MARKET
NOTES

Week of August 28, 2017

Markets Grind Higher as Yellen Leaves Investors Wondering

U.S. economic data was mixed last week. While initial jobless claims were better than expected, new home sales disappointed and existing home sales fell to their lowest level of 2017 thus far. Overseas, both Germany and France reported better-than-expected economic survey data.

All week, investors waited to see if a speech from Federal Reserve Chairwoman Janet Yellen on Friday would provide clues about the Fed's upcoming monetary policy decisions—such as if the Fed was likely to raise interest rates again this year. Chairwoman Yellen's speech offered no such insights, however, focusing instead on the financial regulations implemented after the 2008 financial crisis.

The U.S. equity market was up modestly for the week. Biotechnology stocks performed well as several biotech firms reported positive clinical results. Energy companies also outperformed on strengthening energy prices driven by falling crude oil inventories. In contrast, consumer staples stocks underperformed due to weak earnings results from several companies in the sector. Shares of homebuilders also struggled on disappointing earnings.

Internationally, emerging markets continued their recent outperformance due to their prospects for relatively strong growth. Japan lagged other developed international markets, as investors favored economies with better growth prospects.

In the fixed-income markets, investors favored riskier sectors of the bond markets—such as emerging markets and high-yield bonds. In that "risk-on" environment, more defensive sectors such as short-term Treasury bonds and inflation-protected securities underperformed.

GAIN: Active Asset Allocation

Global stocks posted gains last week, led once again by international equity markets—especially emerging markets, which benefited from their attractive growth prospects relative to developed markets.

We continue to maintain a significant allocation to international stocks in the portfolios, despite the possibility that political and geopolitical risks could emerge unexpectedly. Our direct exposure to emerging markets has been beneficial. However, our small-cap holdings have lagged other asset classes for most of 2017. Despite a positive week for small-caps last week, they have dragged on performance overall.

In the bond market, corporate credits rebounded nicely as concerns over some geopolitical issues waned. We remain overweight in corporate securities.

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PROTECT: Risk Assist

After spiking briefly the previous week, market volatility last week fell back closer to the low levels we've seen for some time now. Market volume was low as investors spent much of the week "on pause" waiting to hear what the Fed's Janet Yellen would say during her speech at a key meeting of global central bankers in Jackson Hole, Wyoming.

Market indicators such as the CBOE Volatility Index (VIX) suggest continued subdued volatility for the next few months, and nothing in our volatility forecasts conflicts with that outlook.

SPEND: Real Spend

The one-year spread between global stock returns and bond returns has recently tightened in the wake of stock market volatility. That said, the gap remains large—around 15%, in favor of stocks

Last week, the top-performing investments in the Real Spend portfolios included fixed income, international stocks and dividend stocks. In contrast, small-caps, mid-cap and growth stocks underperformed. Meanwhile, inflation expectations were flat for the week.