ECONOMY: US Momentum Continues

October continued the divergence of global economic performance and monetary policy. U.S. strength continues amidst global weakness.

Q3 GDP SUGGESTS CONTINUED MOMENTUM
A 3.5% estimate of Q3 GDP growth suggests that domestic economic momentum is continuing. This would put U.S. economic growth on its best pace since the second half of 2003.

QE ENDS, BUT DID IT WORK?
The Federal Reserve ended its historic monthly bond purchase program in late October. However, it maintained that interest rates will remain near zero for a considerable period of time. Historians and pundits will continue to debate the efficacy of the Fed’s Quantitative Easing (QE) programs. At this point, however, it is difficult to argue that they were not successful considering the state of the U.S. economy and financial markets. The future of interest rates and the Fed’s balance sheet will now be in focus.

REPORTS ON BUSINESS
According to the Institute for Supply Management (ISM), economic activity in the manufacturing sector expanded for the 17th consecutive month. Respondents cited positive business conditions, with growth in demand and production volumes. The non-manufacturing sector grew in October for the 57st consecutive month. Respondents noted favorable business conditions, but indicated the rate of growth may be leveling off.

CONSUMER CONFIDENCE REBOUNDS
The Conference Board Consumer Confidence Index®, which had declined in September, rebounded strongly in October and sits at a seven-year high. “A more favorable assessment of the current job market and business conditions contributed to the improvement in consumers’ view of the present situation. Looking ahead, consumers have regained confidence in the short-term outlook for the economy and labor market, and are more optimistic about their future earnings potential.”

MID TERM ELECTIONS
Republicans swept to a convincing victory in the mid-term elections, capturing control of the Senate and expanding their majority in the House of Representatives. According to research from Charles Schwab, the S&P 500 has generated a positive Q4 return 100% of the time during mid-term “lame duck” election years, with an average return of 10.5%.

SOME POSITIVE NEWS FROM EUROPE
The ECB’s quarterly bank lending survey showed looser lending standards and increased loan demand. The number of unemployed in Germany fell 22,000, the largest drop in six months. Spain’s GDP grew 0.5% quarter-over-quarter.

ECB “SHUTDOWN”? 
In mid-October, hearings began in the European Court of Justice against the ECB’s OMT program (QE). They came in the wake of a ruling from the German Constitutional Court that the 2012 program violates both the ECB’s mandate and a ban on funding governments.

QE IN JAPAN
The Bank of Japan (BOJ) stunned investors in October by increasing the pace at which it expands its base money to about 80 trillion yen per year, up from a previous target of 60-70 trillion yen. The BOJ will increase its purchases of government debt by about 30 trillion yen and extend the average duration to around 10 years. Lastly, the BOJ announced it decided to triple its purchases of exchange-traded funds and Japan REITs.

FALLING OIL PRICES: GOOD OR BAD?
Oil prices have plunged over the past five months. The latest world oil demand data from the U.S. Department of Energy shows demand is in line with the year ago level when Brent oil was around $110. This may be a sign that the recent price drop does not necessarily constitute a slowdown in the global economy. While lower costs benefit consumers, this comes at a cost to producers. Nearly 4% of global GDP is spent on oil, so falling prices may stimulate more economic activity.
GLOBAL EQUITIES: A Mid Month Recovery

A HISTORICAL PERSPECTIVE OF OCTOBER
October had traditionally been a very difficult month for equities. According to Standard & Poor’s, 25% of the worst trading days have historically occurred in October. October is a month with a tradition of large declines, including 1987 when equities fell 21.8% and in 2008 when they fell 16.9%.

A TALE OF TWO MONTHS
After a difficult September for U.S. equities, October looked to follow suit. From September 19th through October 15th the S&P 500 fell 9.8%, with many calling it a correction or start of another bear market. After this, however, investors focused on the strength of the U.S. corporate earnings. With 79% of the S&P reporting, 72% beat their estimates with top line sales growth coming in stronger than expected. The S&P 500 roared back the second half of the month, returning 7.5% from October 15th through October 31st and finishing up 2.4% for the month.

GLOBAL MARKETS STRUGGLE
Concerns over European, Japanese, and Chinese growth, lower oil prices, and the ongoing Ebola scare pushed global equities down for much of October. However, the strength of U.S. corporate earnings and an unexpected increase in the Bank of Japan’s stimulus program on the last day of the month, pushed many global markets upwards and stemmed what could have been a very bad month for global equities.

EMERGING OVER DEVELOPED
Emerging markets outperformed developed markets in October, posting a 1.2% gain for the month. Oil producing countries saw significant declines in October, with Nigeria falling 12.9%, UAE falling 11.5%, Egypt falling 6.9%, and Russia falling 2.1%. Thus far, 2014 has marked a wide range of returns in emerging markets, with India up 29.6% and Greece down 28.2% year to date.
QE “OFFICIALLY” OVER
October marked the end of the Federal Reserve’s (Fed) bond buying program, known as Quantitative Easing (QE). The program was effectively a 37 month $1.6 trillion experiment aimed at stimulating the U.S. economy. The Fed has assured investors that short term interest rates would remain low for some time.

THE U.S. TREASURY MARKET
After plunging in mid-October, U.S. Treasury yields have rebounded as investors have gradually increased risk allocations. Long-term Treasury yields still remain near their 2014 lows, however. At 2.33%, the 10-year Treasury bond is still well below its 2013 close of 3.03%. Short- and intermediate-term Treasury yields have seen more pronounced moves, based on a less dovish position from the recent FOMC meeting. The FOMC’s October statement pointed to further improvement in the labor market, and downplayed the recent lower trend in inflation.

OIL & HIGH YIELD
While the sell-off in the high-yield bond market has a number of causes, such as rich valuations and declining investor interest, the recent drop in oil prices may have played a role as well. Oil prices can have a broad impact on the high-yield bond market because energy corporations have become an increasing share of the high-yield bond market. Today, energy companies make up more than 15% of the Barclays U.S. Corporate High-Yield Bond Index, up from less than 5% in 2005.
**EVENT DRIVEN FALLS HARD**

Overall, hedge funds posted negative returns for October amidst increased volatility. Both the HFRX Global Macro and CTA (managed futures) categories posted positive returns from trends in the currency, commodity and fixed income markets. The HFRX Event Driven Index fell 5% due to concentrated positions in Shire, American Realty, and Fannie Mae. Event Driven strategies seek to exploit pricing inefficiencies that occur just prior or after a corporate event (i.e., a merger, spinoff, or bankruptcy). In the “event” they are positioned incorrectly, losses can often be exacerbated.

**MLP SELL-OFF IN OCTOBER**

The Alerian MLP Index fell 4.6% in October, likely as investors sold the energy infrastructure complex amidst falling oil prices. MLP’s are generally less sensitive to commodity price fluctuations, as they tend to operate on a fee basis. However, a sustained move lower in commodity prices, primarily oil and natural gas, could adversely impact the MLP space due to lower volumes, capacity over-supply, and/or the risk of re-contracting at lower rates.