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July 2015

Market Prospects for the Balance of 2015
By Scott P. Noyes, CFA® CFP®

I am incredibly tired of reading articles about Greece and the Kardashians. In fact, I may look for an "app" that blocks all reference to both of them. Bottom line, the Greeks surrendered and will be a ward of the European Commission for the next few years and it will probably make them a better-run nation. Unfortunately, the press and market-prognosticators have found the Greek debt crisis to be a non-stop source of bad news and the markets finally reached a point where it was hard to shake it off. But enough about Greece, I believe the outlook for the financial markets for the balance of the year remains positive but there may be some bumps along the way.

The United States remains the global bastion of economic safety and growth, but many areas of the stock market are fully valued. Stocks in Europe and Japan should benefit from a strong dollar, making their exports more competitive. China is trying to shift form commodity led growth to consumer growth and is having a rocky transition, they are only growing at 6%. With interest rates low and a possible downdraft in the bond market coming as rates drift higher, equities offer the best chance of a positive return.

Relentless Economic Growth in the U.S. Continues

While the U.S. economy slowed in the first quarter of 2015 to near zero levels due to weather, energy-sector layoffs and declining exports, the intermediate-term prospects remain bright. Increased economic stimulus from low energy prices and reduced prices for imports should add approximately 1% to economic growth over the course of the year. During the second half of 2015, GDP growth in the United States is likely to exceed 3% with unemployment dropping to 5%. This should result in another decent year for U.S. equities fueled by the following:

- Positive momentum in U.S. economic growth with low inflation
- Improved consumer spending
- Low commodity prices and financing costs
- A relatively liquid environment aided by stimulus from non-U.S. central banks.

U.S. Consumer Benefits from the Stronger Dollar

U.S. consumers are perhaps the most significant beneficiaries of a stronger dollar as imported goods become less expensive. The U.S. imports approximately twice what it exports. A stronger dollar leads to lower import prices, lower inflation and an increase in consumer purchasing power. This increase in purchasing power provided by a stronger dollar offsets some of the current wage stagnation and is a benefit to overall economic growth. Again, just as with lower oil prices, consumers are big beneficiaries. …And, it should be a great time to travel overseas!

Fed Policy Makers Likely to Raise Rates before Year-End

After the strong jobs data report released on July 3rd, the Federal Reserve has started preparing the markets for a September 2015 interest rate increase. Their message is that the economy will be better off at slightly higher rates. Rate increases of 25 basis points are likely in both September and December. Unless there is another major global crisis, the Federal Reserve continues to signal that it wants to move interest rates higher.

First-Half 2015 Market Performance

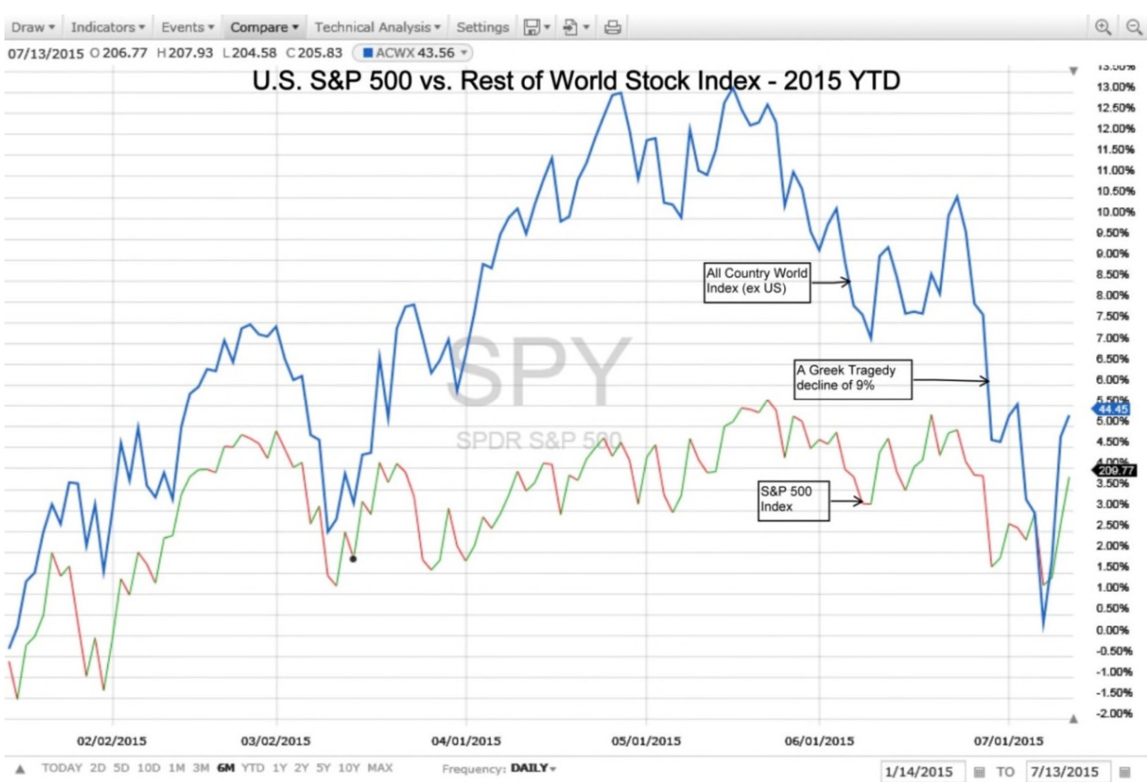
In spite of the Greek negotiating tragedy which created increased concern about over-indebted countries and reduced risk taking globally, international investments have outperformed U.S. equities through the first half of 2015. The Chinese equity market mini-crash which occurred in June also raised fears regarding Pacific Rim investments and resulted in fairly substantial negative market performance globally. As these two crises subside, I expect a reasonable rebound in global markets.

Table 1. Financial Market Returns for 1st Half 2015

Stock Market Indexes	
Dow Jones Industrial Index	0.03%
S&P 500 Composite	1.23%
Russell 2000 Small Cap Idx	4.76%
MSCI World REIT Index	(2.27%)
Gov/Credit 20+ yr Index	(4.47%)
MSCI World X-US	4.04%
MSCI World Small Cap X-US	8.36%
MSCI Emerging Markets	2.95%

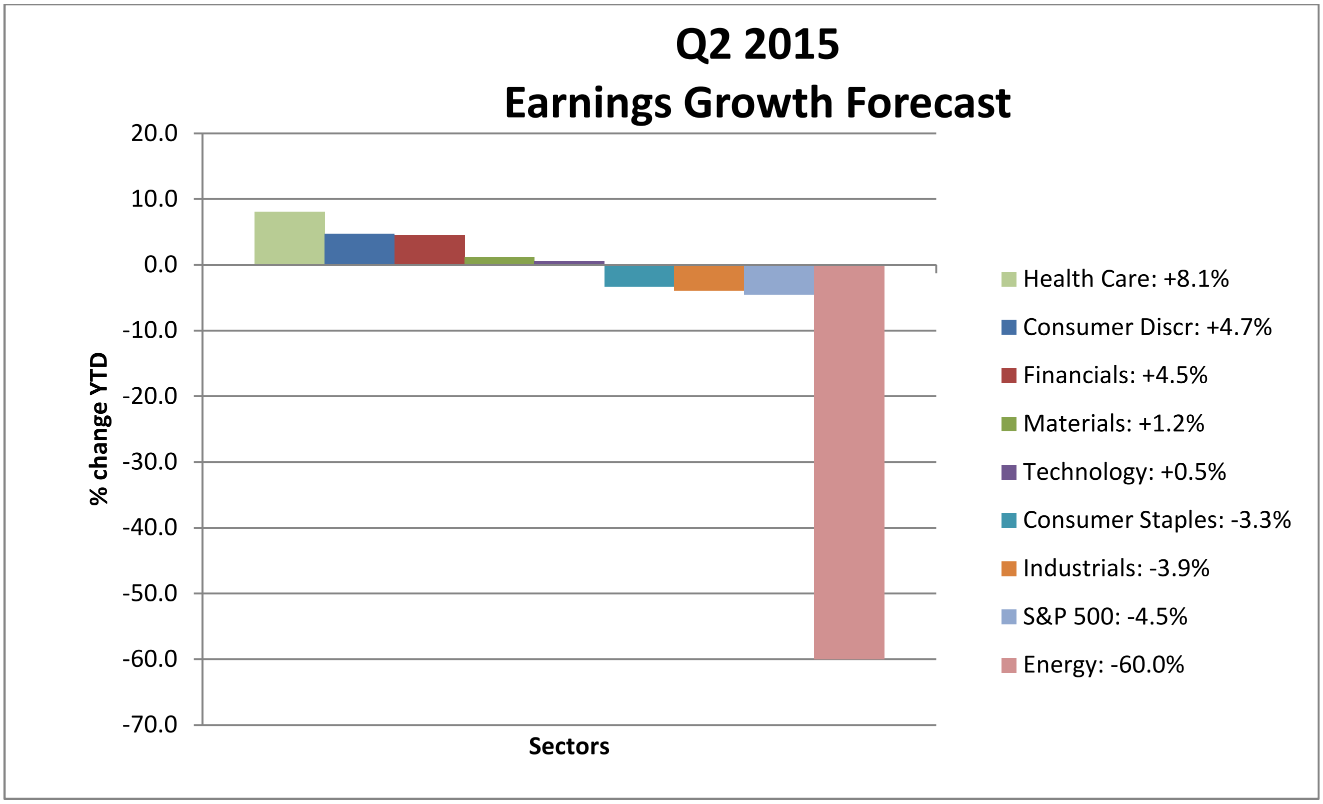
Bond Market Indexes	
Gov/Credit 1-5 yr Index	0.95%
Gov/Credit 20+ yr Index	(4.47%)
US High Yield Index	2.53%
Global Gov Bond Index	(5.43%)

Exhibit 1.   Rebound likely in Foreign Stocks after Greek Tragedy Decline



Second-Quarter U.S. Corporate Earnings are Projected lower

Year-over-year earnings for the S&P 500 are projected to decline by 4.4% for the second-quarter of 2015, due primarily to weakness in the energy sector. Over 80 companies have issued negative Earnings per Share (EPS) guidance, led by the Industrial sector. The leading causes of weaker earnings that have been cited are the stronger U.S. dollar and higher labor costs. However, I believe that actual corporate earnings reports will be less negative than forecast as companies may have intentionally set the bar low so they can more easily beat expectations. In each of the last eleven quarters, actual earnings exceeded estimated earnings by an average of 2.9%.



In addition to the industrial sector, companies in consumer discretionary businesses have also been projecting earnings-growth declines. Companies such as GE, American Airlines and General Motors have all lowered earnings expectations with their recent guidance. The Energy sector is expected to show the greatest decline in year-over-year sales as prices have dropped by approximately 40% in the past year. The Health Care sector is predicted to report the highest revenue growth followed by Consumer Discretionary and Financials.

On a full year basis, earnings are for the S&P 500 are projected to rebound to +1.8% with the Financials, Healthcare and Consumer Discretionary areas showing the greatest improvement. By 2016, earnings are projected to reestablish their upside momentum as Energy and Material sectors are anticipated to show strong improvement.

Better Second-Quarter Corporate Earnings Projected in Europe and Japan

In spite of the macroeconomic difficulties in Europe caused by Greece and Ukraine, the major economies are seeing a rebound in economic activity in 2015. Economic growth in the European Union is expected to increase from 0.3% in 2014 to 1.7% in 2015, led by Spain, Ireland, Poland and the United Kingdom. In addition, Japan's economy grew by 3.9% in the first quarter of 2015. European and Japanese companies are beneficiaries of both local growth and improved export competitiveness due to the strength of the U.S. dollar; a 15% cost advantage has helped expand foreign sales and corporate earnings.

The China Story is More Positive than the Headlines Suggest

The economy in China, as measured by GDP, is projected to grow at 6.9% in 2015. There has been some concern that the recent decline in the Chinese stock market would spook consumer spending, but I view this as a normal correction in a bull market. I believe the bigger story is that the Chinese government is leading a charge to increase the production of value-added products and services in China. This includes the creation of a viable Chinese financial market and a world-class currency. They envision China as the leading regional financial sector in ten years. It is of particular importance to note that the Chinese have retained the Yuan peg with the dollar in the face of the U.S. currency's rally. While this has hurt Chinese exporters it has given increased validity to the long-term viability of the Chinese currency. Over time, I believe China will be viewed as a strong and safe country in which to invest.

Emerging Markets Should Continue to Lag

The prospects for the emerging markets are a mixed bag as the economic picture varies from country to country. The economies of India, Malaysia, China, Philippines and Mexico are booming while resource providers such as Brazil, Australia and Russia have suffered with weak commodity prices. In many cases, growth prospects are strong and valuations are reasonable. I am hopeful that an opportunity presents itself to acquire emerging market stocks at a discount later this year.

Prospects for 2015 are Reflected in Portfolio Allocations

With the expectation that the bull market will continue in 2015, I have fully invested in equities and bonds up to your target asset allocation. Although equities are no longer a bargain, they offer better value than other financial assets and should outperform cash, bonds and commodities. In today's market, there is no alternative to equities and our portfolios reflect that belief.

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