CORRIGAN FINANCIAL, INC.

Market Update: 3rd Quarter (2015)

On a global basis, stocks declined by more than 9% during the third quarter. It was the worst quarterly loss in four years. Stocks are now down 7% for the first nine months of 2015. Bonds saw modest gains for the quarter, as the 10-year U.S. treasury ended September yielding 2.061%, down from 2.335% at the end of June. Inflation expectations have plunged to 5-year lows and have now been below the Fed's 2% target for 40 consecutive months.

What is everyone concerned about?

- China's economy is slowing down and is on track to grow at its slowest rate in six years.
- The decline of China, the world's biggest importer of raw materials, has squashed commodity prices.
- U.S. corporate earnings are on the decline, with third quarter profits projected to fall somewhere between 3 – 5%.
- There is considerable uncertainty surrounding the Fed, and when they will start raising interest rates.
- Geopolitical concerns, such as the recent developments in Syria, are on the rise.
- Stock valuations are at elevated levels, and profit margins are already at record highs.
- The stronger dollar will be a headwind against the profitability of U.S. companies.
- Global debt continues its unabated rise.

Is there any good news?

- Asset prices are inflated, but not in "bubble" territory.
- Stocks have already retreated 12% from their highs.
- The U.S. economy continues to grow … albeit at a slow, consistent pace.
- The U.S. banking system is strong after being "recapitalized" on the backs of savers.
- U.S. banks have massive liquidity available on deposit at the Fed.
- Consumers are in better financial shape, as household debt-service levels have declined significantly since the great recession.
- Monetary policy remains accommodative in the U.S. and highly stimulative in Europe, China and Japan.
- The plunge in commodity prices should be a net benefit to the overall global economy.

- While the China slowdown has hit U.S. manufacturing, that sector only represents 12% of the U.S. economy. (The services side represents the remaining 88 percent.)
- The Eurozone remains in expansion.
- Global growth remains relatively stable despite the recessions in commodity-driven economies and the volatility in markets.

Let's face it, there is a lot going on. At this point, the negatives seem to be overwhelming the positives. The International Monetary Fund acknowledges that we are in difficult and complex times. The IMF is generally concerned about global affairs and troubling signs in international finances. They project global growth to be weaker this year, with only modest acceleration in 2016.

> **The *new mediocre* of which I warned exactly a year ago – the risk of low growth for a long time – looms closer.**
>
> **Christine Lagarde, Managing Director IMF – 9/30/15 WSJ**

Why are emerging markets in sharp decline?

Emerging markets were down by nearly 20% for the quarter, with investors pulling out $40 billion from developing economies – the fastest pace since the global financial crisis.

> **The reaction we're seeing is quite severe, but a lot of the damage has already probably taken place. It's the trifecta of slowing investment growth, declining commodity prices and a strong dollar.**
>
> **Brendan Ahern, Krane Fund Advisor – WSJ 9/29/15**

Near-zero interest rates have supported huge investments in the *riskier* assets of emerging markets, and that flow of capital is reversing. The Institute for International Finance expects more than $500 billion of net asset outflows from developing countries during 2015. **This would be the first year in nearly 3 decades that more money has left emerging markets than has entered them.**

Debt accumulation in developing economies has been staggering. The Bank of International Settlements (BIS) warns of a looming banking crisis as a result of this credit growth. China has a ratio of private sector debt to GDP of 25% … with Turkey and Brazil at 17% and 16%, respectively. According to the BIS, a country with a ratio above 10% has a two-thirds chance of "serious banking strains" occurring within three years.

Much of this debt was borrowed in dollars, making the debt service more expensive as local currencies depreciate against the dollar.

Commodity-driven declines in the BARC (Brazil, Australia, Russia, and Canada) economies are substantially impacting global stock markets.

> **Fortunately, the BARC is worse than their bite. The loss for the BARC countries is typically a gain for many other countries. Unlike financial contagion that has a negative impact across countries, the offsetting impact of the plunge in commodity prices on different economies limits the ability to take a bite out of global economic growth.**
>
> **Liz Ann Sonders, Charles Schwab – 9/25/15**

In any event, investors should take note: Emerging market valuations, after 5 years of underperformance, are at their cheapest relative measure in 12+ years.

The Fed *blinked* in September and did not raise interest rates. This fueled more uncertainty and raised concerns that the global economy may be in worse shape than previously believed. I believe the Fed needs to remove this uncertainty and raise rates. The training wheels need to come off, and the journey to *normalize* the economy has to start sooner rather than later.

> **If the medicine doesn't work, don't keep doubling the dose.**
>
> **Dr. David Kelly, JP Morgan – CNBC 9/2/15**

A government shutdown was just averted. Congress passed a stopgap bill just hours before the deadline. This solution is temporary and only funds the government through December 11. Before that date, Congress must replenish federal highway funding and raise the debt limit.

As I am writing this market update, the September jobs report was released (Friday October 2). The topline number for job creation was a big disappointment … a real surprise. This appears to be the economic equivalent of a punch to the gut. The Dow Industrials reacted by dropping 200 points at the open, but reversed course and finished the day up 200 points. ***Bad news* continues to be *good news* … go figure.**

Investors are now speculating that the Fed will further postpone interest rate hikes. As Yogi Berra once said: "It feels like déjà vu all over again."

If we only had a crystal ball …

But we don't, so we need to adhere to policy, diversification and discipline. Volatility will probably be with us for at least the immediate future. Hang in there, and continue to stay focused on the things that you can control.

Daniel G. Corrigan, CPA/PFS, CFP®