ECONOMY: World Economies Diverge

While the U.S. economy continues to strengthen, Europe’s recovery is faltering leading to divergent expectations and contrasting monetary policies.

Q2 GDP Revised Upwards
Q2 GDP growth was revised up from 3.9% to 4.2%. The revision showed a significant pick up in business investment which should provide additional momentum for the U.S. economy.

Consumer Confidence Surveys Strengthen
Consumer confidence gained more ground. The Conference Board’s Consumer Confidence Index increased from 90.3 to 92.4, a new post-recession peak. Bloomberg’s weekly Consumer Comfort index increased to a five-week high. The final Michigan Consumer Confidence Index reading rebounded from the initially weak preliminary report, up from 79.2 to 82.5.

Housing on the Mend
Housing and sales data recovered from their softer tones earlier in the year. Pending home sales rose 3.3% in July over the prior month. New home sales dropped 2.4%; however, when combined with existing sales, annualized sales totaled 5.56 million, the best since October.

Jobs & Rates
The debate continues over how and when to raise interest rates. Some Fed members believe that the falling unemployment rate is an indication of shrinking slack in the labor market and compelling evidence that the Fed needs to transition to interest rate hikes in early 2015.

Reports on Business
According to the Institute for Supply Management (ISM), economic activity in the manufacturing sector expanded for the 15th consecutive month in August. Comments continued to reflect a positive outlook mixed with caution from geopolitical unrest. The non-manufacturing sector grew in August for the 55th consecutive month. Respondents indicated continued optimism in regards to business conditions, but noted that the strong rate of growth may be difficult to maintain.

Looking to Hire...
The number of U.S. job openings remained near the highest level in 13 years in July, and companies also stepped up hiring that month to the fastest pace in nearly seven years, two signs the labor market continues to heal. Job openings have soared 22 percent in the past 12 months, evidence that employers are confident enough in the economy to boost staffing.

...and Pay More
The 12-month growth rate in average hourly earnings of production and nonsupervisory workers—who make up 80% of the total U.S. labor force—has climbed from a cycle low of 1.3% in October 2012 to 2.3% as of June. The historical record suggests that the wage growth rate will rise to 3.25%–3.50% by the end of next ear.

Weak Europe Contrasts Strong U.S.
The European Monetary Union’s recovery is faltering. Second-quarter GDP contracted in Germany and Italy, while the French economy is stagnant. Prices are falling in Spain at the worst pace since 2009, and the ten-year German bond yield is below 1%. The euro has also plunged to nearly 1.31 to the U.S. dollar, a 13-month low and the key to continuing growth.

What Next?
ECB President Mario Draghi recently expressed confidence in the central banks current policy, but said the ECB “stands ready to adjust its policy stance,” showing a willingness to use “other options.” Those options may include even easier terms on its new lending scheme or bond purchases similar to the Fed’s quantitative easing.
Ongoing Recovery Bullish for U.S. Markets
Stocks recorded solid gains in August as investors focused on stronger than expected U.S. economic data rather than geopolitical concerns abroad. The strong gains helped push the Standard & Poor’s 500 Index over 2,000 for the first time.

Mixed Results Abroad
Developed European markets were mixed in August following steep losses in July. Switzerland, Italy, and France generated relatively strong gains while Germany and Sweden declined. Eurozone deflationary pressures continued to hamper the region’s recovery, and the European Central Bank indicated that it would take stronger measures to promote economic growth.

Emerging Markets Continue to Recover
Emerging markets have continued to move higher, with the exception of Russia and Brazil. The MSCI Emerging Markets Index rose to its highest level in three years on August 27 but pared some of its gain by month-end. August marked the seventh straight month of gains for the index, its longest stretch of monthly gains since 2005. Elections and fiscal and monetary policies have been generally favorable, and the strengthening U.S. economy could boost demand from emerging markets.
**FIXED INCOME: Global Yields Fall**

**EUROPEAN SOVEREIGNS & NEGATIVE YIELDS**
Yields on safe-haven European government bonds fell to record lows as investors snapped up the debt amid heightened geopolitical risks in Ukraine and the Middle East. The yield on 10-year German government bonds reached a record-low 0.88%, and two-year German sovereigns had a negative yield near the end of the month. This means investors were paying to lend the country money.

**U.S TREASURY YIELDS FALL**
The ultra-low yields on European government debt made U.S. Treasuries look attractive in comparison, generating demand for intermediate- and long-term Treasuries and driving their yields lower. The yields on 10- and 30-year Treasury debt reached their lowest levels in more than 12 months. The Treasury yield curve flattened as a result, with short-term rates currently anchored by Fed policy.

**MUNI’S DRIVEN BY SUPPLY & DEMAND**
Municipal bonds enjoyed ongoing solid demand and minimal new supply. Puerto Rico’s electric utility reached a deal with its major creditors to delay repayment of almost $700 million in bank loans until March 2015, giving the utility extra time to address its low cash levels. Detroit, another major municipal debt issuer with significant financial problems, took a step toward exiting bankruptcy when a judge approved $1.8 billion of new debt issuance from the city’s water and sewer department.
HEDGE FUNDS GAINS MODEST
Overall, hedge fund performance continues to trail traditional long only equity strategies, and many sectors of the fixed income markets year to date. The HFRX Event Driven Index posted a gain of 1.3% for August, while the HFRX Distressed Index leads all strategies for the year with a gain of 5.2%. HFRX Macro Index posted a gain of 1.2% for August, its largest gain in over 2 years, with positive contributions from both quantitative, systematic trend-following strategies, as well as macro discretionary strategies. HFRX Macro Systematic Diversified Index (managed futures) posted a gained 1.6% with gains across equity, currency and fixed income exposures.

SUPPLY & GLOBAL GROWTH CONCERNS IMPACT COMMODITIES
Commodities fell to a five-year low in August on speculation that abundant supplies and slowing economic growth outside of the U.S. will curb demand for raw materials. The Bloomberg Commodity Index declined to the lowest level since July 2009, while oil traded at the cheapest levels since 2012. Agricultural commodities such as wheat, corn and soybeans retreated to four-year lows, while gold slumped to a seven-month low.

REITS HOLD UP AS MLPs SOAR
Despite valuation concerns, REITS moved higher in August due to strong U.S. economic data and falling interest rates. Within the MLP sector, Kinder Morgan announced plans to consolidate several partnerships in a bid to become the largest energy infrastructure company and top dividend paying energy company in North America. This helped boost the entire sector and the Alerian MLP index generated an 8.2% return in August.