Market Commentary

After ten consecutive quarters of positive returns for large capitalization U.S. stocks and a long period of well below average volatility, the market reversed course in the third quarter posting the largest quarterly percentage decline since 2011. Despite many media outlets sensationalizing the recent correction, declines of this magnitude are quite common and have occurred in 19 of the last 35 years. The basic tenants of successful investing have not changed, despite the current downturn. It remains important, especially in volatile markets, to maintain a thoughtfully designed, well diversified, risk appropriate portfolio with low expenses and tax costs.

In late August, the S&P 500 dropped by 9.5% from the end of the second quarter. However, the index rebounded to end the third quarter down just 6.4%. Due to turmoil in China and emerging markets, international stocks fared much worse and ended the quarter down 11.7%. Interest rates declined slightly this quarter, measured by a 0.28% drop in the ten-year treasury yield, which helped the Barclays U.S. Aggregate Bond Index rise by 1.2%.

Chinese Currency Devaluation Ignites Stock Selloff

The global stock market selloff this quarter was largely caused by expectations of slowing economic growth in China. In August, the Chinese government made a surprise move to devalue their currency, the Yuan. One of their objectives was to reduce the price of Chinese exports. While a shift away from a fixed Yuan exchange rate is positive from a long-term perspective, it took capital markets by surprise. Lowered Chinese growth expectations put downward pressure on Chinese stocks and many commodity prices, especially oil. Declining commodity prices are detrimental to many emerging markets countries that rely heavily on exported commodities for economic growth. For example, countries reliant on oil exports, such as Brazil, have seen their currencies drop up to 23% vs. the U.S. dollar over the last quarter. These currency devaluations across emerging markets caused the value of international stocks and bonds to drop for U.S. investors since their values are lower in U.S. dollars.

U.S. Federal Reserve Leaves Interest Rates at 0%

Despite declining unemployment and solid GDP growth of 3.9% in the second quarter, the Federal Reserve chose not to raise interest rates at its September meeting largely due to global economic turmoil. After a disappointing September non-farm payroll report, including the announcement of just 142,000 new jobs in September and downward revisions to the two previous month's figures, the decision to not raise rates appears prudent. Financial futures markets indicate there is a 30% chance of a rate hike by the end of the year and the general consensus is that the path of increasing rates will be slower than previously expected. Irrespective of when the Fed increases rates, the timing has little relevance for long-term investors and the move is unlikely to affect stock market prices negatively.

Comparative Returns

	Q3 2015 Returns	Annualized Performance			
		1 Year	3 Years	5 Years	10 Years
Large Cap U.S. Stocks(1)	-6.4%	-0.8%	12.3%	13.2%	6.7%
Small Cap U.S. Stocks(2)	-11.2%	-1.6%	10.9%	11.3%	6.1%
International Stocks(3)	-11.7%	-10.9%	3.0%	2.2%	3.0%
Real Estate(4)	2.0%	9.3%	9.4%	11.9%	7.0%
U.S. Bonds(5)	1.2%	2.8%	1.6%	3.0%	4.6%

1. *Measured by the S&P 500 index, which includes 500 of the largest U.S. companies in all sectors of the economy.*
2. *Measured by the MSCI U.S. Small Cap Index.*
3. *Measured by the FTSE All World ex-U.S. index, which includes large and mid-capitalization stocks from developed and emerging international markets.*
4. *Measured by the MSCI U.S. REIT index, which includes domestic publicly traded real estate stocks.*
5. *Measured by the Barclays Aggregate Bond index, which includes a representation of the performance of the entire U.S. investment grade bond market.*

Matt Goette, CFA, AIF®
President & Chief Investment Officer
Black Diamond Financial, LLC