NEPC MARKET CHATTER

Is it really *All About China*?

I use the "Mom Rule" when determining if market volatility is newsworthy; and last week the "Mom Rule" was enacted. What exactly is the "Mom Rule"? It is when you get a call from your mother at 9:15 a.m. on Friday to see if you are OK. When you respond, "yes, why?", she goes on to tell you that she saw that the Dow futures contracts are down 378 points, she thinks the Chinese market was down overnight below its supported threshold, and she is worried about the dollar strengthening even further. What worries me, worries her… Moms are always thinking.

So, yes, this market volatility is newsworthy and important. Year-to-date, global equity markets are down, largely driven by concerns that the World's second largest economy, China, is slowing. An economic slowdown in China signals the potential of a global recession. Until recently, muted global growth was supported by China's stronger economy. News out of China, including the government devaluing the currency and supporting their local stock market, continues to shake investor confidence. On top of that, continued declines in commodity prices, like oil, put added pressure on commodity exporting emerging market countries. As a result, this is the worst start to the year since (the dreaded) 1929.

Recent Global Equity Market Returns

The U.S. stock market, as measured by the S&P 500, is down over 8% year-to-date and down about 12% since recent and all-time highs last July. A 10% decline loosely defines a market correction, which is what we are currently experiencing.

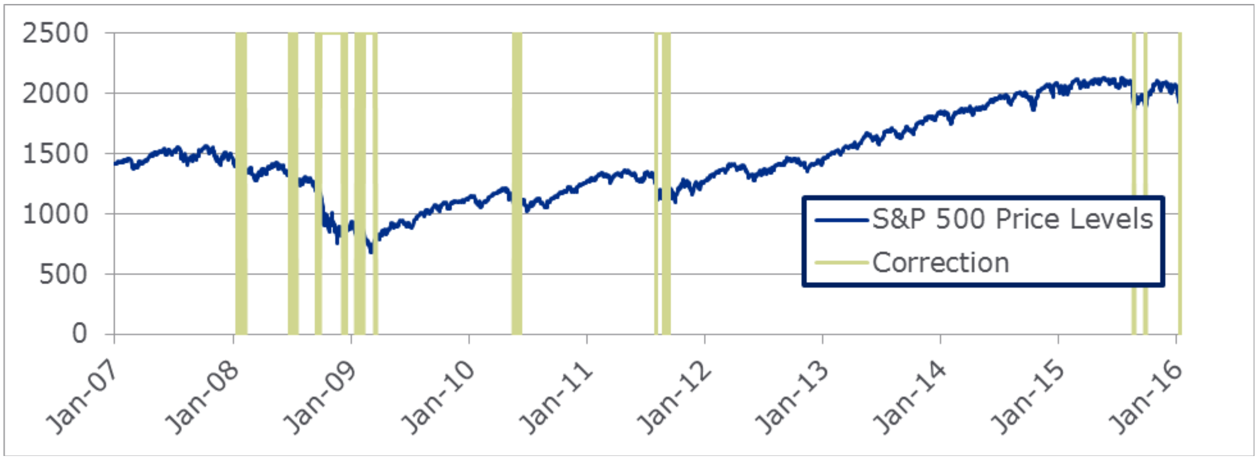
	YTD through 1/15/16	Since Recent High	
S&P 500	-8.0%	-11.6%	Jul-15
MSCI EAFE	-8.8%	-19.7%	May-15
MSCI EM	-10.7%	-24.2%	Apr-15

Notably, recent highs are also at all time levels, as the market has been in a positive run up since 2009. For comparative purposes, the current levels of the S&P 500 (high 1800's) trounce that of peak prices of both March 2000 and June 2007, where prices were in the 1500 range. Furthermore, we've recently tested these high levels twice in the last year, in August and September. But those declines were not defined as corrections. The last correction we saw was in the summer of 2011, when U.S. government debt was downgraded. During that same time, we nearly tested bear market levels, defined as down 20% plus.

S&P 500 Corrections

Today, however, the U.S. economy continues to grow, albeit at a slower pace. Additionally, while China, the world's second largest economy, slows, it is growing at rates still faster than rest of the world. China, however, still has to work through their transition from a commodity/infrastructure oriented economy to a consumer oriented one and, as you are aware, has been the main contributor to the decline in the global equity markets. Corporate profits are certainly reflecting a slower global economy, but most investors, including NEPC, have reflected that in expected returns. This is where your diversification earns its stripes as well as having the liquidity to take advantage of opportunities as they arise. I know, however, that as investors, we have a hard time sitting still. We've thoughtfully considered the overall global landscape and believe that the best way to take action is to cautiously look at rebalancing portfolios. This may seem rules-based, but consider that back in 2008 and 2011, the U.S. economy was in a very different place. In fact, in 2008 we did not recommend aggressively rebalancing back into equities, but into credit, and in 2011 we used some dry powder to enter into less liquid distressed opportunities.

Chart: 10% corrections during 30 day time span



You'll soon be getting our 2016 Market Outlook and Actions for Clients. In summary, we still believe that the U.S. economy is moving forward and that a recession is not imminent. We do think we will continue to experience higher market volatility, as we have in August, September and today.

We encourage that you reach out to your consultant for recommendations relative to your specific positioning. In the meantime, sit tight and hope you don't get more "Mom Rule" calls! Perhaps best said by Bette Davis, "Fasten your seatbelts. It's going to be a bumpy night."