Equity & Fixed Income Outlook July 2015

Federal Reserve Monetary Policy

At the next Federal Reserve meeting on July 29, we expect the Fed to leave rates unchanged between zero and 0.25%. There is a lot of speculation about when the Fed will raise short-term interest rates, but we still do not anticipate any movement in the near future.

Inflation

The year-over-year consumer price index (CPI) released in June was zero percent. The CPI excluding food and energy costs remained at 1.8%. The decline in energy prices significantly reduced the overall CPI rate and will likely continue to have an effect moving forward as lower energy costs for manufacturers could provide an opportunity to compete with lower product prices.

Economic Activity

Some economists are pointing toward the 5.5% unemployment rate as proof that the U.S. economy is reaching full employment. There is something wrong with this methodology, because our labor force participation rate is only 62.9% – nearly a 35-year low. The Organization for Economic Cooperation & Development (OECD) reported Greek labor force participation rate at 68.3% at the end of 2013, more than 5% above the rate in the U.S. In addition, Greek unemployment is 25.6%, meaning a total of 93.9% of the Greek labor force is either working or willing to work. In the U.S., only 68.4% of the workforce is either working or willing to work (the OECD quit reporting Greek labor force participation at the end of 2013).

As long as we are comparing the U.S. to Greece, the Federal debt per capita in the U.S. is $57,000. Greece's debt per capita is much lower at $34,500. Why does Greece have so many budget problems that the U.S. does not appear to have? The answer is the U.S. can still print its own money … for now.

Average hourly earnings are up 2.3%. This change is in the right direction, but it does not give workers much room to increase spending.

Economic growth is moving forward at about 2.5%. Many other countries don't have the benefit of growth at this time. The strong dollar may put more pressure on U.S. exports, which could put some downward pressure on this growth figure in the form of reduced exports.

Fixed Income

Interest rates have established a new range, with the 10-year U.S. Treasury bond trading between 2.25% and 2.50%. The primary concern is the prospect of an increase in the Fed funds rate, but news about Greece and Puerto Rico is creating more volatility than normal.

Many investors are afraid of fixed income allocations in portfolios, because interest rates are so low, and the value of bonds falls when interest rates increase. On the other hand, in a rising rate environment, market value movement in bond prices is more predictable and controllable than stock market price movement.

Stock Market

Equity markets look like they are getting tired. Near the end of June the S&P 500 was up 3.1% for the year. The P/E ratio was 18.59, above the long-term average of 16.

Sales per share are down 3% from the same period last year, and earnings before interest and taxes are down 15% over the same time period. Sure, the decline in oil prices contributed to some of the decline, but not all of it. At some point, this should be a concern for the market.

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