KFG: Keyword for the remainder of 2015? Uncertainty.
August 2015

"Six years into the recovery, the U.S. economy remains in a rut. Growth has failed to achieve much more than a 2% pace since the recession ended in June 2009. Each time the economy revs up, it is upended by a significant slowdown. The latest GDP figures highlighted several areas of concern. Business investment spending and research and development spending fell last quarter to their lowest levels in six years. Exports have also fallen for the first six months of this year."

That statement from the Wall Street Journal illustrates our economy's ongoing uphill battle to increase economic growth. While there are numerous factors that contribute to economic growth, worldwide current events can easily hinder it. Right now, it is uncertain how the remainder of 2015 plays out with regards to China, federal interest rate policy, and U.S. financial markets.

U.S. ECONOMY:

The U.S. economy continues on a path of tepid growth with mixed signals. A perfect example is the jobs market: you can spin the numbers any way you like. In July, the number of Americans filing for unemployment benefits fell to a 42-year low. Also reported, was a reduction in the unemployment rate to a 7-year low of 5.3%. That rate fell because so many more people stopped looking for work than found jobs. The proportion of Americans working or looking for work fell to a 38-year low. Consequently, retail sales and consumer spending varied dramatically over the last three months.

The brightest spot of the economy seems to be a continued surge in new home sales reaching the highest levels since 2007. Much of this is due to first time buyers who are now entering the housing market.

The great debate continues on whether the Federal Reserve is going to raise interest rates during the second half of this year, but comments and press releases have made this probable event almost a certainty.

MARKETS:

The wild ride on Wall Street will most likely persist throughout the remainder of this year. Investors should expect more turbulence with stocks because of the ongoing issues and uncertainty with events in China, current valuations of U.S. stocks and bonds, and the ongoing debate with the Federal Reserve on interest rate policies.

Corporate earnings have been fair, while stock and bond prices remain near or at full valuation levels. Head winds for stock performance between now and the end of this year are provided by the strength of our dollar and the collapse of worldwide commodity prices, particularly that of oil and gas.

Only six stocks out of the NASDAQ composite have been driving that index upward this calendar year, while 27 of the 30 stocks that comprise of the Dow index are in negative territory year to date. While the stock market is not in "bubble" territory, it is certainly overdue for a routine correction - which is defined as a drop in stock prices of 10% or more.

CHINA:

For the second half of the 20th century and into the beginning of the 21st century, the U.S. has been the world's premiere economy. When Americans spend less, the whole world slows down. In the last decade, however the Chinese has accounted for a third of the world's economic growth compared to only 17% coming from the U.S.

In the immediate future, the key to continued global growth appears to be in Beijing's hands. The problem is that China's economic rise over the last decade has been fueled by an unsustainable and massive stimulus campaign orchestrated by the Chinese government. This stimulus has manifested itself in the form of a huge real estate bubble, unprecedented demand for commodities, and most recently a stock market bubble.

China's stock market over the last two months experienced a massive sell off and their economy is clearly progressing at a much slower economic pace than the Chinese policy makers have planned.

Here's why China matters to the U.S.: China is such a big part of the global economy that any slowing in its growth rate or signs of instability in its markets affects everything. China buys a lot of products and materials from U.S. companies, therefore when its economy declines so do the profits of many U.S. firms. The recent devaluation of the Chinese currency (yuan) can make China's exports more attractive to us, but U.S. exports expensive to them.

Despite the panicked efforts of the Chinese government to re-stimulate economic growth and stabilize their financial markets, it is becoming increasingly clear that China's economy is heading for a downturn.

This leaves open the possibility, although not immediate, that these events could trigger another global recession. How the recent slowdown in the recent Chinese economy affects U.S. companies and U.S. markets is a complicated question and the answers remain unclear.

CONCLUSION:

The Fed will continue to debate when to gradually raise interest rates based on recent events here and in China. As our economy continues on a path of uneven growth, we can continue to expect volatility on Wall Street for the remainder of this year.

From all of us at Kapusta Financial Group, we want to thank you for the trust you continue to place in our team.

110 Fort Couch Rd., Suite 108, Pittsburgh, PA 15241
Tel: 412.851.1400 | Fax: 412.851.1403 | Email: kfg@kapustafinancial.com