RETIREMENT & INSURANCE RESOURCES

QUARTERLY ECONOMIC NEWS

Second Quarter 2013

Newton's Cradle (depicted on page 2) is a popular desk adornment in which a metal ball on one end is allowed to swing as a pendulum, causing the ball on the far end to be knocked away from the others at almost the same speed. Although the intermediate balls seem to remain at rest, they play a critical role in transmitting the momentum from one end to the other. Like Newton's Cradle, the economy is often driven by the momentum of one event, and the effects can be far reaching. News of a potential tapering of the Federal Reserve's "QE3" program was a swinging pendulum in the second quarter of 2013. The stock market plunged in the days after the Federal Reserve Open Market Committee announced the possibility of a QE3 wind down later this year. The yield on 10-year Treasury bonds was up significantly in the last week of June as investors were rushing to sell-off government bonds. Interest rates rose sharply in response to rising yields. The stock markets reacted negatively to the news, but rebounded in the last week of June as representatives of the Federal Reserve clarified the central bank's stance on the future of its asset purchase program.

Economic News

After a relatively smooth start to the second quarter, the U.S. stock market underwent periods of turbulence. Despite some drastic day-to-day swings, major markets and indices posted modest gains when all was said and done. The NASDAQ led the pack, climbing 6.03 percent to close the quarter at 3,434; the S&P 500 gained 2.92 percent to close the quarter at 1,615; the Dow Jones Industrial Average advanced 2.76 percent to close at 14,975. Overall, stocks seemed to be on the uptick for April and much of May before stagnating in the month's final two weeks, setting the stage for a volatile June. The positive gains may serve as self-fulfilling prophecies as many analysts predict the continued improvement in the markets, as well as positive employment figures, will result in increased investment activity and drive stock prices upward.

Index	2ndQtr	1 Year	5 Year	10 Year
S&P 500 (Composite Total Return)	2.92%	20.60%	7.01%	7.29%
Russell 2000	3.09%	24.21%	8.77%	9.53%
MSCI EAFE (Price)	-2.13%	15.14%	-3.59%	4.80%
Barclays Aggregate Bond	-1.90%	-1.21%	4.64%	4.33%

The S&P 500 is a commonly used measure of common stock total return performance, the Russell 2000 is a commonly used measure of small capitalization stocks, the MSCI EAFE is a commonly used measure of common stock total return performance of international markets, and the Barclay's Aggregate Bond Index is a commonly used measure of the bond market. All referenced indices are unmanaged and not available for direct investment. Past performance is not a guarantee of future results.

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Soaring Confidence

Consumer confidence was on the rise in the second quarter. The Conference Board's Consumer Confidence Index® results for June (81.4 out of 100) represented its highest level since January 2008. This index is based on consumers' perceptions of current business and employment conditions, as well as their expectations for the following six months. The idea behind consumer confidence is that people are more likely to open their wallets when they feel better about the direction of the economy. Some consumer confidence surveys measure "mood swings" from week to week, month to month, or even day to day. Higher confidence typically encourages higher spending, which in turn benefits the economy. Many economic factors can sway consumer sentiment—unemployment rate, fuel prices, home prices and stock performance are most likely to influence confidence levels. A Gallup survey from June 7 shows that Americans' self-reported daily spending rose to an average of $90 in May, the highest since October 2008. The Federal Reserve's Q1, 2013 Flow of Funds Report published in June reveals that the aggregate net worth of America's households had almost returned, in nominal terms, to its pre-crisis peak by the end of 2012, and to approximately 88 percent of its pre-crisis peak when adjusted for inflation.

Words from the Fed

Since September 2012, the Federal Reserve has engaged in massive asset purchases, driving interest rates to historical lows in an effort to stimulate the economy. According to *The Economist*, unemployment has fallen to 7.6 percent and GDP has grown at 2 percent since the current purchasing plan—or quantitative easing (QE)—of $85 billion per month was initiated. While improvements in the economy are undisputed, questions regarding the effectiveness of the Fed's policy, and how long it should continue, are playing heavily into recent market movements.

The desire to keep money flowing into a recovering economy prompted the third round of quantitative easing, but with diminishing beneficial returns and a balance sheet deficit that has ballooned to $3.4 trillion since the beginning of the recession, the Federal Reserve has hinted that QE3 could begin tapering down by the end of 2013. Though the Federal Open Market Committee made no changes to its current pace of monthly purchases during their latest meeting in June, the following statement from Chairman Ben Bernanke on June 19 sent the markets in a downward spiral: "If the incoming data are broadly consistent with this forecast, the Committee currently anticipates that it would be appropriate to moderate the monthly pace of purchases later this year."

Although the Fed hopes to cease asset purchases by the middle of 2014—which would suggest continued improvement in economic conditions—Mr. Bernanke outlined a possible QE3 exit strategy that would be closely linked to prevailing economic indicators: "We'll be obviously very interested to see if the economy does pick up a bit and continue to reduce unemployment, as we anticipate. […] if you draw the conclusion that I've just said, that our policies—that our purchases will end in the middle of next year, you've drawn the wrong conclusion because our purchases are tied to what happens in the economy."

Those opposed to ending QE3 point to the historically low growth of the Consumer Price Index (CPI) and the subdued rate of inflation. Regardless of which side they are on, investors are looking closely at statements from the Federal Reserve as a change in policy could have a widespread impact.

Mortgage Mayhem

Despite rising home prices, the cost of securing a home loan decreased in the early stages of the second quarter before rebounding dramatically at quarter end. After reaching its lowest rate since January 3 of this year—3.35 percent on May 2—the 30-year mortgage rate bounced back to end the quarter with increases in 8 of the last 9 weeks. By the end of June, the average 30-year mortgage rate for the U.S. reached 4.46 percent, the highest it has been since 2011. This also marked the first time the rate topped 4 percent since March 2012.

According to Freddie Mac, the 0.53 percentage point jump in the final week of the quarter is the largest weekly increase in 30-year mortgages since 1987. Rising mortgage rates are largely attributed to the Federal Reserve's recent statements concerning an eventual slowing of quantitative easing. Fed Chairman Ben Bernanke asserted that the economy continues to show signs of improvement, thereby lessening the need to inject capital into the markets. The allegedly waning policy of buying up bonds has prevented interest rates–and indirectly, mortgage rates–from rising to levels considered "normal" prior to 2008. With the Fed vowing to purchase fewer bonds and soften its efforts to hold down interest rates, many consumers are feeling the pressure to buy now while the cost of buying a home remains relatively low. Since May of this year, the monthly payment on a $300,000 30-year loan has risen more than $190.

Newton's Cradle
(see introduction on page 1)

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