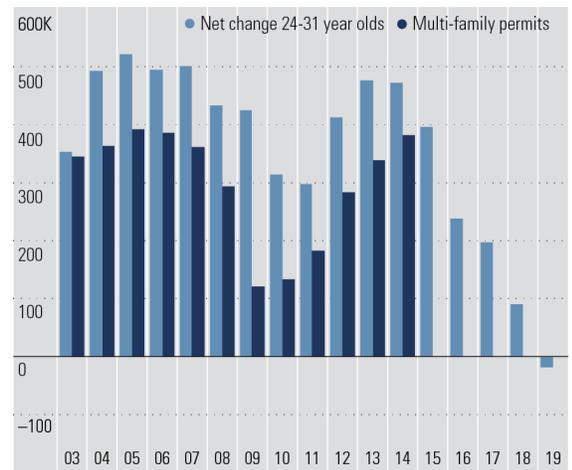




## Aging Millennials Should Drive Up Single-Family Home Sales

In this recovery, there has been a surge in interest in apartment buildings. Meanwhile, single-family home sales are still running about 50% below their previous peak. The chart illustrates what may be behind some of that change. Following the decline in the 24-31 year old cohort, that group is now growing again. Not surprisingly, so are multi-family permits and interest in apartment buildings over the last several years. Looking at the data for 2014-2019, that age dynamic will begin to shrink according to Morningstar economists. That's bad news for people building apartments, but great news for the overall economy. Single-family homes utilize more labor and more materials than apartment buildings do. So, as the age group begins to buy homes instead of living in apartments, it should drive up single-family home sales and boost the economy.

### Demographics Drive Renting Business



This article contains certain forward-looking statements which involve known and unknown risks, uncertainties, and other factors that may cause the actual results to differ materially from any future results expressed or implied by those projected statements. Past performance does not guarantee future results.

Source: Census Bureau, Morningstar



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According to remarks last week, the Federal Reserve still expects interest rates to rise in 2015. This is following seven years of an unprecedented "easy money" policy put in place to revive the economy. For fixed income investors, higher interest rates could mean a decline of market value in their existing bond portfolios. Should this, however, be a reason to eliminate or avoid the asset class altogether? We

don't believe so. Our investment approach relies on an individually appropriate asset allocation target determining the investor's exposure to bond investments. We do not think it wise to move back and forth between asset classes according to forecasts of interest rates. From that point, we build our clients' bond portfolios around high quality, intermediate term, liquid investments that are laddered in

maturity. This approach provides us comfort that these portfolios will weather a rise in interest rates with manageable dislocation. On the positive side, we may soon begin to see higher yielding investment opportunities.

# Monthly Market Commentary

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The biggest debate in the past few weeks was, what mattered more, the Chinese stock market decline or Greece's potential exit from the eurozone? With a Chinese economy at \$10.7 trillion and Greece at \$0.2 trillion, it doesn't seem like much of a fight. However, Greece does have some potential for wrecking the E.U. system, which is a very large, \$13.4 trillion economy. Morningstar economists believe that Greece itself and the solutions to its problems are not likely to have a major impact on the world economy. China's situation, however, remains much more worrisome.

**Employment:** The job openings report continued to show growth in May, setting yet another record for job openings at 5.36 million, up over 16% from a year ago and 0.5% (6% annualized) from April. Although records go back only as far as 2000, this is the highest reading in the entire data set.

Most economists have viewed this as a highly positive and leading indicator of future employment data. Morningstar economists, however, have pointed to the job openings data in several reports as an indicator that labor markets are tightening. Indeed, the indicator did a great job of forecasting the surge in hiring in late 2014 that almost no other data series did. Right now, the indicator seems to be saying that job growth may be plateauing as year-over-year averaged growth in openings is showing early signs of peaking. Year-over-year growth is still elevated at 19%, but that is down from a high of 24% several months ago.

**Housing:** Unfortunately, housing doesn't seem to be as strong as previously hoped. Demand seems somewhat better, but on the supply side, housing starts still look pretty anemic and inventories of existing homes still aren't really moving up, which is keeping continued pressure on prices.

**Trade:** The trade balance was the single largest factor in the U.S. economy's weak first-quarter performance. Trade took almost 2 full percentage points off of the GDP calculation. Without the negative trade performance, the economy would have grown 1.7% instead of shrinking 0.2%. The trade deficit, which had swung as high as \$50 billion in March, moved to \$40.7 billion in April and stabilized in May at \$41.9

billion.

**International:** The International Monetary Fund revised its entire world growth outlook last week. These revisions were lower than the prior forecast, produced in January, which, in turn, was also lower than the forecast produced in October 2014. That October forecast predicted world growth of 3.8%, which was reduced to 3.5% in January and now to 3.3% in the July update. That is lower than the 3.4% actual world growth rate for 2014. And much like the United States, it's stuck in a rut that it can't dig itself out of, with world growth equaling 3.4% for each year of 2012 through 2014. (U.S. growth has been between 2.1% and 2.4% since 2011).

**Demographics:** Demographics will also hold back the overall growth rates for some time to come. Low population growth (0.7% now, instead of 1.8% in the 1960s) is likely to keep the economy from growing any faster than Morningstar's 2.0%–2.5% forecast, versus the average GDP growth rate over the last 50 years of around 3.1%. In addition, it isn't helping that the fastest-growing age group in the U.S. economy is the miserly 65 and over crowd, while the absolute number of free-spending, high-income 50 year olds will be in a pattern of decline over the next five to 10 years.

**Quarter-End Insights:** Despite a disappointing first quarter, Morningstar economists expect higher growth rates in the second half of the year. Inflation is likely to run considerably higher in 2015 than either 2013 or 2014. Core inflation (excluding food and energy) will likely be around 1.7% for 2015, very similar to the last two years, but the ups and downs of energy prices will cause headline inflation to accelerate in 2015, especially if energy prices don't fall soon.

# How Much Foreign Stock and Bond Exposure Do You Need?

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This is one of the central questions confronting investors putting together their portfolios, yet there seems to be no consensus. Some experts argue for highly globalized portfolios, with allocations to foreign and U.S. stocks and bonds mirroring their market values. But other experts believe that due to the extra costs and volatility that can accompany foreign stocks and bonds—and especially the foreign-currency swings that can occur when those market gains or losses are translated into U.S. dollars—less is more when it comes to foreign exposure. A related question is whether (and how) a portfolio's allocations to foreign and U.S. stocks and bonds should change over time.

Stock Allocations: Fully Global, U.S.-Centric, or Somewhere In-Between?

The issue of how much investors should stake in foreign stocks has been a contentious one for years. In the "less foreign is more" camp are experts who believe that because many U.S. blue chips are increasingly global in their reach, investors in them get exposure to foreign markets indirectly, while avoiding the extra costs and volatility associated with foreign stocks (foreign-currency swings in particular). At the other extreme are the "global market-cap agnostics"—those who suggest buying a basket of U.S. and foreign equities weighted according to their market values. The U.S./foreign allocations of global-market indexes have hovered around 50/50 for the past several years.

Meanwhile, most asset-allocation experts recommend a middle ground. Investors may not need to steer half of their portfolios to foreign stocks to obtain most of their diversification benefits. The rationale behind how much foreign exposure an investor may choose gets back to volatility. Because foreign stocks typically entail some currency risk as gains or losses are translated from foreign currencies to dollars, investors who want to reduce volatility may want to also reduce their foreign weightings accordingly.

Bonds: It's Complicated

Even though more than 50% of the world's fixed-income investments exist outside the United States, investing in foreign bonds has the potential to add cost

and volatility to a U.S. investor's portfolio. Few asset-allocation experts are in favor of mirroring the global markets' allocation to U.S. and foreign bonds.

Because types of foreign-debt exposure vary so widely, one-size-fits-all recommendations are tricky. Investors could steer a larger share of their fixed-income portfolio to foreign sovereign bonds rather than corporate and/or local-currency-denominated debt.

The volatility issue can be addressed, at least in part, by hedging out the currency risk of the foreign bonds. That helps ensure that investors partake of foreign bonds' yields and any price changes, but not the currency-related impact when those returns are translated into dollars. However, hedging strategies entail costs, and in a low-returning asset class like bonds, those costs can take a big bite out of returns.

Past performance is no guarantee of future results. An investment cannot be made directly in an index. Diversification does not eliminate the risk of experiencing investment losses.

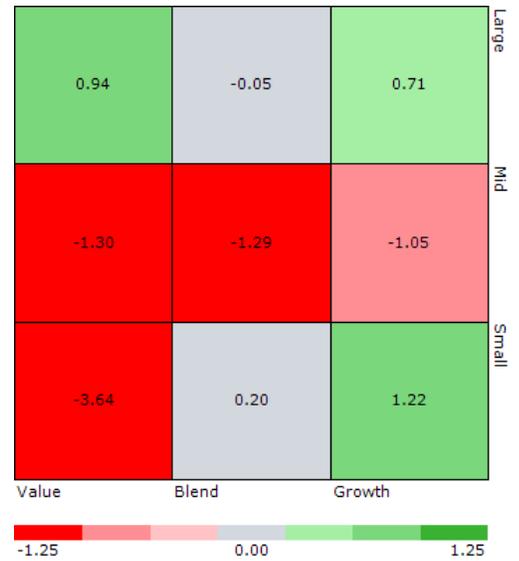
Returns and principal invested in stocks are not guaranteed, and stocks have been more volatile than the other asset classes. International bonds are not guaranteed. With international bonds the investor is a creditor of a foreign government or corporation. International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards.

This article contributed by Christine Benz, Director of Personal Finance with Morningstar.

# Quarterly Market Barometer

3 Months, ending June 30, 2015. The U.S. Market returned 0.08% (YTD 1.85%).

The Morningstar Market Barometer provides a visualization of the performance of various stock market indexes. The color scale (red for losses and green for gains) allows you to assess which areas of the market performed strongly and which areas showed weakness for the time period analyzed. The nine-square grid represents stocks classified by size (vertical axis) and style (horizontal axis). There are three investment styles for each size category: small, mid and large. Two of the three style categories are “value” and “growth” while the central column represents the core style (neither value nor growth characteristics dominate). Large-caps account for the top 70% of the capitalization; mid-caps represent the next 20%; and small-caps represent the balance.



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