Q3

July - Sept 2015

QUARTERLY ECONOMIC NEWS

GDP (lagging indicator)

Q2, 2015 (Third Estimate)

Expands by a rate of 3.9% due to higher consumer and construction spending.

EXISTING HOME SALES

Thru August 2015

Down 4.8%: due to tight inventory levels deterring buyers.

UNEMPLOYMENT RATE

Thru September 2015

Declined to 5.1% (seasonally adjusted)..

CONSUMER PRICE INDEX

August 2015

Declines 0.1% (seasonally adjusted)

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Economic News

Commonly used economic indicators told an inconsistent story throughout the third quarter of 2015. National unemployment continued its positive trend on the year. Unemployment remained at 5.3 % in July and subsequently fell to 5.1% in August, where it would remain through September. Nonfarm payroll employment increased from 141,870 in July, 142,220 in August, to 142,371 in September.

Meanwhile, the major stock indices reflected a quarter of market volatility. The Dow Jones Industrial Average declined 8% (1354 points) in Q3, after starting at 17,638 and ending at 16,284. The S&P 500 told a similar story, as it declined 7% (147 points) over the same period, starting at 2067 and ending at 1920. The Russell 2000 Index fell during the third quarter, dropping 162 points (13%) over the period. The NASDAQ fell 409 points (8%) and the NYSE Composite fell 1091 points (10%) over the same period.

The Federal Reserve once again avoided a highly-anticipated rate increase in the third quarter, perhaps showing its ambivalence regarding the direction of the economy. The Federal funds effective rate started the quarter at 0.13%, and dropped to 0.07% by quarter end.

Interestingly, the Bureau of Labor Statistics reported a drop in the Consumer Price Index of 0.1% in August following an increase of 0.1% in July. September numbers were not available at the time of writing, however data shows a 0.2% increase in the unadjusted 12-month period ending in August 2015. The August drop is being largely attributed to the month's sharp decline in the gasoline index.

According to Freddie Mac, the Monthly average commitment rate on 30-year fixed-rate mortgages dropped slightly each month in Q3. After starting the quarter off at 4.05% in July, it dropped to 3.91% in August, and ultimately ended the quarter at 3.89% in September.

Index	1st Qtr	1 Year	5 Year	10 Year
Barclays U.S. Aggregate Index	1.23%	2.94%	3.10%	4.64%
MSCI AC World Ex US Net Total Return	-12.17%	-12.16%	1.82%	3.03%
Russell 2000 Total Return	-11.92%	1.25%	11.73%	6.55%
S&P 500 Composite Total Return	-6.44%	-0.61%	13.34%	6.80%

The Diesel Dupe

In September, Volkswagen ("VW") was stung by the US Environmental Protection Agency (EPA) for using software to fool regulators and pass emissions tests for 11 million of their diesel vehicles. VW activated the software that was embedded into the cars only when they

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“To be an investor you must be a believer in a better tomorrow.”

Benjamin Graham

were being tested for emissions. According to the EPA, these diesel vehicles were emitting nitrogen oxides at up to 40 times the standard amount allowed by regulations.

The repercussions of this scandal are not to be underestimated: days after the news broke CEO Martin Winterkorn was replaced by former Porsche CEO Matthias Muller. VW is facing a maximum of $18 billion in civil fines in the US alone for alleged violations of the Clean Air Act on roughly 500k vehicles. VW has already set aside $7.3 billion to cover associated recall and retro-fitting costs. With gross revenue in the region of $200 billion, a net income of roughly $11 billion in 2014, and a cash reserve hovering around $25 billion, the potential penalties represent a significant setback.

Market values have plummeted through the end of September with overall market cap at $55 billion after a May 2015 value north of $125 billion. After gross revenues jumped 25% from 2011 to 2012, growth has leveled out to around 2.5%. As legal proceedings are imminent for VW, the impact to net income is yet to be seen. Beyond the immediate concern reflected in financial markets, permanent damage to a worldwide brand who also owns other major players, such as Audi and Porsche, stands to severely stress the long term outlook of VW.

Power of a Tweet

After multiple quarters of outperformance of the broader market indices, the healthcare sector finished the quarter down 11% vs a decline of 7% for the S&P 500. The sector slumped after Presidential candidate Hilary Clinton set out to social media, via twitter, proclaiming a new plan to curb prescription drug price gouging. Clinton’s tweet was sparked after Turing Pharmaceuticals, a company who bought the rights to a 62 year old drug called Daraprim that is used to treat a parasitic disease, raised the price overnight from $13.50 per pill to $750 per pill. The tweet and ensuing strategy by Clinton, sent jitters throughout the healthcare sector. It was especially felt within the Biotech sector which has soared since the bull market began in March, 2009. Since then, the Nasdaq Biotech ETF has climbed nearly 600%.

With such strong outperformance within the healthcare sector for the past few years, some argue that the sector, particularly Biotech, was due for a pullback. While the talk of controlling prescription drug costs is nothing new, Clinton’s recent tweet seemed to have returned the topic to Washington’s leader’s minds and acted as a catalyst to the selloff. Investors in the sector may be fretting that any price controls could put a cap on future earnings as many small firms, Biotech in particular, have been accused of raising drug prices to drive future earnings and revenue growth as well as aiding in offsetting any reduction in demand for key drugs. It remains to be seen whether or not any major changes to prescription drug pricing will be approved in Washington, and what kind of impact it could have on drug company’s bottom lines.

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