CEP FINANCIAL

INVESTMENT NEWSLETTER

CEP FINANCIAL, LLC September 30, 2015

September 30, 2015 Year-To-Date

The overall US Equity Markets have lost about 5% so far this year.

Large Cap Stocks - -5%
Mid Cap Stocks - -9%
Small Cap Stocks - -8%

Foreign Stocks

Developed Economies - -7%
Emerging Markets - -17%

Fixed income interest rates dropped again to historically low levels.

Short/term rates – +0.01%
Long Term rates - +2.1%

Commodities declined dramatically in the 3rd quarter, and are now down 19% for the year.

Real Estate recovered some of its losses but is still down 4% year-to-date.

The Investment Letter is mailed periodically to our clients and friends. This letter was prepared from material provided by Bob Veres , Morningstar, The Wall Street Journal, and other sources that we believe to be reliable).

2015 Third Quarter Report: That Growling Sound

Most investors are glad to finally see the end of the third quarter of 2015, and most of them will feel like their portfolios are worse off than they actually are. If you hear a growling sound, it's the sound of a bear market. (The bear isn't officially in the neighborhood just yet, but you can hear it.) It's also an end to that optimistic feeling that many people had been cautiously building during the long 6-year bull market.

Summary

The third quarter could be a temporary drawdown that sets the market up for a push back into positive territory by the end of the year, which would give us a record seven years of positive market performance. Or we could see the year end in negative territory, perhaps even giving us the first true bear market (defined as a drop of 20% from the peak) We don't know how the psychology of millions of investors will turn in the next few months, but then neither do the smart money analysts who thought that interest rates would be nudged upward by our central bank last month.

Silver Lining

Market declines are always followed by yet another bullish period that will eventually take us back into record territory, and the markets, almost always, punish anyone who tries to outguess their unpredictable short term behavior.

Meanwhile, perhaps we should celebrate the fact that we can buy many kinds of investments at cheaper prices than we could just three short months ago. It's not much, but it's something to feel good about.

Market Performance as of 9/30/2015

The past three months turned yearly gains into yearly losses almost completely across the board. The Russell 3000—a the broad measure of U.S. stocks—fell 7.2% in the third quarter of 2015, posting a total return of -5.4% in the first three quarters of the year.

The Russell 1000 Large Cap index dropped 6.8% of its value for the quarter, and is now down 5.2% for 2015. The widely-quoted S&P 500 index of large company stocks posted a loss of 6.4% in the third quarter, and is now down 5.3% for the year.

The Russell Mid-Cap index lost 8.0% for the quarter, and is now off 5.8% as we head into the fourth quarter.

Small company stocks, as measured by the Russell 2000 Small-Cap index, gave investors a 11.9% loss during the latest three months, which takes the index down 7.7% so far in 2015. The technology-heavy Nasdaq Composite Index lost 7.4% for the quarter, and stands at a 2.4% loss for the first three quarters of the year.

Meanwhile, in the global markets, the broad-based EAFE index of companies in developed foreign economies lost 10.8% in dollar terms in the third quarter of the year, for a negative 7.4% return so far this year. In aggregate, European stocks lost 9.1%, and are down 7.3% for the year. Emerging markets stocks of less developed countries, as represented by the EAFE EM index, were down a whopping 18.5% for the quarter, and are down 17.2% for the year.

Looking over the other investment categories, real estate investments, as measured by the S&P U.S. REIT index, gained 2.1% for the third quarter, but is still standing at a 4.1% loss for the year. Commodities, as measured by the S&P GSCI index, lost 19.3% in the third quarter, largely due to a fall in oil prices. They are down 19.5% this year.

There were many contributors to the loss of confidence in the stock market, and they appear to have been mainly psychological. Analysts blame the Federal Reserve Board for not having raised rates as the so-called "smart money" seems to have expected in September. Why are low rates a bad thing? Because Fed economists seem to believe that the economy has not recovered sufficiently to warrant stopping the central bank's long-running stimulus program. Who are we investors to argue with the Fed economists?

Except… The explanation for not raising rates had little to do with actual economic activity, which is finally moving ahead, as of the second quarter, at an annualized 3.9% growth rate for U.S. GDP. This is higher than the 3.7% estimate from the Bureau of Economic Analysis, and much higher than the 2% rate that the U.S. economy has experienced since 2009. At the same time, consumer income, wages and salaries, and spending are all increasing modestly, existing home sales are growing at a 6.2% rate over last year, and the unemployment rate, once higher than 10%, has finally dropped down to the 5% range.

The Fed explained that it was delaying its rate rise because the core inflation rate—currently 1.8%, is below the 2% target rate the Fed set back in June 2012. Some pundits are speculating that the real reason could be the slower growth of the Chinese economy, coupled with the recent unnerving drop in its stock market. Unfortunately, the commies (less than truthful when it comes to finance) control China's economic statistics, which makes it hard to know exactly how fast China is or isn't growing.

If you were thinking that interest rates could not get lower (as we were) you were wrong. For the time being, investors will have to continue to accept interest rates at historically low levels. 30-year Treasuries are yielding 2.9%, down from 3.1% a quarter ago, and 10-year Treasuries currently yield 2.1%, down from 2.4% in June.

At the low end, the yield on 3-month U.S. T-bills remains at 0.01%. 6-month bills are modestly more generous at 0.08%.

When you look at the decline year-to-date, you see relatively small losses. But many investors are remembering that they were 10% wealthier just a couple of months ago, measuring their pain from the high point of the various indices. It's tough to watch your portfolio go down, but it's also worth remembering that people have been predicting a significant downturn—erroneously—for the better part of six years. Now that the downturn has finally arrived, so far it hasn't been terribly painful for most of us.