Observations on the Capital Markets
– Week Ended 11/28/14

OPEC’s failure to cut production shocked the market:

- **Commodities:** On Thursday, OPEC didn’t cut production. WTI crude lost $7 on Friday, ended the week down $10 to $66 (lowest since 2009). Gold fell $21 to $1,183.

- **Currencies:** More of the same. The euro ended the week up 0.5% against the dollar; the yen declined another 1%. The Russian ruble and Brazilian real lost 8% and 2%; respectively … I guess the prior week’s bounce wasn’t a bottom, just a pause.

- **Global Bonds:** Most Eurozone sovereign yields fell to record lows as European Central Bank (ECB) speakers continue to hint at QE. German 10-year yields fell 7 basis points (bps) to 0.66%; peripheral spreads generally narrowed. Spain’s 10-year fell below 2% for the first time ever. Irish 10-year yields broke 1.5%. Japanese 10-year yields fell 4 bps to 0.42%.

- **U.S. Bonds:** Treasuries participated in the global rally; energy continues to weigh on the corporate sector. The 10-year Treasury yield dropped 13 bps to 2.18%; the 10-year TIPS yield fell 6 bps to 0.39%. The Barclays U.S. Aggregate Bond Index returned 0.5% for the week. The BoAML High Yield Index returned 0.0% (flat) as its OAS rose another 10 bps to 4.64%.

- **International Equities:** Markets like QE. The MSCI Europe Index was up 0.9% in U.S. dollar terms. The MSCI Japan Index was down 0.3%. The MSCI Emerging Markets (EM) Index ended flat. Within EM, China and Korea led; Russia and Brazil were notably weak.

- **U.S. Equities:** OPEC’s decision drove sector-level returns. The S&P 500 Index rose 0.2%, extended its winning streak to six weeks. Consumer Discretionary (+2.5%, led by retail…lower gas prices free up spending money) and Information Technology (+2.1%) sectors led. Energy (-9.5%) was by far the weakest sector, reacting to commodity prices; Materials (-3.1%) and Industrials (-0.5%) were also down on the week, with oil-linked businesses lagging.

**U.S. Growth a Modest Positive**
Q3 U.S. GDP growth was revised up from 3.5% to 3.9% (annual rate). This is backward-looking, but it’s a modest positive. Key contributors to the change included:

- +0.5 points from less inventory liquidation (mean-reverting noise in the long run)
- +0.3 from higher personal consumption expenditure (mostly on discretionary items)
- +0.2 from higher business equipment spending
- -0.5 from higher imports and lower exports
Business Indicators Point to Moderate Q4 Growth
October durable goods orders rose 0.4% month-over-month (m/m), above consensus, but the details were weak. There was a double-digit jump in defense aircraft orders, but orders ex-transportation fell 0.9% and core capex orders fell 1.3%.

- The Markit services PMI slid 1.0 m/m to 56.3. Lower, but still well above 50 (moderate growth).
- The Richmond Fed Manufacturing Index fell from 20 to 4, still positive, but below consensus.
- The Chicago PMI reversed October’s rise (from 60.5 to 66.2), falling to 60.8.
- On a more positive note, the Milwaukee Fed Index rose from 65.6 to 68.9.

Consumer Income, Spending Rose Modestly
- Personal income rose 0.2% m/m and 4.1% year-over-year (y/y).
- Disposable (after-tax) was up 0.2% m/m and 3.9% y/y as taxes paid rose 0.5% m/m and 4.9% y/y.
- Consumer spending rose 0.2% m/m (3.6% y/y in nominal terms, 2.0% in real terms).
- The savings rate didn’t change.
- The Conference Board Consumer Confidence Index fell 5.4 to 88.7, reversing its rise last month.
- The University of Michigan Surveys Consumer Confidence Index slid from 89.4 to 88.8.

Housing Still Trending Sideways
- New home sales came in at a 458k annual rate in October ... the trend is still flat.
- Pending (existing) home sales fell 1.1% m/m in October ... up about 2% y/y.
- The FHFA and S&P/Case-Shiller 20-City Home Price Indices were essentially flat m/m. Year/year appreciation slowed from 4.7% to 4.3% and from 5.6% to 4.9%, respectively.
- Both the mean ($401k) and median ($305k) new home price jumped to all-time highs.

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