INVESTMENT UPDATE
NEWSLETTER

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Third Quarter Review: Volatility Makes a Comeback

Asset prices fell across the board in the Third Quarter, bringing a level of volatility all the more jarring because of the market calm that had prevailed for nearly four years prior. What's more, correlations jumped as prices dropped – assets that don't typically move in step with each other synchronized to the downside – so that for stock investors in particular there didn't seem to be anywhere to shelter from the squall. Yet just a squall it remained: At deepest cut, the S&P 500 had given up about 12% of its value from the highs reached earlier this year, which qualifies the tumult as a garden variety correction, but certainly not a bear market.

With no further ado, here is the round-up by asset class:

All major stock indices were negative on the quarter, with a loss of -6.4% for the S&P 500, -11.9% for the small cap Russell 2000, -10.2% for MSCI EAFE foreign developed market stocks, and -17.9% for the MSCI Emerging Markets equity index. Looking within the S&P 500, larger companies outperformed smaller ones, and "growth" beat "value" such that stocks with little or no dividend yield outstripped those with modest to high dividend yields; this latter dynamic is consistent with this being a garden variety stock market shakeout rather than a bull-market-ending cataclysm. Though some foreign markets hit bear market levels in US dollar terms, the only S&P 500 sector to suffer that kind of punishment has been energy, hammered by oil's drop from over $100/barrel last year to under $50/barrel today.

Bonds were a mixed bag, with the Barclays US Aggregate index turning around a slight First Half loss to close up 1.2%, investment grade US bonds rising 0.8%, high yield U.S. bonds losing -4.9%, and foreign bond performance varying by currency, with emerging markets bonds especially getting creamed by US dollar strength. Municipal bonds held up nicely, clocking a 1.7% return for the quarter. Interest rates brushed lower to end with the 10-year Treasury yield near 2%, and short rates stayed pinned near zero as the Fed refrained from taking new policy action.

The commodities market continued its years-long slide, with the Bloomberg Commodity Index losing -14.5%. Our exposure in this area is mainly in the precious metals sector, which turned in second-best performance for the asset class (slipping -5.6%) and was only just edged out by a -5.4% drop in the livestock sector. "Lean Hogs" delivered the sole positive performance out of 21 sub-sectors in the commodities complex; a triumph, at least, for those with a fondness for oxymoron.

Heading into the home stretch for 2015: The Fourth Quarter has seen risk assets turn on a dime and start chugging back upward again, for the moment at least. For that to continue, we'll need to see corporate earnings reports that show profit margins staying wide – near all-time highs, indeed – or sales growth finding firm footing. The overseas picture will play an important role too, as slowing in China especially has stepped down a major source of global vitality. And many eyes will be on the US Federal Reserve as it deliberates whether to finally start lifting rates off the deck. For our part, we don't expect a relentless ascendancy in rates; when this Fed moves, it will move slow.