Perspective from
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The End to a Spooky Summer

The third quarter of 2015 was dominated by weak global trade and deteriorating commodity prices (DJ Commodity Index –14.5% QoQ) that clouded the global growth outlook, especially for the emerging markets. Commodity producing countries such as Russia and Brazil ended the quarter in recession while emerging market (EM) currencies fell to a record low. As a result, aggressive measures were taken by central banks as the People's Bank of China devalued its currency at the fastest pace since 2014, India, China, Canada, Korea and Russia cut rates and the Fed delayed its long awaited rate hike. While U.S. growth was resilient due to better domestic demand and improving housing market, the ongoing deterioration in the energy renaissance weighed on manufacturing as seen by the ISM Manufacturing Index falling to a two-year low. As a result, U.S. GDP is on pace to slow from 3.9% (2Q15) to 2.5% (3Q15).

As the global growth outlook became uncertain, risk assets suffered. Global equities (MSCI AC World in USD -9.3% QoQ) fell at the fastest pace since 3Q11. In addition, emerging markets (MSCI EM in USD -17.8%) underperformed developed markets (MSCI EAFE in USD -10.2%) by the widest margin since 4Q08. The U.S. fared better than Japan (MSCI Japan in USD –10.7% and Europe (MSCI Europe ex UK in USD –8.0%) but posted its worst quarterly decline since 3Q11 (-6.4%). The sell off in risky assets also spilled into high yield and emerging market bonds which fell sharply (-4.9% and -2.4%, respectively). In contrast, the sell off sparked a flight to quality as Treasuries (+1.8%) and the Dollar (+0.8%) rallied.

A Laboring Interest Rate Decision

The disappointing September jobs report (+142K jobs created) will likely continue to fuel the debate over the timing of the Fed's first rate hike. With two consecutive months of below 150K jobs being created, Fed funds futures suggest the first rate hike will not happen until March 2016 at the earliest. Ironically, with the understanding that the economy is approaching full employment San Francisco Fed President John Williams yesterday said a gain of "above 100,000 or 150,000 [jobs] would be good to me," suggesting that the rate of healing is naturally slowing and expected. The bottom line is that our U.S. economist, Josh Feinman, believes that Fed policymakers will bide their time, holding their powder at the October FOMC meeting and waiting for more evidence before making their decision in December. The recent slower pace of improvement in the labor market likely makes the hurdle for lift-off in December higher, but a move at that meeting remains very much alive. Next week, the September meeting FOMC Minutes will be released (Thursday) and provide additional insights into the differing opinions (e.g. Lacker's dissent) within the committee.

As We Await Fed Hike Focus Turns to Earnings

Next week (Thursday), kicks of the "unofficial" start to 3Q15 earnings season. With the Fed on hold until December and equity markets remaining highly volatile, the new focus for market direction is the health of corporate earnings. While Alcoa is the only major company to release earnings next week, earnings season kicks into full gear in the weeks of October 12th, 19th and 26th when nearly 80% of the S&P 500 companies report earnings. Currently, consensus expects earnings to decline 3.3% (YoY) led by weakness in commodity-related sectors (e.g. energy and materials). However, we expect earnings to ultimately beat expectations by ~3-5% to come in flat to slightly positive YoY.

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