HBK Wealth Management
Haire • Bohmer • Kilcoyne

WEEKLY ECONOMIC COMMENTARY

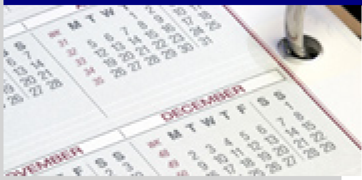
This Week's Economic Review and Outlook

August 2016

Making a positive impact on as many lives as I can.

David Haire
HBK Wealth Management
President
9360 Montgomery Rd.
Cincinnati, OH 45242
513-942-9700
Fax: 513-942-9701
d.haire@hbkwealthmanagement.com
www.hbkwealthmanagement.com

In This Issue



Weekly Economic Commentary | Week of August 1, 2016

SEE YOU IN SEPTEMBER?

KEY TAKEAWAYS

- We continue to expect that the Fed won't raise rates until the December 2016 meeting, but a potential path to a September hike also exists.
- Key items to watch for a possible September hike include U.S. manufacturing, financial conditions, the labor market, wage inflation, foreign central banks, and comments from key Fed officials.

As of Monday, August 1, 2016, the fed funds futures market is pricing in less than a 20% chance that the Federal Reserve (Fed) raises rates by 25 basis points at the conclusion of its next policy meeting on September 21, 2016. This assessment is the result of the Federal Open Market Committee (FOMC) statement released on July 27, 2016, which provided no hint of a hike as soon as September, and a weaker than expected report on gross domestic product (GDP) in the first half of 2016, released on Friday, July 29, 2016. We continue to expect that the Fed will raise rates once this year, likely at the December 2016 meeting. However, there is likely a narrow path to a September hike, which includes U.S. manufacturing, financial conditions, the labor market, wage inflation, actions of foreign central banks, and of course comments from key Fed officials. We'll take a look at that potential path in this week's report.

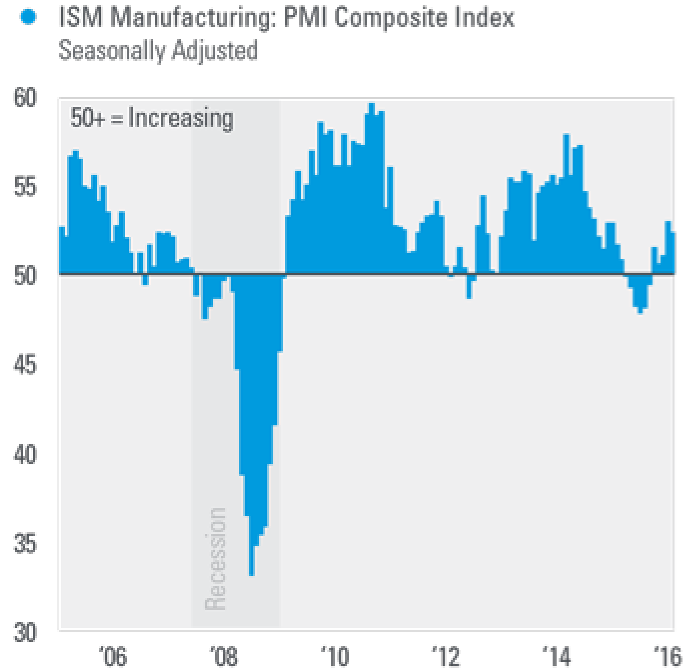
U.S. MANUFACTURING

As this commentary was being prepared for publication, the Institute for Supply Management (ISM) released its manufacturing index for July. The index was at 52.6 in July 2016 versus 53.2 in June 2016. The 52.6 reading in July 2016 was the fifth consecutive reading over 50, indicating an expanding manufacturing sector in the United States. The ISM had been below 50 for six months, ending in February 2016, held down by a soaring U.S. dollar and plunging oil prices. Another ISM report is due out on September 1, 2016, and in order for the Fed to consider raising rates on September 21, 2016, the September ISM report-along with the other key reports on the health of the manufacturing economy due out over the next seven weeks-would have to continue to show solid improvement despite another leg down in oil prices in recent weeks and a modest move higher in the value of the U.S. dollar after the Brexit. In short, the timing of the next Fed rate hike remains "data dependent."

These reports include:

- Industrial production for July (released August 16, 2016) and August (September 15, 2016)
- Markit PMI for manufacturing for August (August 24, 2016)
- Orders and shipments of durable goods for July (August 25, 2016)

1 MANUFACTURING HAS RECOVERED AS OIL AND THE DOLLAR HAVE STABILIZED



Source: LPL Research, Institute for Supply Management, Haver Analytics 08/01/16

Performance is historical and no guarantee of future results.

Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI is based on five major indicators: new orders, inventory levels, production, supplier deliveries, and the employment environment.

FINANCIAL CONDITIONS

Financial conditions are also likely to play a key role for the Fed over the next seven weeks. In a sense, tighter financial market conditions do the Fed's work for them, and policymakers won't want to "overtighten" policy in the current, somewhat fragile economic environment. As measured by the St. Louis Fed's Financial Stress Index, financial conditions in early August 2016 are the most accommodative since just prior to the spike in financial stress following the Chinese yuan revaluation in August 2015. Over the final few weeks of July 2016, the initial post-Brexit tightening of financial conditions seen in late June and early July 2016 has more than reversed, and if that trend continues-aided by a weaker dollar, stabile oil prices, more bank lending, and narrower credit spreads-the Fed may be in a position to act in September.

2 AFTER A POST BREXT RETREAT. FINANCIAL CONDITIONS ARE THE BEST IN THE YEAR

Source: LPL Research, Federal Reserve Bank of St. Louis, Haver Analytics 08/01/16

Performance is historical and no guarantee of future results.

The St. Louis Fed Financial Stress Index is an aggregate of 18 indicators that reflect financial stress in the stock and bond markets which the Fed monitors to measure financial conditions

LABOR MARKET & WAGE INFLATION

Further progress on the labor market and wages also remain key to a Fed rate hike in September. This Friday, August 5, 2016, the U.S. Bureau of Labor Statistics (BLS) will release its July employment report. The August employment report is due out on Friday, September 2, 2016. In addition to those two crucial reports, the weekly readings on initial claims (released every Thursday morning), along with the July and August Job Openings and Labor Market Turnover Summary reports (JOLTS) due on August 10, 2016 and September 7, 2016, will provide the FOMC with plenty of information on the health of the labor market and the pace of wage pressures in the economy for July, August, and early September. We continue to expect that monthly job growth, which averaged 200,000 per month from mid-2010 through early 2016, will continue to decelerate and move into the 120,000 to 150,000 range by the end of the year.

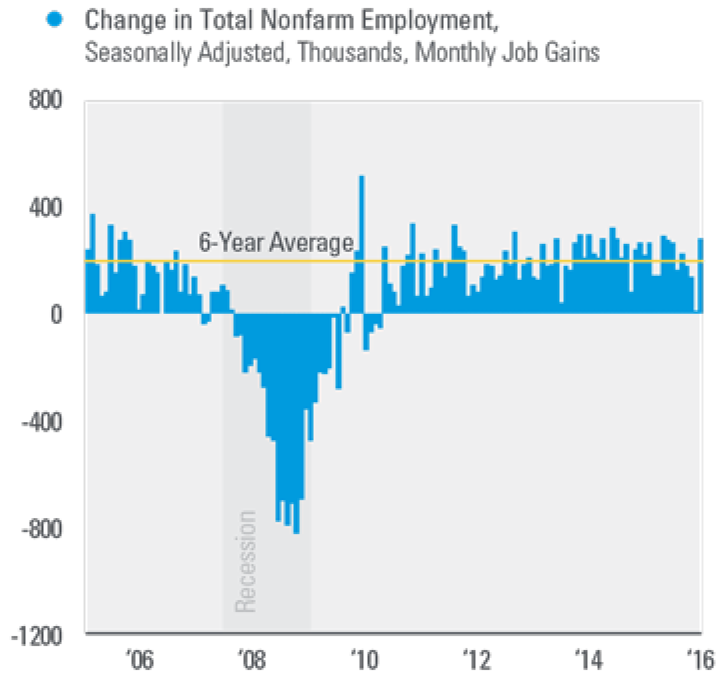
Despite that deceleration, the pace of job gains should still be enough to tighten the labor market and push up wages, and ultimately, inflation, and help prompt the Fed to act to raise rates in December. However, if there are strong (200,000+) readings in both the July and August jobs reports, initial claims remain near 250,000 per week, wage inflation moves from 2.6% in June to closer to 3% by August, and the JOLTS data continue to show record high levels of job openings and quit rates (the percentage of job leavers who leave their jobs voluntarily), the Fed may be in a position to raise rates in September. The Fed's next Beige Book, due in early September, will also contain key information on wage pressures in the economy that will be closely watched by Fed officials. (The Fed's Beige Book is a qualitative assessment of economic, banking, consumer and labor market conditions in each of the 12 Fed districts.)

TIMELINE: LABOR MARKET

- August 5, 2016: July Employment Report
- August 9, 2016: July JOLTS

- September 2, 2016: August Employment Report
- September 7, 2016: July JOLTS

3 **FED SAYS JOBS TARGET IS 125,000–150,000; MARKET LIKELY EXPECTS MUCH HIGHER**



Source: LPL Research, Bureau of Labor Statistics, Haver Analytics 07/08/16

Performance is historical and no guarantee of future results.

4 **ACCELERATING WAGES ARE KEY TO THE NEXT FED RATE HIKE**

Source: LPL Research, Bureau of Labor Statistics, Haver Analytics 08/01/16

Wages represented by total private industry average hourly earnings of production and nonsupervisory positions.

Performance is historical and no guarantee of future results.

CENTRAL BANKS

Late last week, Japan's central bank, the Bank of Japan (BOJ), met and did increase the size of their quantitative easing program, though they did not take interest rates further into negative territory. The next BOJ meeting is the same day as the September FOMC meeting (September 21, 2016), and between now and then the Japanese government is expected to enact fiscal policy to help the Japanese economy escape deflation. The Bank of England (BOE) meets this week and is expected to cut rates to aid the U.K.'s post-Brexit economy. The BOE meets again on September 15, 2016, a week before the next FOMC meeting. The European Central Bank next meets on September 8, 2016, and is currently in a "wait and see" mode, but is leaning toward more easing following the Brexit vote on June 23, 2016, and the results of the European bank stress tests that were released last Friday, July 29.

While the Fed, the BOJ, the BOE, and the ECB all have set meeting schedules and are generally loathe to surprise markets, China's central bank, the People's Bank of China (PBOC) does not have a set meeting schedule and its decisions often catch the market off guard. Any action by the PBOC to tighten policy or to dramatically alter the value of the Chinese yuan would make a September Fed rate hike highly unlikely. The global imbalances that buffeted financial markets in early 2016 were mainly the result of discord between the markets and central banks and among the central banks themselves. Six months later, the discord has dissipated somewhat, and that has led to fewer global imbalances, looser financial conditions in the U.S., and less financial market volatility. Any central bank driven unwinding of this 6-month old regime may keep the Fed on hold in September and beyond.

TIMELINE: CENTRAL BANKS

- August 4, 2016: Bank of England Meeting
- August 17, 2016: Minutes of the July 28-29, 2016 FOMC meeting released
- August 26, 2016: Fed Chair Yellen speech in Jackson Hole, WY
- September 7, 2016: Fed releases Beige Book
- September 8, 2016: European Central Bank Meeting
- September 15, 2016: Bank of England Meeting
- September 21, 2016: Bank of Japan Meeting
- September 21, 2016: FOMC decision, Yellen press conference and new FOMC economic forecast

FEDERAL RESERVE

Fed Chair Janet Yellen will address the Kansas City Fed's annual Monetary Policy Symposium in Jackson Hole, WY on August 26, 2016. Yellen skipped the meeting last year, but in the past, her predecessors-notably Ben Bernanke-have used Jackson Hole as a launching pad for new policies. Bernanke famously hinted at the Fed's second round of quantitative easing (QE2) in August 2010 and hinted at QE3 at the Jackson Hole symposium in 2012. If the pre-August 26, 2016, data and events we discussed above have lined up on the side of a September hike, we expect to see:

- Stable oil prices and improved manufacturing data
- Looser financial conditions
- Solid readings on the labor market and inflation
- Ongoing concord among global central banks

Fed Chair Yellen may lay out the case for a September rate hike. If the data are mixed-or worse-Yellen may have to deliver an entirely different message at Jackson Hole.

DEFINITIONS

Quantitative easing (QE) refers to the Federal Reserve's (Fed) current and/or past programs whereby the Fed purchases a set amount of Treasury and/or mortgage-backed securities each month from banks. This inserts more money in the economy (known as easing), which is intended to encourage economic growth.

INDEX DESCRIPTIONS

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Institute for Supply Management (ISM) index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

Weekly Market Commentary | Week of August 1, 2016

KEY TAKEAWAYS

- We continue to expect an improving economic backdrop in the second half and a stock market with the potential for more new highs before year-end.
- However, growing near-term concerns are making the odds of some type of a late summer correction more likely.

TIME FOR AN AUGUST SWOON?

The S&P 500 gained 3.6% during the historically bullish month of July 2016, closing higher for the fifth consecutive month for the first time in two years. It also soared to new all-time highs for the first time since May 21, 2015. As discussed in our *Weekly Market Commentary,* "Overcoming a Wall of Worries" (June 20, 2016), the list of worries had been long, but we thought an improving economic backdrop coupled with strong market breadth and a very pessimistic sentiment backdrop should help the market resolve higher, which fortunately happened.

Now the big question is, can this strength continue and the S&P 500 close higher in August to make it six straight months of gains? Although we continue to expect an improving economic backdrop in the second half of the year and a stock market with the potential to make more new highs before the year is over, there are some growing near-term concerns--making the odds of some type of a late summer correction more likely. The good news is we do think this weakness will be an opportunity to add to equity exposure and higher prices could still come later this year.

Here are four growing concerns:

#1: SEASONALITY

The good news is July seasonality (on average the strongest summer month) worked perfectly this year. The bad news is after the S&P 500 gains more than 3% in July (like 2016), August has been lower four of five times going back 20 years, with an average decline of 2.3%. Also, as we mentioned on the LPL Research blog last week, the S&P 500 is in one of the its tightest ranges ever. In fact, using daily closing prices it was recently in the tightest 11-day range since August 1995. In other words, the odds that this tight range changes into rising volatility are very high this August.

More bad news is that August and September are historically two of the weakest months of the year for the S&P 500. Going back to 1980, they are the only two months to have a negative average return [Figure 1]. Looking specifically at August, on a price return basis it returns -4.8% on average when it is negative, the largest drop for any month of the year. In other words, when August is down, it is really down. For example, it lost 6.3% last year on the surprise China yuan devaluation, lost 5.7% in 2011 on the U.S. debt downgrade, 14.6% in 1998 thanks to the Russian financial crisis, and 9.4% in 1990 after Iraq invaded Kuwait.

Why do these unknown events seem to take place in August? It could be simply random, or maybe the effects of big news is amplified in the summer when trading is light and many are taking summer vacations. This doesn't mean we will have another unforeseen market shock this month (we would tell you if we knew!), but be aware it wouldn't be out of the question either.

1 **THE NEXT TWO MONTHS ARE HISTORICALLY WEAK**

S&P 500 Monthly Returns Since 1980

Month	Average Return	Rank	% Higher	Average Return When Down
January	1.0%	7	61.1%	-3.8%
February	0.4%	9	63.9%	-4.0%
March	1.0%	5	63.9%	-2.9%
April	1.7%	1	69.4%	-2.2%
May	1.0%	6	66.7%	-3.1%
June	0.1%	10	55.6%	-2.8%
July	0.7%	8	44.4%	-2.3%
August	-0.1%	11	58.3%	-4.8%
September	-0.7%	12	47.2%	-4.2%
October	1.4%	4	66.7%	-4.5%
November	1.5%	2	69.4%	-3.8%
December	1.5%	3	72.2%	-2.1%

Source: LPL Research, FactSet 07/29/16

Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

#2: DERIVATIVES POSITIONING

With the S&P 500 making new highs, we are seeing a significant change in overall investor sentiment. As we noted in our *Weekly Market Commentary* from late January 2016, "Any Bulls Left?" many sentiment polls and indicators had been flashing extreme fear consistent with major lows. Now after more than a 20% rally from those February 2016 lows, sentiment is beginning to turn much more optimistic, potentially a warning sign.

Recently, positioning in the derivatives markets has become much more bullish, according to data from the Chicago Board Options Exchange (CBOE). In fact, last week, the 21-day moving average of bearish equity derivatives relative to bullish equity derivatives was the most bullish this group has been in over a year. From a contrarian point of view, this many bulls showing up at new highs could be meaningful.

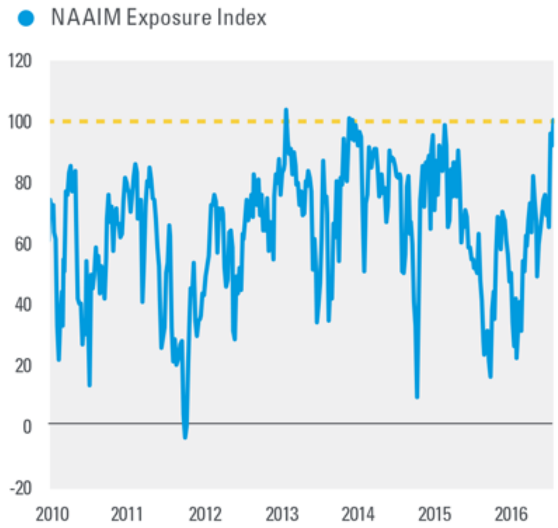
#3: SENTIMENT POLLS ARE MUCH MORE BULLISH

Active money managers are the most exposed to U.S. equities they have been since November 2013. In fact, the National Association of Active Investment Managers (NAAIM) Exposure Index jumped above 100 last week for only the fifth time in the 10 year existence of the weekly survey. For reference, this survey was 22 in early February 2016 [Figure 2].

Not surprisingly, the other moves above 100 happened with the S&P 500 near all-time highs. The good news is the S&P 500 has been higher six months later all five times with an average return of 7.9%, so this doesn't appear to be a major contrarian warning.

Adding to the bullish sentiment backdrop, the Investors Intelligence U.S. Advisors' Sentiment Report has 54% bulls, the most since May 2015--although it isn't quite at the historically worrisome level of 60%. Last, the Citigroup Panic/Euphoria Model is at its highest level in a year, again suggesting more positive sentiment for equities. The good news is this still isn't near "euphoric" levels, but it is still high relative to recent readings.

2 ACTIVE MANAGERS ARE PILING INTO EQUITIES



Source: LPL Research, NAAIM 7/29/16

Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

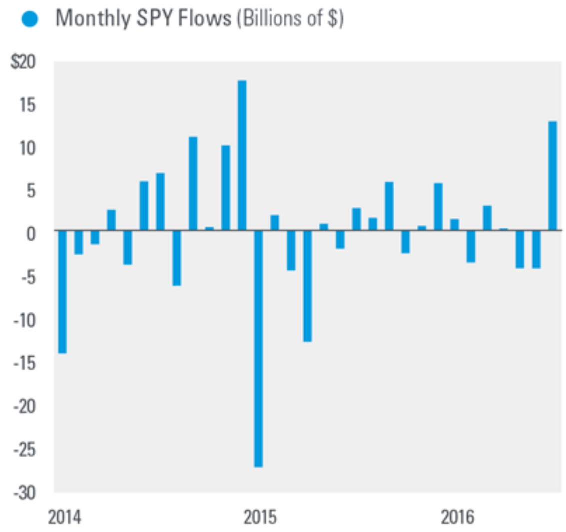
The NAAIM Exposure Index represents the average exposure to U.S. Equity markets reported by the active money managers that make up its member firms.

#4: HUGE INFLOWS INTO THE SPDR S&P 500 ETF TRUST

Looking at Bloomberg data, we've noted before the huge outflows from equity mutual funds and that trend continues with no end in sight. The majority of those funds have found their way either to bond mutual funds or exchange-traded funds (ETF), or stock ETFs. But the S&P 500 making seven new highs last month has sparked a huge surge back into the SPDR S&P 500 ETF Trust (SPY). For the month of July 2016, this ETF saw inflows of $13.3 billion, the third most since 2011, and the most since $17.8 billion in December 2014 [Figure 3].

Is this a "late to the party" surge, or could it just be the beginning of money moving out of bond funds and ETFs and into stock funds and ETFs? We'll call it more a near-term worry than anything, as flows into equity funds and ETFs are still nowhere near past major peaks. But the sudden surge does add to the potential for a near-term shake out.

3 **INVESTORS LATE TO THE PARTY AS THEY JUMP INTO SPY?**



Source: LPL Research, FactSet 7/29/16

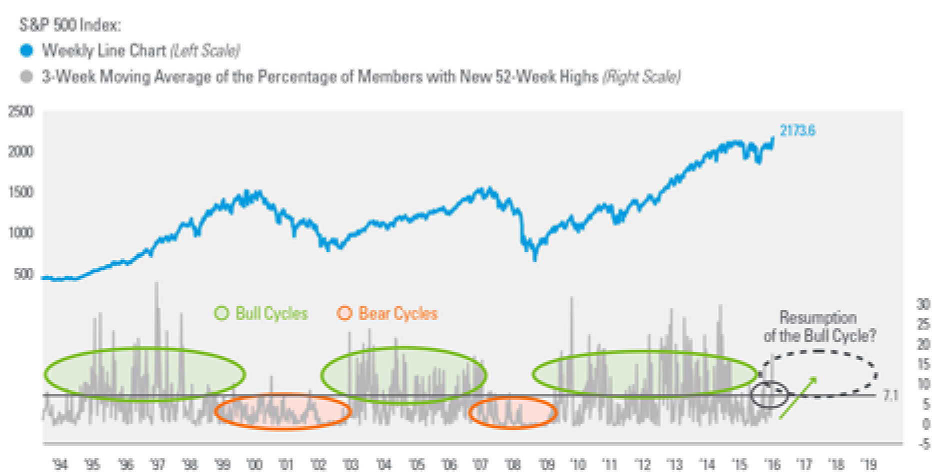
Monthly Flow figures are historical and no guarantee of future results.

WHY ANY PULLBACKS WILL LIKELY BE CONTAINED

As the risk of increased market volatility becomes higher in August due to seasonal price patterns and increasing bullish sentiment, one saving grace may be the recent improving trend in equity market breadth (as measured by the percent of S&P 500 members with new 52-week highs), which may lessen the impact of a potential equities market sell-off.

We first introduced this market breadth indicator in a blog post entitled "Bullish Market Breadth: Better Late to the Party Than Not Show Up at All" (June 9, 2016). Since then, the three-week average of the percent of S&P 500 members with new 52-week highs has remained above the 6% threshold (currently at 7.1%), which increases the likelihood that this breadth indicator is supporting the beginning stages of a bullish cycle or trend [Figure 4].

4 **MARKET BREADTH IS SUPPORTING THE BEGINNING STAGES OF A BULLISH TREND**



Source: LPL Research, Bloomberg 07/29/16

Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

Looking at historical weekly data, when the three-week average of the percent of S&P 500 members with new 52-week highs is above 6%, subsequent returns on the index tend to be bullish. Going back to 1990, there were 57 times this happened. Three months later, the S&P 500 was higher 38 times (67% of the time) with an average return of 1.1% and a median return of 2.4%. Going out six months, the returns are higher 46 times

(80% of the time) with an average return of 4.2% and a median return of 5.1%. Looking out over 12 months, the returns were higher 51 times (89% of the time) with an average return of 9.9% and a median return of 9.7%.

With the percent of S&P 500 members with new 52-week highs remaining at levels that support the continuation of a bullish price trend for stocks, we view any potential short-term weakness in the equities market as an opportunity to buy on a dip.

CONCLUSION

Seasonality, sentiment, and the coming election could all add to potential volatility over the next few months. From a bigger picture perspective, it is comforting that many sentiment indicators are nowhere near levels seen at past major peaks. Yes, near-term the concerns have greatly increased, as there are many more bulls now, but we don't see any signs from sentiment readings that would lead us to think the bull market is near an end.

We still expect a better economy in the second half of the year, which we believe may result in total equity returns potentially in the mid- to high-single digits when 2016 is all said and done.* This, along with support from breadth and minimal pressure from improving sentiment, may limit any potential pullback to 5-10%. But put your seatbelts on, as August may provide for a lot more volatility than the second half of July did.

**We expect mid-single-digit returns for the S&P 500 in 2016, consistent with historical mid-to-late economic cycle performance. We expect those gains to be derived from mid- to high-single-digit earnings growth over the second half of 2016, supported by steady U.S. economic growth and stability in oil prices and the U.S. dollar. A slight increase in price-to-earnings ratios (PE) above 16.6 is possible as market participants gain greater clarity on the U.S. election and the U.K.'s relationship with Europe.*

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

An investment in Exchange Traded Funds (ETF), structured as a mutual fund or unit investment trust, involves the risk of losing money and should be considered as part of an overall program, not a complete investment program. An investment in ETFs involves additional risks such as not diversified, price volatility, competitive industry pressure, international political and economic developments, possible trading halts, and index tracking errors.

Amounts in mutual funds are subject to fluctuations in value and market risk. Shares, when redeemed, may be worth more or less than their original cost. An increase in interest rates may cause the price of bonds and bond mutual funds to decline.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal, and potential liquidity of the investment in a falling market.

All investing involves risk including loss of principal.

DEFINITIONS

The Citigroup Panic/Euphoria model is a gauge of investor sentiment. It identifies "panic" and "euphoria" levels which are statistically driven buy and sell signals for the broader market. Historically, a reading below panic supports a better than 95% likelihood that stock prices will be higher one year later, while euphoria levels generate a better than 70% probability of stock prices being lower one year later.

The Investors Intelligence U.S. Advisors Sentiment Report has been widely adopted by the investment community as a contrarian indicator and has a consistent record for predicting the major market turning points. The report is developed by studying over a hundred independent market newsletters and assess each author's current stance on the market: bullish, bearish or correction.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The NAAIM Exposure Index represents the average exposure to U.S. Equity markets reported by the active money managers that make up its member firms.

Investing in SPY entails risk including loss of principal, passive strategy index risk and index tracking risk.

Investors should consider the investment objectives, risks, charges and expenses of the Exchange Traded Fund carefully before investing. The prospectus and, if available, the summary prospectus contain this and other important information about the Exchange Traded Fund. You can obtain a prospectus and summary prospectus from your financial representative. Read carefully before investing.

This research material has been prepared by LPL Financial LLC.

To the extent you are receiving investment advice from a separately registered independent investment advisor, please note that LPL Financial is not an affiliate of and makes no representation with respect to such entity.

Not FDIC or NCUA/NCUSIF Insured | No Bank or Credit Union Guarantee | May Lose Value | Not Guaranteed by Any Government Agency | Not a Bank/Credit Union Deposit8

Tracking #1-521701 (Exp. 08/17)

When Should You Collect Social Security?

Those choosing to collect before their normal retirement age face a reduction in monthly payments by as much as 30%.

A growing number of Americans have been forced to delay their planned retirement date due to job and savings losses suffered during the past five years. According to a survey, 40% of U.S. workers said they have resolved to retire later due to concerns about outliving their savings and fears of rising health care costs.[1] Postponing retirement not only means working longer, but also delaying when you start collecting Social Security. Currently, workers can begin collecting Social Security as early as age 62 and as late as age 70. The longer you wait to start collecting, the higher your monthly payment will be. Your Social Security monthly payment is based on your earnings history and the age at which you begin collecting compared with your *normal retirement age*. This *normal retirement age* depends on the year you were born.

Year Born	Normal Retirement Age
1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 or later	67

Those choosing to collect before their *normal retirement age* face a reduction in monthly payments by as much as 30%. What's more, there is a stiff penalty for anyone who collects early and earns wages in excess of an annual earnings limit ($14,160 in 2011).

For those opting to delay collecting until after their normal retirement age, monthly payments increase by an amount that varies based on the year you were born. For each month you delay retirement past your normal retirement age, your monthly benefit will increase between 0.29% per month for someone born in 1925, to 0.67% for someone born after 1942.

Which is right for you will depend upon your financial situation as well as your anticipated life expectancy. Anyone with a good pension or substantial savings may want to delay a bit. Similarly, if you're in no hurry to retire, you may want to continue working longer and collect later.

Likewise, those with a family history of longevity who expect to live a long time stand to gain more by delaying. If you think it unlikely to survive beyond age 78, you may want to start collecting at age 62. And if you expect to survive beyond age 82, you might consider a delayed collection.

Whenever you decide to begin collecting, keep in mind that Social Security represents only 38% of the average retiree's income.[2] So you'll need to save and plan ahead -- regardless of whether you collect sooner or later.

[1]*Source: Towers Watson, October 2010.*

[2]*Source: Social Security Administration, "Fast Facts & Figures About Social Security," August 2011.*

Tracking #1-016562