



PROVIDING CONTEXT TO THE TURMOIL



*Robert White, CFA,
CFP, Director,
Investments*

Global equity markets suffered from indiscriminate selling pressure on Monday as a continued stock market crash in China spread through global markets. Before we discuss the reasons for the sell-off, I want to be clear that we believe that the sell-off is unwarranted given global economic fundamentals and equity market valuations. While short-term volatility is likely to continue and markets may test yesterday's lows again over the coming months, we believe that looking out over the next

12-18 months the current environment may offer opportunities for strategic investments.

WHY HAVE MARKETS CORRECTED?

Although U.S. equities have been positive for five years without a material pullback, the current correction has been in the making for a while. Emerging market equities have underperformed since 2011 as investors feared a slowdown in their economic growth. Subsequently, oil and commodity prices slumped in early 2015 and then European markets declined in the early summer. The contagion eventually hit U.S. stocks last week. The final catalyst was China's currency devaluation on August 11, 2015. This significantly increased investor fears regarding the strength of the Chinese economy and put pressure on those areas most connected to China - global commodities and emerging markets. While no one has a crystal ball with respect to China, its economic growth prospects or the actions of the Communist Party of China, we do believe that the current fears are overblown in a global context.

IS THERE A SILVER LINING?

- We believe that economic fundamentals are little changed in the developed markets. While U.S. growth has softened, it remains positive and we do not feel that there is any material risk of recession given the strength in the labor market. However, the Federal Reserve must now decide whether to delay the long-awaited rise in interest rates. While we cannot predict this outcome, market commentators are suggesting that equity market volatility and softening global growth may cause the Fed to delay the rate rise until December 2015 or even March 2016.
- Economic prospects in Europe remain constructive and we do not believe that they will be derailed by the continued softening of growth in China. Having said this, the Euro has strengthened (due to investor belief that U.S. rates will remain at 0% for longer) and, if sustained, this may put downward pressure on exports and corporate earnings.
- Valuations are significantly more attractive now than at the start of the year. In the U.S., earnings growth and profit margins remain elevated and some of the froth in the market has been removed. Throughout Europe equities are down almost 20% and are now trading at a 45% discount to U.S. equities. With improving economic fundamentals and an accommodative European Central Bank, we view the sell-off as an opportune time to invest in European equities.
- Lower oil prices will continue to be a driver of consumer spending in the U.S. and most of the developed world.

HOW IS MARKET STREET POSITIONED?

We believe our diversified strategies are well positioned to provide protection against equity market volatility. Year to date, U.S. and international developed market equities are down around 7% and although the Market Street Growth Strategy has provided a disappointing absolute return, portfolios have certainly been protected from the full force of the correction.

- We have explained previously that despite low return expectations, high quality municipal bond exposure reduces risk by providing protection against equity market losses. Over the past year we reduced U.S. equity exposure and increased portfolio allocations to municipal bonds. Municipal bonds are up around 1% over the year to date - while the return is low, it is positive!
- Although exposure to hedged strategies has hurt during the 6-year long bull market in equities, it is at times like this that portfolios benefit from the downside protection that is offered. As an example, our long/short emerging market manager is down 5.8% over the year to date compared to a 17.9%

decline in the MSCI Emerging Market Index. We continue to believe that hedge funds have a role in portfolios, with sophisticated strategies providing exposure to both alpha opportunities and downside protection.

Additionally, indiscriminate selling provides a great opportunity for our active managers to buy their favored stocks at a discount. We have been increasing exposure to active managers in the belief that stock returns would become more fundamentally driven. Despite the highly correlated sell-off, we continue to believe that over the coming months, active managers will outperform.

To conclude, stock market volatility can be a scary time for investors. However, we advise you to look past the volatility and the fearful headlines. The world is in a much better shape than it was in 2008 and we fully expect portfolio returns to be attractive (although not double digit) in the coming years. At Market Street, we are focused on constructing thoughtful long-term diversified exposure to the markets, a strategy and mindset that will be not be derailed by short-term events and fears.

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80 E. Market Street, Suite 300 | Corning, New York 14830 | 607.962.6876 phone | 607.962.6709 fax
499 Park Avenue, 26th Floor | New York, New York 10022 | 212.400.9070 phone | 607.962.6709 fax
www.MarketStreetTrust.com