AF CAPITAL MANAGEMENT
Registered Investment Advisor

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INSIDE THIS ISSUE

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Perspectives

The second quarter was a stressful time for investors as the S&P 500 fell 4.78 points in second quarter, ending a nine-quarter winning streak. We learned the US gross domestic product (GDP) contracted in the first quarter. Puerto Rico's governor said they might not be able to make an upcoming debt repayment and asked for concessions on their loans. Greece missed a debt payment on June 30 to the International Monetary Fund and is in jeopardy of leaving the European Union. The Fed started preparing investors for an interest rate hike as soon as September. China's Shanghai composite index fell into bear market territory, down more than 20%.

Many economists were surprised by the reversal of growth in the first quarter's GDP, but early indicators show a second quarter economy that is on the mend and is not destined for another recession yet. Economic indicators from housing to employment are showing an environment that isn't growing as quickly as some would like, but is growing at a steady rate and is not in bubble territory yet.

Debt issues in Puerto Rico and Greece are big for their own needs, but will not hamper many US companies' earnings as much as some media outlets project. Their fiscal impact is simply too small to derail the world's economy that is awash in stimulus programs from multiple central banks. Greek voters went to the polls on Sunday to decide if they should accept further austerity measures as a condition of additional rescue loans. The "No" side won and the Greeks believe they will be able to negotiate with a stronger hand now. The result could soon turn into an exit from the EU for Greece, but it could also cause Greece's creditors to forgive some of their debt and allow Greece to rebuild on a more solid foundation without overwhelming austerity. The next few weeks will have many twists and turns as the leaders work out the details of any agreement. The US stock market could have a severe reaction to the vote and the ripple effects, but any such sell-off will be a buying opportunity for those investors who can look past short-term fear and focus on the longer-term opportunities.

As some investors fear a rate hike from the Federal Reserve, the time for drastically low interest rates is over. If rates rise in September or even in December, the Fed is not required to raise rates at every quarterly meeting. Based on the Fed's recent record, they do not appear to be on the brink of making drastic changes that will endanger growth just for the sake of raising rates. The federal funds rate is forecast to increase steadily through 2020. If this forecast is accurate, the economy will continue to improve over the next five years. If the economy does not continue to expand, the Fed will delay further rate hikes and will have the opportunity to adjust lower if needed. Any rate hike should be viewed as a positive factor because it means the Fed views the economy as stable enough to handle a reduction in "easy money" stimulus.

China's unstable stock market might be the one wild card investors need to keep an eye on. Investors have heard warnings about China's growing bubble of an economy for years. The recent move into bear market territory could be the beginning of a much more severe sell-off. How much this change affects the US economy is unclear. U.S. and European investors will have to pay attention in case their economy is dragged down with the falling Chinese stock prices.

While some traders worry US stocks are overdue for a 10% correction, the Dow Jones Industrial Average is essentially flat year-to-date, up only 0.71%. As investors slowed their buying in fear of a sharp drop in prices, the market has consolidated by lack of movement rather than a sharp decline. The absence of price gains for most of the market has given companies time for their earnings to catch up to their expanding P/E ratios that were in jeopardy of becoming overvalued.

Summary of Indexes

Courtesy of Morningstar.com

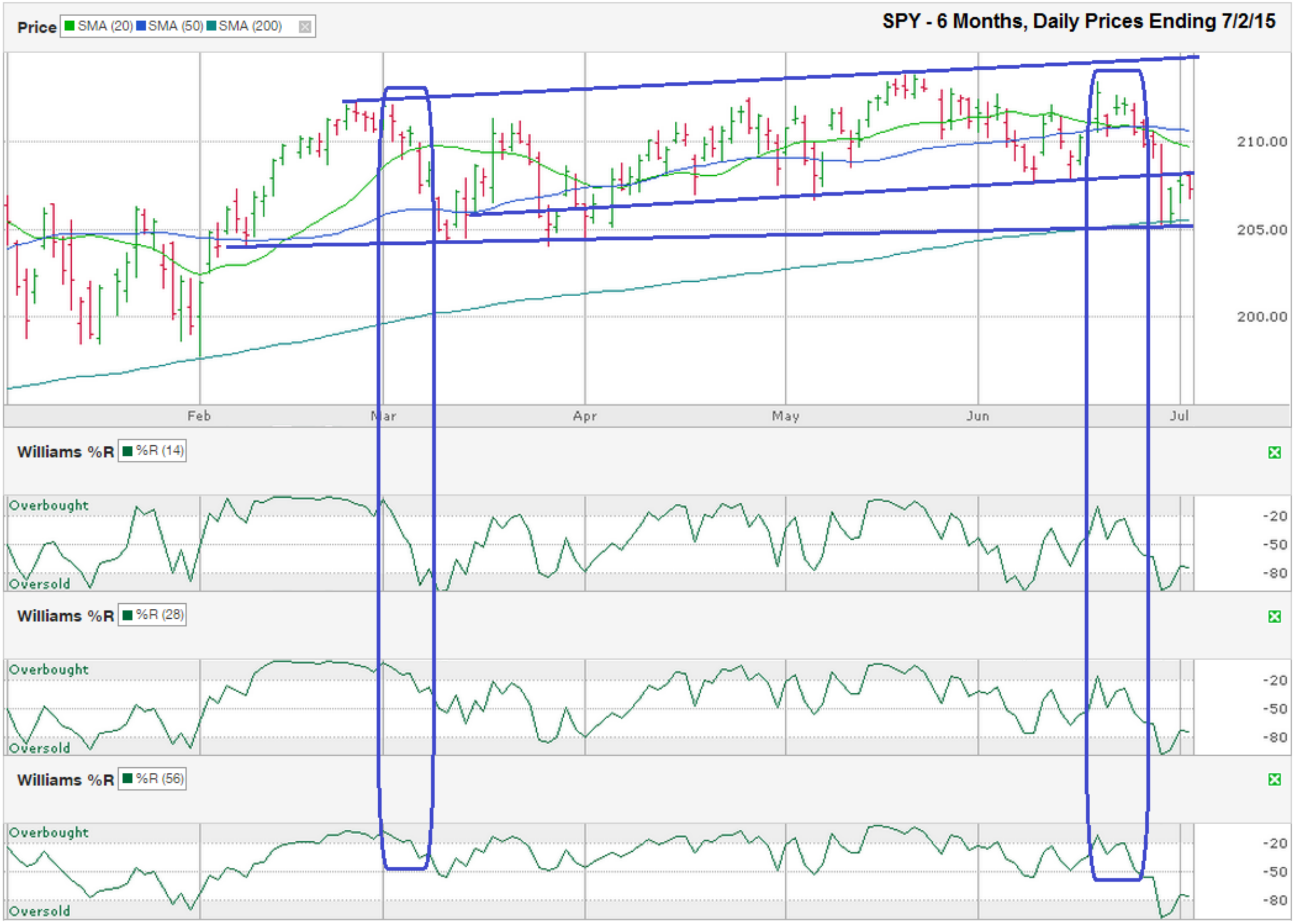
Name	As of Date	YTD	1-Year	3-Year	5-Year
US Stock Indexes					
DJ Industrial Average	7/2/2015	0.71	6.96	14.05	15.77
NASDAQ Composite	7/2/2015	5.77	12.37	19.29	19.08
Russell 2000	7/2/2015	4.29	5.42	17.18	17.39
S&P 500	7/2/2015	1.93	7.35	17.48	17.69
S&P MidCap 400	7/2/2015	4.45	6.40	18.43	18.19
Global Stock Indexes					
MSCI Emerging Markets	7/2/2015	1.59	-8.40	1.05	1.24
MSCI World, Excluding US	7/2/2015	5.08	-5.44	11.21	9.10
Bond Indexes					
Core Bond	7/2/2015	-0.10	2.49	1.80	3.45
Intermediate Core Bond	7/2/2015	0.68	2.88	2.16	3.48
Long-Term Core Bond	7/2/2015	-3.54	2.96	1.92	5.93
Short-Term Core Bond	7/2/2015	0.83	1.18	1.09	1.49

Fundamentals & Indicators

- The Empire Manufacturing Survey fluctuated over the past few months with an April reading of -1.2 followed by +3.1 in May and then down again in June with a reading of -2.0.
- The Philadelphia Fed's Business Outlook Survey has remained positive with reports beginning at 7.5 in April, 6.7 in May and an even more positive 15.2 June report.
- Retail sales originally reported a seasonally adjusted gain of 0.9% in March, which was the strongest gain in a year and a month later was revised up to 1.1%. While the March report was revised higher, the April report came in flat at 0.0% originally. The April report was revised higher in May to 0.2% along with a report that showed May sales rose 1.2%.
- The Producer prices index (PPI) broke its four months streak of declines in March with an increase of 0.2%, but dipped again in April by 0.4%. May came back strong with a 0.5% rise.
- The Consumer Price Index (CPI) has remained below the Fed's target level with March through May readings of 0.2%, 0.1%, and 0.4% respectfully. The gain in May was mainly due to a big increase in energy prices and is not expected to become the new trend.
- Housing starts rose 20% to a seasonally adjusted annualized rate of 1,135,000 units in April. That pace was up from an upwardly revised 944,000 million units in March (from 926,000) and was the first time starts reached 1,135,000 since November 2007. May housing starts dropped some, but stayed strong at 1,036,000 units.
- Existing home sales had a net positive over the past three months. The March report showed an increase of 6.1% to an annualized rate of 5,190,000. April sales slowed 3.3% to an annualized rate of 5,040,000. May sales increased 5.1% to 5,350,000, the most existing homes sold in one month since November 2009.
- New home sales continue to show a much stronger trend in 2015 than in 2014. New home sales hit an annualized rate of 484,000 in March followed by 534,000 in April and 546,000 in May. The May report was the best level since February 2008.
- Pending home sales rose 1.1% in March, 2.7% in April, and 0.9% in May
- The Case-Shiller 20-city Home Price Index rose 5.0% in February and March and then rose 4.9% in April. Rising home prices is an indicator of strong economic health.
- Factory Orders fell for seven consecutive months before the March reported gained 2.2%. Much to the dismay of hopeful economists, April factory orders fell 0.7% and May orders fell 1.0%.

- Total durable goods orders benefited from strong demand in the aircraft sector in March and gained 5.1%. April orders fell 1.7% as the defense sector's demand dropped significantly. May durable goods orders declined another 2.2% as aircraft orders experienced a big pullback.
- The ISM Manufacturing Index maintained its growth trend with readings of 51.5, 52.8 and 53.2 in April, May, and June respectfully.
- The ISM Services index added three more months to its streak of consecutive months of an expanding services (non-manufacturing) sector. March, April, and May reports came in at 56.5, 57.8, and 55.7 respectfully.
- Construction spending added to the economy's growth over the past three reports. March increased by 0.5%, April gained 0.8%, and May added another 0.8%.
- Gross Domestic Product (GDP) contracted in the first quarter. The advance estimate projected a 0.2% expansion, but the second estimate pointed to a 0.7% contraction. The third estimate improved, but still showed a 0.2% contraction. Early indicators predict the second quarter will return to expansion.
- Weekly unemployment claims have stayed consistently below 300,000 and after a brief move up, the four-week moving average is down to 275,000, close to levels last seen in 2007.
- The unemployment rate fell to 5.4% in April, but rose to 5.5% in May. June demonstrated an improving employment picture as the rate fell to 5.3%
- The U-6 unemployment rate that includes the total number of unemployed and those employed part-time, but seeking full-time employment fell to 10.8% in both April and May and then fell to 10.6% in June.
- Non-farm payrolls continued to show growth over the past quarter, but at a relatively slow pace. 223,000 new jobs were added in April after the previous month was revised lower by 41,000 to 85,000. May jobs came in at 280,000, while the April count was revised down by 2,000. The June count came in at 223,000, while May numbers were revised down to 254,000.
- The average workweek remained steady at 34.5 hours for each of the past four months, which indicates the demand needed is not outpacing the supply available.
- Average hourly earnings rose by 0.3% in April and May and remained unchanged in June.

Index Chart & Analysis



The chart above shows the daily prices for the past six months on SPY, an S&P 500 Index ETF, after closing the week at $207.31 on July 2, 2015. SPY has traded in a fairly narrow ascending trading channel for the past five months. The range of the channel narrowed even more over the last three months, until last week when the large-cap ETF dropped to the bottom of the longer channel. Once again, the longer trend line of higher lows offered support for the index and stocks began to climb again.

The trend line of higher lows that started in February wasn't the only indicator that came into play this week. The 200-day moving average coincided with the trend line to provide a second reason for the selling to stop. The 200-day moving average has been a solid line of support during the current bull market. SPY has only taken one trip below it since November 2012 and traders will be watching this line carefully to see if it can hold through the latest headlines again. Traders should keep an eye out for a close below the 200-day moving average and treat it as a bearish indicator.

Bears expect the three-month trend line of higher lows that was support to become resistance now that SPY has traded through it. Bolstering their case, SPY could not move above this line in either of the past two sessions. It is highly unlikely that this extremely narrow trading range from the past few days will last much longer. Debt issues in Greece and Puerto Rico or the upcoming corporate earnings announcements will push stocks sharply in one direction in the near-term.

The Williams %R indicator will give an early prediction on the new sentiment shift. Just as it did in March, Williams %R signaled the mini-correction in the second half of June too. For the first time in five months, all three Williams %R indicators fell into the oversold area in this past week's slump. While getting there is bearish, coming out of this gray area is bullish. Traders need to be careful not to assume that one or two days above the gray area is enough. The move needs two or three confirmation days to validate the shift in sentiment and those days should not include a down day, as we saw on Friday.

Monday will be an important day of trading to see how the markets react to Greece's vote on Sunday. Based on the media hype from most of last week, it shouldn't take more than a day or two to decipher where stocks are headed. The opening reaction in the first 30 minutes of trading will not necessarily dictate the direction that will follow in the coming weeks. Traders will need to be cautious with their moves.

A rally from the lows might not have much room to run beyond the highs from May. Resistance should come into play around $215, near the top of the upper trend line of higher highs, only $8 above Thursday's close. A bearish move has approximately the same room to fall. If the 200-day moving average and the longer trend line of higher lows breaks support, SPY could drop quickly to where support caught SPY throughout the winter months, around $198, only $9 below Thursday's close. A decline of this magnitude would only give SPY a 7% retracement, still not a technical "correction" of 10%. Longer-term investors should ignore much of the noise surrounding Greece and concentrate on the value of their stocks as corporations release their latest earnings.

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