

## News or Noise: Leaders in U.S., EU and China Take Center Stage

By David Fisher, Chief Investment Officer

Even if the thermometer is not yet cooperating, the calendar is turning from a summer lull to a fall full of activity. Globally, leaders and investors are returning from holiday, and specifically in the U.S., the time following Labor Day ushers in the sprint to the finish for the presidential election.

Post Brexit, the markets have shown surprising strength this summer, while volatility has been quite subdued. Standard & Poor's pointed out in a recent note that there have been 40 market sessions without a move of 1% up or down in the S&P 500, and so far in 2016, the average spread of the daily high to low has been 26% below the long-term average. But even as the averages have been subdued, individual positions have moved materially. Since the last 1% market day (July 8), 108 individual stocks and bonds have risen 10% or more, while 20 have lost a similar amount.

It won't take long for the news flow to pick up in September. Over this past weekend, leaders of the G-20 nations met in China. Over the first half of this month, the European Central Bank and Bank of England will both hold meetings. The biggest potential market-moving day of the month will come September 21, when both the Bank of Japan and the U.S. Federal Reserve meet and announce any policy changes. The Bank of Japan's meeting is especially significant, as it will announce the results of a month's-long review of the central bank's policy since the financial crisis.



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## No. 1: Labor Report Likely Complicates Fed Decision

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The Federal Reserve has been relatively successful over recent weeks in preparing the market for rate hikes. Fed Chair Janet Yellen's speech in Jackson Hole, Wyoming, and the various comments by Vice Chair Stanley Fischer have provided the market with warning that the Fed stands ready to raise rates if it gets an opportunity—maybe even two times, in September and December. However, the data out last week probably makes that decision harder as a defined split between hawks and doves on the Fed gives both sides plenty of ammunition. With gross domestic product (GDP) over the last two quarters averaging less than 1% and data last week from manufacturing and employment coming in weaker than expected, the market is placing less than 1-in-5 odds of a hike in September. The Institute for Supply Management (ISM) manufacturing index dropped to 49.4 in August (below 50 indicates contraction), which is much weaker than expected. With other similar data showing better results, the one-month figure appears to be an anomaly, but it will take future reports to make this clear. The all-important labor report was also weaker than expected, with a headline private-sector payroll number of 126,000 versus the 180,000 expected. On top of the headlines, there was no improvement in hourly earnings and a slight decrease in hours worked, both reflective of some weakness.

With the markets acting relatively well in recent weeks as the expectations for a September increase rose, it appears that the markets could tolerate the increase with minimal surprise. However, with the Fed division fairly intense, our gut feeling is that this lack of consensus will keep a rate increase on hold until at least December.

## No. 2: EU Shakes Up Global Corporate Tax Regime

☒ News

☐ Noise

The European Union threw a major curveball in the global corporate taxation discussion with a ruling against Ireland as it relates to taxes paid by Apple. The EU argument is that Apple had sourced income from various jurisdictions in the EU and that the practice of claiming all of this under its EU headquarters in Ireland was a deliberate attempt to improperly shift income. The EU claimed that the Irish headquarters was a tax avoidance technique and not based in financial reality. Apple and Ireland will argue that the arrangement was fully legal, was based on Irish law and could not be retroactively changed. But Ireland will have a hard time satisfying all parties, as it now has to battle politics in the EU and could balance this with the global view that it is a tax haven for multinationals in Europe.

For Apple's part, it is likely to accelerate discussion of a change in U.S. corporate taxation, as it announced Friday that it intends to accelerate the repatriation of as much as \$215 billion of cash that it holds overseas. Up until now, Apple had stated it would wait until a new administration in Washington takes up the tax debate with hopes that a repatriation tax would be lowered in an attempt to bring in large holdings of cash held overseas by large U.S. companies. The conclusion could arguably be even more important for Ireland. The country is home to regional offices for 700 U.S. multinationals, which employ more than 160,000 workers. Foreign investment in Ireland is second only to Singapore for a country

of its size. To the extent that this announcement starts the wheels in motion of global corporate tax reform, especially in the U.S., it could end up being a very newsworthy story.

### No. 3: G-20 Meeting and IMF Push for “Growth Policy”

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Ahead of the weekend G-20 meetings, the International Monetary Fund (IMF) published another report that advocates for significant and coordinated policies to accelerate global growth. The report specifically highlights the risks from global growth, which has now been below the long-term average for five consecutive years. Specifically, the report highlights that the combination of weak growth and rising inequality “feed a political climate in which reforms stall and countries resort to inward-looking policies.” In the report, the IMF advances a three-part solution that first focuses on fiscal expansion, stating that “record-low interest rates make for an excellent time to boost public investment and upgrade infrastructure.” Second, the report urges policymakers to accelerate structural reforms. Finally, the paper pushes for reinvigorating global trade with reduced trade costs and barriers.

The results of the preliminary talks seemed to have come through, even if the G-20’s final communique was light on details. A portion of the closing statements confirms the intent for a much-anticipated handoff from monetary to fiscal stimulus. We shall see if leaders actually follow through:

“Our growth must be shored up by well-designed and coordinated policies. We are determined to use all policy tools—monetary, fiscal and structural—individually and collectively to achieve our goal of strong, sustainable, balanced and inclusive growth. Monetary policy will continue to support economic activity and ensure price stability, consistent with central banks’ mandates, but monetary policy alone cannot lead to balanced growth. Underscoring the essential role of structural reforms, we emphasize that our fiscal strategies are equally important to supporting our common growth objectives.”

#### **What Is News or Noise?**

*Like most of you, we are inundated with information on our phones, in our email inboxes and on the Internet. Clearly, the world doesn’t need another investing blog to reprocess stale information or reformat the day’s useless headlines. Thus, in our investment blog, “News or Noise,” we’ve taken up the challenge of sorting through the infinite bits of background noise and seeking the few truly newsworthy nuggets of information. What are the stories today that are likely to be meaningful for investors in the future? A very small number of headlines are important, and of those, many are immediately processed by investors. Only a tiny fraction of all the new data is truly relevant and underappreciated.*

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