Rock Solid or Rocky?

Key economic indicators and capital market events for October 2013 by Joe Terranova, Chief Market Strategist

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So far, 2013 has challenged investors with numerous global headline risks – including the sequester, Cyprus crisis, FOMC taper talk, China slowdown, and Syrian conflict – yet the S&P 500® Index (SPX) has managed to be resilient, producing double-digit returns. This year's pullback of 7.5% (May 22 to June 24) is significantly lower than the corrections of the previous few years: 10.9% in 2012, 21.6% in 2011, and 17.1% in 2010. Clearly, the market's technical foundation is built upon rock. If the SPX is to continue to perform like a rock for the remainder of the year, we need to see evidence that economic growth is accelerating. For the fourth quarter, markets will either appreciate further or transition into weakness based on the pure math of the economic data, including U.S. and China's growth rates, corporate profit margins, and U.S. Treasury yields. A rock solid or rocky outcome for October will depend on whether the market can find the next growth catalyst to carry it higher.

October 2013

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
	Sept. 30 **U.S. Federal Spending Authority Deadline** **China PMI (September)**	1 **European PMIs** 10:00 AM: **U.S. ISM Manufacturing**	2 **ECB Monetary Policy Meeting**	3 10:00 AM: **U.S. ISM Non-Manufacturing**	4 8:30 AM: **U.S. Labor Report**	5
6	7	8	9 2:00 PM: **FOMC Minutes (September)**	10	11 **JPM & WFC Kick Off Earnings Season***	12
12	14 **U.S. Columbus Day Holiday**	15	16 2:00 PM: **Fed Beige Book**	17 **China Q3 GDP** 10:00 AM: **U.S. Philly Fed Manufacturing**	18	19
20	21 10:00 AM: **U.S. Existing Home Sales**	22	23	24 10:00 AM: **U.S. New Home Sales**	25 **U.S. Treasury/Debt Limit Borrowing Red Zone**	26
27	28	29 9:00 AM: **U.S. S&P Case-Shiller HPI**	30 2:00 PM: **FOMC Meeting Decision**	31 **U.S. Debt Limit "Trick or Treat"**		

*Times shown are Eastern Time. *Expected earnings release date; may be subject to change.*

October indicators / events of note:	You should be watching:
U.S. Federal Spending Authority Deadline **U.S. Treasury/Debt Limit Borrowing Red Zone** The U.S. federal government faces two fiscal deadlines: 1) If Washington cannot reach an agreement on a stopgap spending bill, the federal spending authority for agencies will expire on October 1 and cause nonessential programs to shut down. 2) The government is expected to exhaust its borrowing authority in late October and will be unable to pay its obligations unless the federal debt limit is raised.	There is a significantly higher chance that the federal spending authority deadline will be breached than the actual debt limit. If a shutdown in nonessential government services occurs – as happened in November and December 1995 – it is unlikely to have a significant economic impact. However, the closer we get to September 30 without reaching a federal spending agreement, the markets will continue to sour, which will only add to the negative tone surrounding the federal debt limit debate. That is a much larger, more contentious issue that will take up the second half of the month, and will need to be resolved by November 1.
China PMI China PMI (purchasing managers' index) provides a monthly gauge of China's manufacturing sector which, when combined with the monthly U.S. ISM Manufacturing Index value, gives a clear picture of global manufacturing health. A PMI value above 50 indicates growth, below 50 contraction.	Last month's China PMI came in at 51.0 – the first time the index has hit this level since April 2012. At this point, China's modest manufacturing growth does nothing more than suggest there is the potential for stability to bleed through to the broader emerging markets.
European PMIs Each country's PMI is a key measure of the state of its manufacturing sector. An index value above 50 indicates growth, below 50 contraction.	We all know, Europe is investable once again. The euro currency, which has been trading at 1.30 on average for the last six months, has been a strong contributor to a slight increase in exports and a clear resurgence in manufacturing. However, it may be too late in the cycle for manufacturing to become an investable theme, especially in the United Kingdom where PMI came in at 57.2 last month, considerably higher than February's 47.9. The recovery in European manufacturing seems modest at best. Eurozone PMI was 51.1 for August, and I'd be surprised if it rose above 52 for September. If it does, then Europe's growth rate may be greater than expected.
U.S. ISM Manufacturing Issued by the Institute of Supply Management, this report provides an influential monthly measure of the health of U.S. manufacturing based on an in-depth survey of 300 manufacturing firms. An index value of 50 is the dividing line between an expanding or slowing economy. Data released is for the previous month.	Sluggish ISM reports for April, May, and June (50.7, 49.0, and 50.9) were followed by strong reports for July and August (55.4 and 55.7) as the impact of the second quarter sequester budget cuts appears to have worn off. The new orders-to-inventory ratio also continues to expand, a show of strengthening. The rapid manufacturing recovery supports my baseline expectations for U.S. growth to accelerate toward 3% in 2014.
ECB Monetary Policy Meeting The European Central Bank (ECB) releases its monetary policy announcement on October 2.	Investors may be inclined to ignore the ECB meeting – but they shouldn't. With Europe investable once again, we've been turning our worries to the Fed, the Bank of Japan, and U.S. fiscal issues. However, we really should be worrying about the euro currency, which has been walking its way back up uncomfortably higher. I fully expect ECB President Mario Draghi to use verbal intervention to attempt to walk the euro currency lower as he successfully did back in February. The eurozone cannot handle a currency valuation that is challenging 1.37, with the potential to go to 1.40. Mr. Draghi must take action to counter the effects of U.S. policy, which has weighed on the U.S. dollar. The October ECB meeting is not to be ignored.

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U.S. ISM Non-Manufacturing The index is based on surveys of nearly 400 firms from 60 sectors across the U.S., including agriculture, mining, construction, transportation, communications, wholesale trade, and retail trade. The index provides the economic backdrop for the various markets, and consists of data on business activity, new orders, employment, and supplier deliveries.	Consumer spending continues to increase on the services side of the U.S. economy. Last month, the ISM non-manufacturing reading was 58.6 for August, following strong numbers for July (56.0), June (52.2), May (53.7), and April (53.1). The services sector has not seen strength like this in eight years. For me, it is another important condition that suggests there is real potential for acceleration in U.S. economic growth.
U.S. Labor Report Private payroll data is part of the Labor Department's monthly U.S. Employment Situation report. This data gives the true employment story, is the best gauge of the economy's direction, and has the power to move markets.	Last month's U.S. labor report (for August data) was mildly disappointing. Some of the positive expectations for that report might show up in the October report. Last month, total payrolls added 169,000 jobs and private payrolls picked up 152,000. This month, both figures could add another 180,000 to 190,000 jobs. We might also see further decline in the unemployment rate, from 7.3% last month to perhaps 7.2%.
FOMC Minutes The Federal Open Market Committee (FOMC) releases the minutes from its September 17-18 meeting.	The FOMC minutes from the September "no taper" meeting will be insightful in revealing whether its decision not to reduce monthly asset purchases was universal among all committee members. Were they concerned with the perceived fiscal tightening following Dr. Bernanke's testimony in May that led rates to rise 50 to 75 basis points, or do they see true impediments in the economy of concern? Either way, the Fed has lost some credibility by trying to be too transparent. One thing to keep in mind, if the market has an oversized reaction to the minutes in either direction, investors should resist making any significant portfolio adjustments.
JPM and WFC Kick Off Earnings Season* J.P. Morgan (JPM) and Wells Fargo & Company (WFC) are expected to release earnings on Friday, October 11.	Earnings season begins Tuesday, October 8, but the season doesn't really start for me until Friday, October 11, when J.P. Morgan and Wells Fargo release earnings. We may see some volatility in the marketplace ahead of this long holiday weekend. Financials have remained under pressure, underperforming relative to their peers. Certainly, the pullback in interest rates has been problematic. In addition, trading revenues are expected to be softer, and we could see mortgage revenue on the decline. If there's going to be a market catalyst in October, it could come from earnings, and we should be looking for any sign of resiliency here. Will financial firms be able to post solid earnings despite what has been thrown at them?
Fed Beige Book The Beige Book provides FOMC commentary on the current economic conditions in each of the Federal Reserve's 12 districts and is released two weeks prior to the next FOMC meeting.	The Fed's Beige Book will be even more relevant than the FOMC minutes released earlier this month. Investors should be paying attention to the latest economic conditions revealed in this report, which will be relevant in determining whether a taper announcement will come out of the October FOMC meeting.

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China Q3 GDP China's gross domestic product (GDP) growth rate provides an aggregated measure of changes in the value of goods and services produced by the world's second largest economy.	Expectations for China's growth were lowered significantly in the spring, with many analysts setting their expectations below 7%. In fact, China GDP came in at 7.5% for the second quarter, and many are expecting the same for the third quarter. We could see a modest surprise to the upside in third quarter GDP, potentially closer to 7.6% or 7.7%. The bigger question, might we see a reacceleration in growth that suggests a return to 8% in future quarters? Currently, there is a wide divergence in expectations for 2014 China GDP, ranging from 7.0% to 8.0%.
U.S. Philly Fed Manufacturing This monthly survey provides useful intelligence on manufacturing conditions within the Philadelphia Federal Reserve district and is useful as an indicator of broad manufacturing sector trends.	The June through September Philly Fed readings (22.3, 9.3, 19.8, and 12.5) were four of the strongest months for the index since the calendar turned from 2010 to 2011. In fact, you may recall that in his March 2011 testimony before congress, Fed Chairman Bernanke cited the strength in the Philly Fed numbers for the prior four months as one of the reasons he thought tightening was closer than many expected. His comments led to a spike in interest rates. He was wrong then, just as I think he is now, not to taper.
U.S. Housing Indicators > **Existing Home Sales** – This monthly report from the National Association of Realtors provides sales-closing data on previously constructed homes, condos, and co-ops. > **New Home Sales** – Issued monthly by the U.S. Census Bureau, U.S. Commerce, and U.S. Housing Departments, this report reveals the number of newly constructed homes with a committed sale. > **S&P Case-Shiller Home Price Index (HPI)** – This index, released on a two-month lag, tracks changes in the value of residential real estate in 20 metropolitan regions across the U.S.	Housing data will be important this month, as it's provides the last look the Fed will have at key economic data before the October FOMC meeting. Existing home sales have come in strong over the last three months: 5.06 million in July, 5.39 million in August, and 5.48 million in September. We have not seen numbers this strong since September 2005. New home sales for the last few months have also been relatively strong: 454,000 in June, 390,000 in July, and 421,000 in August. The slight moderation seen since June could be due to the impact of fiscal tightening on mortgage interest rates. S&P Case-Shiller home price data remains important for its role in the "wealth effect." Consumers are more inclined to spend money when the value of their homes and their investments rise. As the FOMC prepares to meet in late October, wealth creation will be very important to them. Home prices have been rising around 12% on a year-to-year basis, consistently over the last four months. Of all the housing data, a negative home price report would cause the most market reaction.

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FOMC Meeting Decision Following its October 29-30 meeting, the Federal Open Market Committee (FOMC) releases its monetary policy statement.	I think the yield on the 10-year Treasury rose too much for the Fed's comfort level to initiate tapering at its September meeting. Once again, the 10-year Treasury yield may be the ultimate determinant for whether the Fed tapers or not at its October meeting. Much of the FOMC's decision may be riding on where the 10-year is trading in the week to 10 days prior to its meeting. If October's economic data comes in strong and the 10-year is yielding 2.50% to 2.60%, they will probably go for the taper. I would be astonished if the taper doesn't start by the end of the year. If they don't start to reduce asset purchases soon, we could have a larger problem on our hands economically. However, we may have a "trick or treat" situation instead. If the debt limit debate hasn't been resolved by the FOMC meeting, the Fed may decide to act on headline risk, rather than economic risk, and delay the tapering decision until its December meeting.
U.S. Debt Limit "Trick or Treat" If the debt limit debate is not resolved by the end of October, the U.S. Treasury will exhaust its borrowing authority and be unable to pay its obligations.	This will be the last weekend before the target deadline for raising the debt limit. I don't expect the U.S. government will default on its debt, as that would be political suicide for sitting members of Congress. However, if a resolution to the debt limit has not been reached by the last Thursday or Friday of October, the market will begin to worry and react accordingly.

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Joe Terranova is chief market strategist for Virtus Investment Partners. He was elevated to that position in June 2009, having started with the company in the role of chief alternatives strategist.

In his current role, Mr. Terranova works with Virtus' regional sales teams and the financial advisors who sell the company's investment products, providing insight into the domestic and global investing landscape and has represented Virtus as a keynote speaker for several financial institutions. He is a member of the Virtus Investment Oversight Committee.

Prior to joining Virtus in 2008, Mr. Terranova spent 18 years at MBF Clearing Corp., rising to the position of director of trading for the company and its subsidiaries. In this capacity, he managed more than 300 traders and support staff for MBF, one of the New York Mercantile Exchange's largest firms. His work was highlighted as the feature story in the June 2004 issue of *Futures* magazine.

Mr. Terranova is perhaps best known for his risk management skills, honed while overseeing MBF's proprietary trading operations during some of the most calamitous times for the U.S. markets, including the first Gulf War, the 1998 Asian Crisis, 9/11, and the collapse of Amaranth Advisors. In 2003, he was one of the first Wall Street professionals to make an early call for higher energy, natural resources, and commodity prices. In June 2008, he cautioned investors to move to the sidelines in commodities and, in March 2009, he encouraged investors to ignore the global "embracement of pessimism" and overweight equities. Before joining MBF, Mr. Terranova held positions at both Swiss Banking Corp. and JP Morgan Securities.

Mr. Terranova has been an ensemble member of the CNBC *Fast Money* franchise since 2008. He also frequently contributes exclusively to CNBC's other business programs. He is the author of *"Buy High, Sell Higher"* (Business Plus, 2012), a book about the "new rules" of investing based on his years as a professional trader.

In 2007, Mr. Terranova and Hockey Hall of Fame player Mike Bossy established "Bossy's Bunch," a program that rewards excellence in the classroom for elementary school students.

Mr. Terranova earned a bachelor's degree in finance from the Peter J. Tobin College of Business at St. John's University in New York.

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