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WEEKLY INVESTMENT COMMENTARY

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Keeping Firm Perspective as Markets Gyrate

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A See-Saw Week

Stocks experienced their most volatile week in years, but still managed to close with modest gains. The S&P 500 Index rose 0.91% to 1,988 and the Dow Jones Industrial Average gained 1.12% to end the week at 16,643. The tech-heavy Nasdaq Composite Index fared better, climbing 2.59% to 4,828. Meanwhile, despite the extraordinary level of volatility, bond yields were surprisingly resilient, with the yield on the 10-year Treasury rising from 2.05% to 2.18%, as its price correspondingly slipped.

Investors may be feeling unnerved from the recent roller-coaster ride in the markets, but it is important *to maintain perspective*. U.S. growth has been stalwart in the face of a slowdown in emerging markets. And to the extent the U.S. avoids slipping into a China-induced recession, we believe market fundamentals remain sound. With that as our base case, we expect volatility to remain elevated, but believe the selloff has created some areas of value.

Early Selloff, Midweek Turnaround

Stocks got pummeled early in the week on continued concerns over China, global growth and deflation. At the intraday low on Monday, the S&P 500 Index was down more than 12%, while the VIX Index, which measures U.S. equity market volatility, spiked to over 50, the highest reading since the 2008 financial crisis. The selling was particularly harsh in emerging markets. At the lows on Tuesday, the MSCI Emerging Markets Index was down nearly 30% from its April peak.

However, several developments here at home helped to turn stocks around as the week progressed. Among them were a solid durable goods report for July, a sharp upward revision to second quarter gross domestic product (GDP) and comments from at least one Federal Reserve (Fed) official suggesting a lower likelihood for a September hike in interest rates. The improved U.S. economic data and similarly positive numbers out of Europe were particularly important, as they suggested most developed markets had enough economic momentum to withstand the slowdown in China and other emerging markets.

Economic Resilience Offers a Bulwark

It is important to note that the recent resilience in U.S. economic data paints a comforting picture, confirming a longer-term trend: The economy is still in relatively decent shape. Put another way, for all the markets' twists and turns, and despite the economy's headwinds and travails, this is not 2008.

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A quick refresher: While stocks peaked in the fall of 2007, markets did not really start their meltdown until the following spring. By then, however, there were already several indicators flashing red, not only for the market but for the broader economy. For example, by May of 2008, leading economic indicators had been consistently falling for nearly two years, new orders data had been contracting for six months and unemployment had been rising for 18 months.

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In contrast, the U.S. economy is now holding up relatively well, despite the *challenges in China* and some other emerging markets. True, nobody would confuse the current economy with the glory years of the late 1990s. But leading indicators are up over 4% year-over-year, new orders are comfortably in expansion territory and job creation remains robust. Although it's still entirely possible to have a bear market despite a decent economy, given solid growth and a timid Fed, we don't believe the current correction marks the end of the bull market.

The Return of Value

Last week, we spoke about value in Europe, which managed to end the week with a modest gain. In addition, indiscriminate selling has opened up other *pockets of value*, including in U.S. mega-cap stocks and high yield bonds.

Starting with the former, at the lows on Tuesday, the Dow Industrials were trading at slightly above 13 times forward earnings. While many of these companies are facing pressure from a stronger dollar and sluggish global growth, current prices appear to discount those risks. Plus, as we have discussed in the past, high-quality companies, rather than stocks that are driven by market momentum, are likely to offer some insulation given our expectation for more equity market volatility.

Meanwhile, at the lows early last week, high yield bonds were offering the largest premium over Treasuries in three years. Given our view that the U.S. economy should continue to post moderate growth and any increase in interest rates will be modest, we believe this asset class offers a combination of attractive yields and tamer volatility relative to equities.

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