More Market Volatility Likely

US equity markets continue to suffer from ***bouts of volatility*** induced by ***uncertainty*** about Federal Reserve moves and intentions and ***worries about China*** and global growth. Indeed, the ***ongoing correction*** in equity prices and valuations amidst a reassessment of earnings expectations appears to be just that – a correction within a longer term "bull market". It is important to reiterate that we have not really had a correction of this magnitude for over four years.

We believe that the Federal Reserve ***missed an opportunity*** to raise the Fed Funds Target (albeit by a small amount) two weeks ago at the Federal Open Market Committee Meeting (Sep 17th). At a press conference following the meeting, Janet Yellen, the Chairwoman of the Federal Reserve sounded quite ***"dovish"*** as if they were unlikely to increase interest rates for the rest of the year.

In subsequent speeches, Ms. Yellen (and several other voting members of the FOMC) sounded more ***"hawkish",*** perhaps with an intent to correct any misperceptions in the market. However, this has caused ***more uncertainty*** as it relates to the market's understanding of the Fed Reserve's intentions. Be that as it may, the pace and trajectory of the moves by the Federal Reserve is more critical than the timing of the initial rate hike.

Our reading of the Federal Reserve's tea leaves indicates that the Fed is likely to remain ***quite gradual*** in their pursuit of interest rate hikes and if anything, monetary policy will stay quite accommodative for a while. It is certainly possible that the Federal Reserve could hike rates at either the October (Oct 28th) or the December (Dec 16th) FOMC meeting, but such a move is likely to be small and very well telegraphed ahead of time.

Worries about China and the attendant slowing in global economic growth are another reason for the volatility. China's growth is ***slowing – this is not news***. China is undergoing a ***difficult transition*** from an infrastructure investment led export driven growth economy, to one driven by consumer consumption and amidst slowing infrastructure investment. Many countries take years, if not decades, to accomplish this transition, and it is fool hardy to expect that China will accomplish this in just a few quarters.

We do not foresee an imminent implosion in the Chinese economy and while the transition is likely to remain uneven with bumps along the road, we do believe that Chinese growth will probably slow to a more reasonable pace. The concomitant decline in prices for commodities (mostly crude oil as well as industrial metals like ***Dr. Copper***) is also having a sizable impact on some companies and we view these as potential longer term opportunities to add value to client portfolios.

The television air waves are filled with news of ***"death-crosses"*** and ***technical buy and sell levels*** on the major averages – as many market participants resort to drawing lines on a chart rather than conducting a robust analysis of markets. In our view, ***economic growth in the US remains reasonable,*** and despite the outsized gain in 2Q GDP (some of it was inventory accumulation), we do believe that the economy is making slow but steady progress. The run rate for US GDP is somewhere north of ***2.0% per year*** – a steady but not spectacular pace.

US corporations will report ***3Q earnings figures*** in the next few weeks: Expectations going into this season have been beaten down. Consensus earnings expectations do imply a decline of -3.2% for 3Q (year-on-year) and a decline of -1.7% for 2015 as a whole. This is probably overly pessimistic in our view. We do feel that positive earnings figures could provide a fillip to volatile markets.

In summary, current volatility in markets while ***uncomfortable***, is a much needed correction within a ***longer term uptrend in equity prices.*** We do feel that this correction provides an opportunity to execute a ***thoughtful rebalancing*** of client portfolios, especially in some areas like ***energy*** which have witnessed significant price declines, beyond what is justified by fundamentals. We continue to scour the world for those assets that are mispriced from a long term perspective.

Please do not hesitate to contact any of us if we can provide further details or if you have any comments or questions.

Warm regards.

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