IdahoTrust

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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

The Federal Reserve Bank's September meeting left investors very confused by the intension of the members and the direction of future interest rates. Market volatility and global economic weakness has contributed to the confusion. Corporate profit expectations have come down in recent months but several of the headwinds that have contributed to these declines may well subside going into the first half of next year.

The Fed's September Meeting

The Federal Reserve Bank (Fed) decided to leave interest rates unchanged at the September meeting, keeping its benchmark rate pegged at 0% to 0.25%. The statement explained that the Fed is now "monitoring developments abroad," and Fed Chair Janet Yellen pointed directly to the market and economic volatility in China as well as other emerging markets as risks.

The September meeting was highly anticipated as many market observers thought there was a good chance that this would be the first time in nine years that the Fed would raise interest rates. In August, China shocked world markets by deciding to devalue the yuan. Ever since the yuan devaluation, the September rate hike became more doubtful. The decision to maintain the current interest rate created more anxiety in the financial markets, rather than calm the nerves of those worried

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that economic activity was not strong enough to withstand a rate hike.

The most unusual part of the policy statement was that the Fed specifically highlighted the problems with "recent global economic and financial developments." Economic activity in China has been the source of much concern as a slowdown there has brought a sharp decline in commodity prices. The CRB Index, a broad measure of commodity prices, is near a 40-year low. The Fed is in charge of U.S. monetary policy, so many were confused as to why global volatility factored into their policy decisions.

Immediately following the meeting, the markets began to expect that a rate increase may not happen until early next year, perhaps as late as March of 2016. In yet another twist, several days later, Janet Yellen gave a speech and stated that "I anticipate that it will likely be appropriate to raise the target range for the federal funds rate sometime later this year." The Fed has confused many in recent weeks with communicating its intentions. However, Yellen was very clear that a rate increase is possible this year. The Fed has only two meetings left in 2015, one in October and another in December.

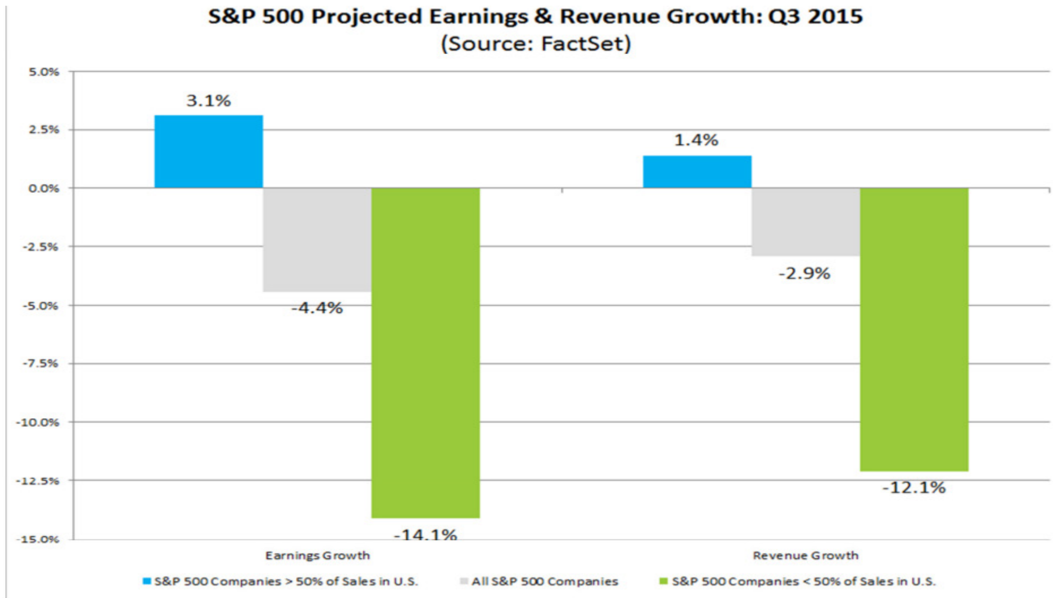
Corporate Profits

The slowdown in global economic activity has impacted corporate profits. Wall Street analysts have been reducing their earnings estimates to reflect what is developing into an economic soft patch. For the third quarter, Wall Street has reduced its earnings estimates by 14% compared to what was expected at the start of the year. Most of that is due to the strong U.S. dollar and weakness in overseas economies.

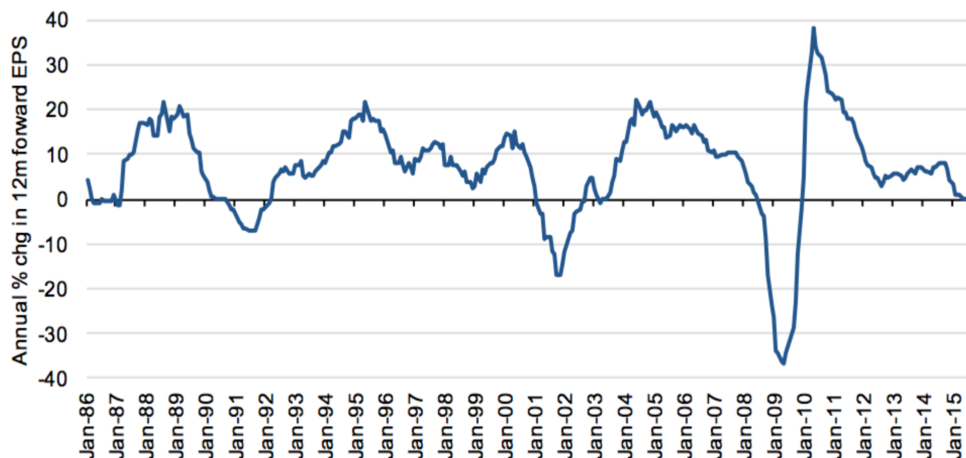
For companies that generate more than half of their sales in the U.S., the estimated earnings growth rate in Q3 is 3.1%, and the estimated sales growth rate is 1.4%. By contrast, for companies that generate less than 50% of sales stateside, the estimated earnings decline is -14.1%, and the estimated sales decline is -12.1%. Much of the impact may be attributable to the impact of the energy sector, given the sharp decline in crude oil prices over the past year. Even if you took energy out of the analysis, companies in the S&P 500 with more global exposure are still expected to report weaker sales and earnings relative to domestic oriented companies.

For non-energy companies that generate over 50% of their sales in the US, the estimated earnings growth rate is almost 9%. Meanwhile, for non-energy companies that generate less than 50% of their sales in the US, the estimated earnings decline is about -5%.

S&P 500 revenue for the third quarter is estimated to decline 2.9%, which would mark the third straight quarter of declines. Revenue in the fourth



quarter is also now expected to show a 1.4% decline. Many have begun to refer to this three-quarter string of sales drops as a "revenue recession," which would be the first time since 2009 that S&P 500 revenues have declined for three straight quarters.



Conclusion

Looking ahead to 2016, analysts expect the S&P 500 to generate a 10% earnings growth rate. Assuming that global economic activity does not get worse, several headwinds should subside going into next year; such as the negative impact of the rising US dollar as well as the decline in earnings from energy companies. Assuming corporate profits continue to make gains, we think this provides a decent backdrop for financial markets.

S&P 500 Index

3 Month	-6.44%
Year-to-Date	-5.29%
1 Year	-0.62%
3 Year	12.37%
5 Year	13.32%

MSCI EAFE Net Index

3 Month	-10.23%
Year-to-Date	-5.28%
1 Year	-8.66%
3 Year	5.62%
5 Year	3.98%

Barclays Aggregate Bond Index

3 Month	1.23%
Year-to-Date	1.13%
1 Year	2.94%
3 Year	1.71%
5 Year	3.09%

As of 9.30.2015

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