Economic Commentary

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As the end of the year approaches, the market still hangs on the Fed's every word. The Fed in turn is looking for global economic and financial stability. Let's take a look into how the markets reacted in the third calendar quarter to a post-Brexit environment.

Bond Market - Bond yields remain low; however, as anticipated there has been a "bounce back" in Treasury yields subsequent to the Brexit announcement that occurred late in the second quarter. While the largest fall in yields this year has been in the 7-10 year part of the curve, the 1-7 year portion of the curve experienced the greatest increase in yields in the third quarter. The three-month Treasury was little changed for the quarter, concluding only 1.5 basis points higher at 0.27%. The 10-year Treasury shifted up 12.5 basis points to end the quarter at 1.59%. The yield on the 30-year Treasury moved up only 3 basis points ending the third quarter at 2.32%.

FOMC- With the bounce back in Treasury yields and economic data improving, the market has begun pricing in expectations for rate increases from the Fed. The timing of the change is what remains in question. While neither of the two scheduled FOMC meetings in the third quarter resulted in a rate increase, two more meetings remain (early November and mid-December). At the time of this writing, implied probabilities indicate a 20% chance of a November hike and a 60% chance of a hike in December. The Fed is waiting for "further evidence of continued progress toward its objectives." While the wording on near-term risks has changed to "roughly balanced" the Fed will continue to "closely" monitor economic and financial developments and inflation indicators. With unemployment declining to a near-full employment level this year, one could assume inflation concerns are the only inhibitor to moving the needle. As of now, the anticipation is the Fed's short term borrowing rate will be increased for the first time this year in December.

Stock Market- Subsequent to the late second quarter Brexit impact on the domestic equity market, major market indices more than recovered some of which achieving new record levels. The S&P 500 Index gained 3.85% for the third quarter, closing about twenty points off its all-time high in mid-August. Similarly, the Dow Jones Index closed about 300 points off all-time highs to close the quarter at 18,308, or 2.78% higher than it began. The NASDAQ Index, which was more negatively impacted from the Brexit news, rebounded to a greater degree. The third quarter return was an impressive 10.02%, only 1% off its all-time highs just a week before quarter end.

Summary- I anticipate the Fed will raise its benchmark rate in the fourth quarter and we will see shorter term Treasury rates rise and the overall yield curve flatten more before year-end. With more volatility expected in the domestic equity market, I presume relatively flat performance is in store for the major equity indices for the remainder of the year.

US Treasury Yield Curve

	Tenor	09/30/16	06/30/16	09/30/16-06/30/16
11)	1M	0.183	0.168	1.5
12)	3M	0.274	0.259	1.5
13)	6M	0.432	0.350	8.1
14)	1Y	0.585	0.432	15.3
15)	2Y	0.762	0.582	18.0
16)	3Y	0.875	0.693	18.2
17)	5Y	1.149	1.000	15.0
18)	7Y	1.422	1.279	14.3
19)	10Y	1.594	1.470	12.5
20)	30Y	2.315	2.285	3.1

S&P 500 Index


SPX Index
95) Compare
96) Actions
97) Edit
Line Chart
06/30/2016 - 09/30/2016
Last Price
Mov Avg
No Lower Chart
USD
1D 3D 1M 6M YTD 1Y 5Y Max Daily
Table
Security/Study
Event
Last Price 2168.27
High on 08/15/16 2190.15
Average 2161.08
Low on 07/05/16 2088.55
2180
2168.27
2160
2140
2120
2100
2080
Jul 8
Jul 15
Jul 22
Jul 29
Aug 8
Aug 15
Aug 23
Aug 31
Sep 8
Sep 15
Sep 22
Sep 30
2016

Dow Jones Industrial Average

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