&P 500 returned -11.9%. For a bit of context, this marks the 28th correction for the S&P 500 since World War II. While corrections are a normal yet unpredictable occurrence, some investors had forgotten the associated level of 'sting', perhaps due to amount of time that had passed since the previous double digit pullback. While understandably painful, the current market environment is well within historical norms.

International equities have exhibited lower returns than domestic equities on average for the past several years. Further, emerging market international equities have had performance numbers well below those of developed international equities. In reviewing the chart of benchmark returns below, particularly for the trailing 5 year period, one is able to see the degree to which domestic, developed international, and emerging international equity returns have diverged. There will come a time when this trend reverses itself, as international valuations are becoming more attractive on a relative basis.

| Returns as of 9/30/15 | **1 Year** | **5 Year** |
|---|---|---|
| **Domestic Equities** | | |
| S&P 500 Large Cap | -0.6% | 13.3% |
| S& 400 Mid Cap | 1.4% | 12.9% |
| S&P 600 Small Cap | 3.8% | 14.0% |
| **International Equities** | | |
| MSCI EAFE Devel Int'l | -8.7% | 4.0% |
| MSCI Emerging Markets | -19.3% | -3.6% |
| **Bonds** | | |
| Barclays U.S. Agg Bond | 2.9% | 3.1% |

Fixed income returns have remained modest, largely due to the current ultra-low interest rate environment. While interest rates are more likely to go up than down from current levels, the timing of a move is quite hard to predict. However, low inflation levels and a strong desire on the part of market participants for yield are likely to keep a lid on mid-to-long term interest rates for some time to come, even if the Fed decides to raise their benchmark rate.

The outlook for China's economic growth remains front and center. With 1.5 billion people and the world's second largest economy, China will continue to play a critical role in global economics and geopolitics. Many are questioning whether or not China will be able to successfully transition to a more consumption-based economy from a dependency on debt fueled infrastructure spending and cheap exports. At the same time, Chinese equity markets have had some growing pains from an influx of domestic retail investors. While the point-to-point price level of Chinese equities is roughly unchanged from 12 months ago, a near vertical rise in early 2015 was followed by an equally dramatic decline.

The U.S. economy is progressing, albeit at a moderate pace. U.S. gross domestic product (GDP) was recently revised to 3.9% for the 2nd quarter of 2015 following a very weak 0.6% in the 1st quarter. Full year numbers should be closer to 2.5%, which is slightly above the trend line of the current six year recovery. A stronger dollar has had a negative effect on exports, making it more expensive for those outside of the U.S. to buy our goods. However, this has been more than offset by an increase in domestic consumer spending, which still accounts for roughly 70% of U.S. economic output. The annualized rate of light vehicle sales in the U.S. recently crossed the 18 million unit mark. The same data point bottomed out at less than 10 million units in the spring of 2009. The recovery in auto sales has also been helped by low oil prices.

On the jobs front, the unemployment rate stands at 5.1% nationally, compared to a peak of 10.0% in October of 2009. However, the portion of the working age population that is either working or looking for work, known as the labor force participation rate, remains at a 38 year low of 62.4%. This continues to be an area of concern.

Perhaps the most impactful and ultimately most positive economic and geopolitical change for the U.S. over the past year is the precipitous drop in the price of oil, which has been largely driven by an increase in domestic supply. Not only does it help the U.S. domestically from a discretionary spending and manufacturing point of view, but it has also put a real hole in the budgets of some of our key global adversaries (i.e. Russia, Venezuela, Iran, etc.).

As we move into the final quarter of the year, a few key items should remain front and center for investors. First, it can be helpful to assess whether or not your portfolio is truly in line with your overall tolerance for risk. Has the recent pullback led you to want to sell, or have you used it as a buying opportunity? Second, consider harvesting taxable losses. Selling or replacing taxable positions that are at a loss can result in significant tax savings. Finally, look to rebalance when there have been significant moves within your portfolio. Rebalancing is a great way to buy low and sell high in a very non-emotional way.

As always, we truly appreciate the opportunity to serve as your advisor.

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