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Fed Blinks on Brexit Fears

Weekly Update – June 20, 2016

Markets fell on Brexit fears and concerns about the Fed’s dovish statements, giving the Dow its worst week in a month.ⁱ For the week, the S&P 500 slipped 1.19%, the Dow fell 1.06%, the NASDAQ dropped 1.92%, and the MSCI EAFE lost 2.78%.ⁱⁱ

The big news last week was the Federal Reserve’s decision not to raise interest rates. The decision wasn’t a surprise; just before the announcement, traders had assigned just a 1.9% chance of a June rate increase.ⁱⁱⁱ

Looking at the official statement, we can see that the Fed is concerned enough about a slowdown in the labor market and persistently low economic growth to hold off on raising rates.^{iv} However, the Fed hasn’t lowered its forecasts for economic growth or unemployment, indicating that its concerns may be short-term.^v Is that decision a reflection of the data or a political move designed to support its vision of a healthy economy? It’s hard to say.

A July rate increase is still possible though traders don’t seem to buy it. Current probabilities of a July rate hike sit at just 7.0%.^{vi} What would need to happen for the Fed to move in July? Well, we’re not Fed economists, but experts think the Fed would want to see a strong June jobs report, a British vote to remain in the EU, solid data out of China, and stable financial markets.^{vii}

It seems more likely that the Fed will push rate increases out to September or December despite Fed Chair Janet Yellen’s hawkish statements. With a contentious presidential election in November, it doesn’t seem likely that the Fed will rock the boat until the votes are tallied.

In a Q&A session, Yellen cited Britain’s upcoming referendum vote on EU membership as a factor in the decision to hold pat on interest rates. She believes that a Brexit is a decision that would have consequences for the U.S. financial and economic outlook.^{viii}

After the shocking murder of a British member of Parliament, Brexit polls have swung closer to a “Remain” vote.^{ix} However, the vote is still too close to call and politicking will continue until the votes are counted. Uncertainty around Britain’s possible exit will likely keep markets on edge, and investors should expect continued volatility as we approach the end of the quarter. We’ll keep you informed.

ECONOMIC CALENDAR:

Monday: International Trade in Goods, Dallas Fed Manufacturing Survey

Tuesday: GDP, S&P Case-Shiller HPI, Consumer Confidence

Wednesday: Personal Income and Outlays, **Janet Yellen Speaks 9:30 AM ET**, Pending Home Sales Index, EIA Petroleum Status Report

Thursday: Jobless Claims, Chicago PMI

Friday: Motor Vehicle Sales, PMI Manufacturing Index, ISM Manufacturing Index, Construction Spending

Data as of 6/17/2016	1-Week	Since 1/1/16	1-Year	5-Year	10-Year
Standard & Poor's 500	-1.19%	1.33%	-1.39%	12.58%	6.55%
DOW	-1.06%	1.44%	-1.45%	9.45%	6.05%
NASDAQ	-1.92%	-4.14%	-5.22%	16.69%	12.54%
U.S. Corporate Bond Index	-0.12%	6.32%	6.39%	5.48%	7.83%
International	-2.78%	-7.05%	-14.25%	-0.63%	-0.84%
Data as of 6/17/2016	1 mo.	6 mo.	1 yr.	5 yr.	10 yr.
Treasury Yields (CMT)	0.22%	0.37%	0.51%	1.13%	1.62%

Notes: All index returns exclude reinvested dividends, and the 5-year and 10-year returns are annualized. Sources: Yahoo! Finance, S&P Dow Jones Indices, and Treasury.gov. International performance is represented by the MSCI EAFE Index. Corporate bond performance is represented by the SPUSCIG. Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly.

HEADLINES:

Retail sales beat forecasts. Stronger-than-expected May retail sales numbers point to renewed demand for automobiles and other goods. Core retail sales, which correspond best with the economic component consumer spending, rose 0.4% after growing 1.0% in April.^x

Industrial production falls in May. Industrial output fell more than expected on declines in utilities and manufacturing output.^{xi}

Business increase slightly. Stockpiles for U.S. businesses edged upward in April, indicating that businesses expect higher demand this summer.^{xii}

Housing starts fall. Groundbreaking on new houses fell in May as construction on multi-family units dropped. However, permits for future construction grew, indicating that the housing sector is still active.^{xiii}

QUOTE OF THE WEEK



"My father told me to find something you enjoy doing... If you enjoy your work, then it is not work."

– Martin Sorrell

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Diversification does not guarantee profit nor is it guaranteed to protect assets.

The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.

The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ. The DJIA was invented by Charles Dow back in 1896.

The Nasdaq Composite is an index of the common stocks and similar securities listed on the NASDAQ stock market and is considered a broad indicator of the performance of stocks of technology companies and growth companies.

The MSCI EAFE Index was created by Morgan Stanley Capital International (MSCI) that serves as a benchmark of the performance in major international equity markets as represented by 21 major MSCI indexes from Europe, Australia and Southeast Asia.

The Dow Jones Corporate Bond Index is a 96-bond index designed to represent the market performance, on a total-return basis, of investment-grade bonds issued by leading U.S. companies. Bonds are equally weighted by maturity cell, industry sector, and the overall index.

The S&P/Case-Shiller Home Price Indices are the leading measures of U.S. residential real estate prices, tracking changes in the value of residential real estate. The index is made up of measures of real estate prices in 20 cities and weighted to produce the index.

The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.

Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.

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ⁱ <http://www.cnbc.com/2016/06/17/us-markets.html>

ⁱⁱ <http://finance.yahoo.com/q/hp?s=%5EGSPC&a=05&b=13&c=2016&d=05&e=17&f=2016&g=d>

<http://finance.yahoo.com/q/hp?a=05&b=13&c=2016&d=05&e=17&f=2016&g=d&s=%5EDJI%2C+&ql=1>

<http://finance.yahoo.com/q/hp?a=05&b=13&c=2016&d=05&e=17&f=2016&g=d&s=%5EIXIC%2C+&ql=1>

<https://www.msci.com/end-of-day-data-search>

ⁱⁱⁱ <http://blogs.wsj.com/economics/2016/06/15/fed-interest-rate-decision-and-janet-yellens-press-conference-live-updates/>

^{iv} <http://blogs.wsj.com/economics/2016/06/15/parsing-the-fed-how-the-june-statement-changed-from-april-2/>

^v <http://blogs.wsj.com/economics/2016/06/15/economists-react-to-the-fed-decision-too-many-uncertainties/>

^{vi} <http://www.cnbc.com/2016/06/15/july-rate-hike-is-still-alive-but-faces-high-hurdles-strategist.html>

<http://www.cmegroup.com/trading/interest-rates/countdown-to-fomc.html>

^{vii} <http://www.cnbc.com/2016/06/15/july-rate-hike-is-still-alive-but-faces-high-hurdles-strategist.html>

^{viii} <http://blogs.wsj.com/economics/2016/06/15/fed-interest-rate-decision-and-janet-yellens-press-conference-live-updates/>

^{ix} <http://www.usatoday.com/story/news/world/2016/06/19/brexit-polls-show-swing-remain-campaigning-resumes/86110136/>

^x <http://www.foxbusiness.com/markets/2016/06/14/may-retail-sales-beat-expectations-point-to-strong-demand.html>

^{xi} <http://www.cnbc.com/2016/06/15/us-industrial-production-may-2016.html>

^{xii} <http://www.foxnews.com/us/2016/06/14/us-business-inventories-edged-up-in-april.html>

^{xiii} <http://www.foxbusiness.com/markets/2016/06/17/may-building-permits-rise-housing-starts-fall.html>