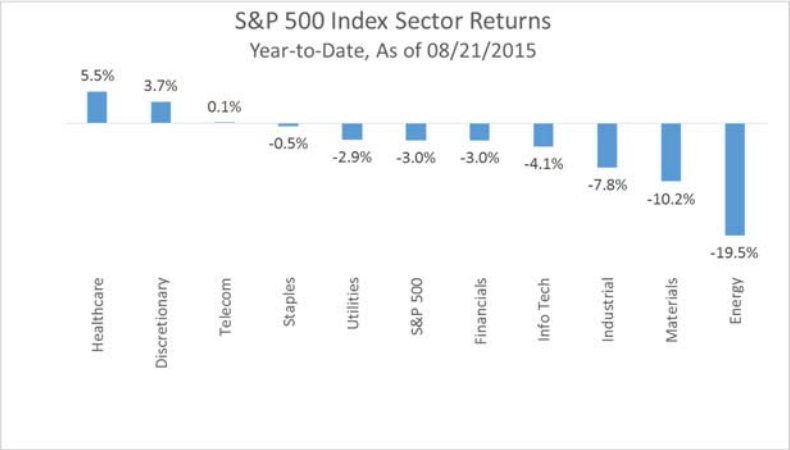
HFS WEALTH MANAGEMENT

Market Update (8/24/2015)

The global sell-off continued today on the back of declines last week. China, declining crude prices, continued concerns over Greece, and the Federal Reserve's near-term interest rate policy have created a potent cocktail for investors to swallow.

China, Greece, Oil, and the Fed

Investors have become increasingly skeptical of China's economy and its growth prospects. The resulting uncertainty has cast a shadow over the global economy. This shadow has been especially dark in areas where China previously provided growth-driven demand like energy and materials (see chart below).



Source: Goldman Sachs Asset Management

The Chinese equity market, as measured by the Shanghai Composite, has had an eye-popping run – boom and bust – over the last 12 months. Its compound growth rate peaked at 131% through mid-June. Following the release of August PMI data, the market tumbled and is down -28% in the last 49 days and -38% from its mid-June peak. (See chart below) While this decline is noteworthy, it is important to keep it in perspective. This marks the Shanghai Composites' 27th bear market in its 25 year history, and it represents the 21st worst in this relatively short time frame. In total, shares of the Shanghai Composite have lost 66% once and 50% three times.

Source: StockCharts.com

While China has been a significant contributor to the recent global market sell-off, Greece is also back in the news. Prime Minister Tsipras recently announced his resignation, paving the way for a new election. This renews uncertainty with Greece's ongoing negotiations with its creditors after the €86 billion bailout to keep it in the Eurozone.

Also newsworthy is crude oil. The West Texas Intermediate (WTI) closed below $40 on Friday, which represents a fresh 6.5 year low (see chart below). The potential for Iranian oil to come online in 2016 and OPEC nations (like Saudi Arabia) feeling the pinch of lower prices both remain causes for concern. It is unclear where crude prices trade from here, but, at some point, the focus by investors will shift from the negative ramifications to energy-related businesses and economies to the simulative effects that cheap oil and fuel prices can have on the economy.

Source: Federal Reserve Bank of St. Louis

COUNTRY	ESTIMATED OIL PRICE REQUIRED TO BALANCE 2015 BUDGET
Norway	$40
Kuwait	$54
Abu Dhabi	$55
Russia	$105
Saudi Arabia	$106
Nigeria	$122
Iran	$131
Algeria	$131
Venezuela	$160

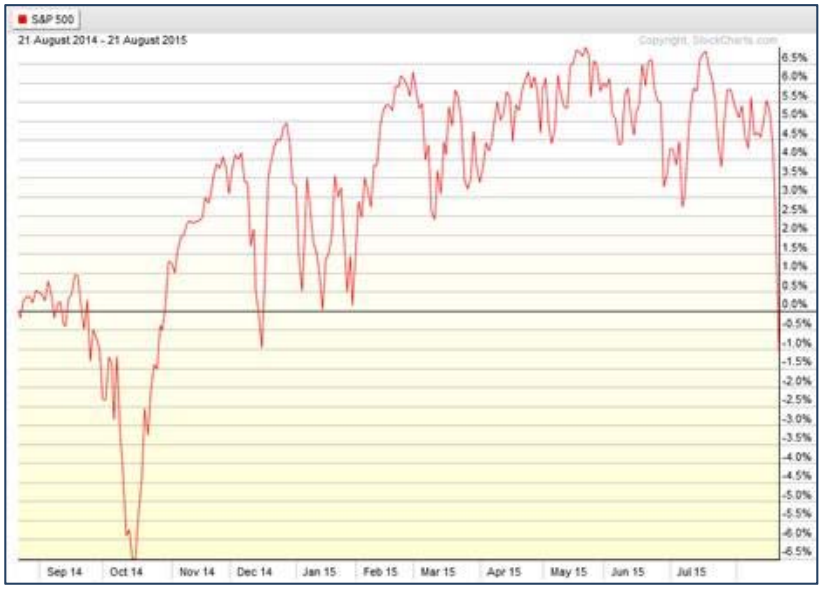
Sources: International Monetary Fund (2014b), except for Nigeria, Russia and Venezuela (Deutsche Bank, 2014) and Norway (Fitch Ratings, 2014).

Source: Federal Reserve Bank of St. Louis

The result of so many negative macro headlines bombarding investors has caused the prices of relatively safer assets to be bid up. Since reaching a high of 2.48% for the year, the benchmark 10yr U.S. Treasury yield has declined, closing last week at 2.05%, a level not seen since February. (Remember that bond prices move inversely to interest rates.) With declining interest rates and sub-2% inflation (and the prospect of deflation coming out of China), the Fed may delay raising interest rates in September and possibly December.

Impact on U.S. Stocks

U.S. equities have not been immune from selling pressure impacting other markets. The S&P 500 shed -5.7% last week, is down -4.2% mid-way through Q3 and -3.0% YTD. It is currently at a 15-month low, with roughly 1/3 of the S&P 500 constituents in a bear market (defined as a 20% loss) and another 1/3 in a correction (defined as a 10% loss). As with the Chinese stock market decline, it is important to keep things in perspective. The S&P 500 has had 27 corrections of 10% or more, versus only 12 full-blown bear markets (with losses of 20%+) since the end of WWII.



Source: StockCharts.com

Market Implications

While we cannot predict the end of the current sell-off in global equity prices, we do not think it is the start of a global bearish trend because we do not think the global economy is on the brink of recession. The U.S. continues to lead globally, and its consumer-driven economy is supported by strong fundamentals, with low unemployment, household finances that are far improved from the financial crisis, and financial institutions that have vastly stronger balance sheets. Additionally, the consumer will benefit from lower energy prices and lower import prices. As one financial pundit noted in relation to the U.S., "this is a stock market gone mad, not an economy gone bad."

HFS Positioning

While last week's economic data out of China was negative, and the rout in equity prices has been painful to experience, it has not changed our views on global growth which ultimately underpin our investment strategy. We remain focused on assets in developed economies, both large cap equities and higher-quality, lower duration bonds. Further, we continue to take a disciplined and unemotional approach to managing assets, focusing on the fundamentals of the investments we own and maintaining a long-term perspective. Price volatility creates opportunities for long-term investors and we will look to take advantage as opportunities arise.