World Markets Review — August 2016

Stocks finished the month essentially flat as signs of an improving global economy were offset by investor concerns about higher U.S. interest rates. Information technology and financial stocks enjoyed the biggest gains while the utilities and health care sectors lost ground. High-quality bonds also declined as the Federal Reserve hinted at a rate hike this year. The dollar rose modestly against the euro, the yen and most other currencies.

Index Returns

<table>
<thead>
<tr>
<th>Index</th>
<th>August 2016</th>
<th>YTD 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>U.S. dollar</td>
<td>Local currency</td>
</tr>
<tr>
<td>MSCI World</td>
<td>0.1</td>
<td>0.4</td>
</tr>
<tr>
<td>MSCI EAFE</td>
<td>0.1</td>
<td>0.9</td>
</tr>
<tr>
<td>MSCI EM IMI</td>
<td>2.4</td>
<td>2.6</td>
</tr>
<tr>
<td>MSCI Europe</td>
<td>0.3</td>
<td>1.2</td>
</tr>
<tr>
<td>MSCI Pacific ex Japan</td>
<td>−1.5</td>
<td>−0.7</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>MSCI Japan</td>
<td>0.4</td>
<td>1.3</td>
</tr>
<tr>
<td>MSCI UK</td>
<td>0.2</td>
<td>1.5</td>
</tr>
<tr>
<td>Barclays Global Aggregate Index</td>
<td>−0.5</td>
<td>—</td>
</tr>
<tr>
<td>Barclays U.S. Aggregate Index</td>
<td>−0.1</td>
<td>−0.1</td>
</tr>
<tr>
<td>J.P. Morgan EMBI Global</td>
<td>1.8</td>
<td>1.8</td>
</tr>
<tr>
<td>J.P. Morgan GBI–EM Global Diversified</td>
<td>0.0</td>
<td>0.3</td>
</tr>
</tbody>
</table>

MSCI index returns reflect net dividends. Source: RIMES

North America

U.S. stocks were flat as the positive momentum from quarterly earnings reports subsided and the specter of a Fed rate hike weighed on investors. The Standard & Poor’s 500 Composite Index and the Dow Jones Industrial Average were essentially unchanged, and technology-heavy Nasdaq composite rose 1%.

Four of 10 S&P sectors had positive returns. The growing prospect of a Fed interest rate hike this year helped lift financial stocks 4%. Shares of banking giants Bank of America, Citigroup, and JPMorgan Chase all rose as improving U.S. economic data raised the probability of the Fed raising its benchmark interest rate, which would be seen as a boost to bank profits. Berkshire Hathaway rose 4% as the investment conglomerate registered solid second-quarter profit and revenues due to its stakes in Kraft Heinz and Geico. The interest-rate-sensitive utilities and telecommunication services sectors declined by 6% amid growing speculation of an impending rate hike.

Information technology stocks climbed 2% as improving economic data pushed investors into more cyclical sectors. Semiconductor toolmaker Applied Materials advanced 14% after reporting record orders and a larger-than-expected profit in the second quarter. Yahoo rose 12% due to its equity stake in China internet giant Alibaba, which posted a 59% increase in quarterly revenue during the second quarter. Yahoo is set to be acquired by Verizon for $4.8 billion following regulatory approval. Apple shares increased despite a decision by the European Union antitrust regulator voiding a tax deal between the company and Ireland, requiring Apple to pay more than $14 billion in back taxes.

Investments are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity, so they may lose value.

© 2016 The Capital Group Companies, Inc. All rights reserved.
Poor clinical drug trial results and an uncertain near-term outlook for the industry pushed health care shares 3% lower. Bristol-Myers Squibb fell more than 23% after its Opdivo lung cancer drug failed to meet expectations during a clinical trial. Shares of Pfizer retreated as the company reported a 23% decline in second-quarter profit and said it had earmarked nearly $500 million to settle ongoing legal cases. Johnson & Johnson and UnitedHealth shares slid throughout the month.

Ongoing cost-cutting efforts and higher crude oil prices lifted energy stocks 1%. Shares of EOG Resources rallied 8% after the oil and gas producer announced a higher target for well completions this year. With increased capacity, the company expects to increase crude oil production by 10% annually through 2020.

M&A activity picked up pace during the month and was highlighted by Pfizer’s $14 billion acquisition of prostate cancer drug producer Medivation. Elsewhere, solar panel installer SolarCity agreed to be purchased by carmaker Tesla for $2.6 billion and convenience store operator CST Brands was acquired by Canada-based Alimentation Couche-Tard for $4.4 billion in cash and assumed debt. Several larger deals failed to materialize. Food manufacturer Mondelez International’s proposed $25 billion acquisition of Hershey was rebuffed, leading shares of Hershey to slide 9%.

U.S. economic data was generally positive. Overall consumer spending moved higher in July, although retail sales were essentially flat. July payroll employment notched a 255,000 gain and wages increased, while the unemployment rate held at 4.9%. New home construction, home sales and capital goods orders all accelerated. Second-quarter gross domestic product growth was revised slightly downward and corporate profits decreased. The minutes from the Fed’s July rate-setting meeting showed policymakers diverged on whether a rate hike is needed in the near future. However, the prospect of a rate increase gathered momentum following statements from several Fed officials at the annual Jackson Hole Economic Policy Symposium pointing to a strengthening labor market and stabilizing inflation. Futures markets predict about a 25% probability of a September hike.

In bond markets, the Bloomberg Barclays U.S. Aggregate Index fell 0.1%. Treasury yields rose across curve, with the yield on the benchmark 10-year Treasury note up 12 basis points to 1.58%. Investment-grade corporate spreads to Treasuries fell 10 basis points to the lowest levels in more than a year, ending at 135 basis points. Investment-grade corporates rose 0.2%, while high-yield bonds gained 2.1%. Treasury Inflation-Protected Securities lost 0.4%. For a second straight month, municipal bonds remained about flat.

The new-issue market was relatively quiet, which is typical for August. Yet the month included a mammoth $19.75 billion debt offering from Microsoft, its largest ever and the third biggest of the year. It was met with strong demand. The deal included a $4.5 billion 30-year tranche and a $4 billion 10-year tranche, with coupons of 3.7% and 2.4%, respectively. Proceeds will be used to fund the company’s acquisition of LinkedIn.

Europe
European stocks rose modestly as markets continued to recover from sharp losses incurred earlier this summer after U.K. voters opted to leave the European Union. Investor fears over the so-called Brexit decision abated somewhat amid signs of improving economic data in the U.K. and indications that the process for separating from the EU may take longer than expected. Overall, the MSCI Europe Index rose 1% and the euro remained little changed against the U.S. dollar.

British Prime Minister Theresa May stressed that the U.K. will move forward with the EU withdrawal process, reiterating that “Brexit means Brexit.” However, various reports suggested the official EU exit negotiations would not begin until April 2017, giving British leaders time to consider important trade and immigration issues. Once negotiations are initiated, the process is expected to take two years. Meanwhile, a key U.K. manufacturing index rose to a 10-month high in August, calming worries about an imminent economic slowdown.
Economically sensitive stocks generally outpaced defensive sectors, highlighted by a strong rally in the previously hard-hit banking sector. European bank stocks, which have been hurt most of the year by negative interest rates and signs of slowing economic growth, advanced 7% in August. Potential M&A activity helped drive bank stocks higher, including reports that executives at Deutsche Bank and Commerzbank had met to discuss a possible tie-up. Shares of HSBC, Europe’s largest bank, gained nearly 16%.

The industrials and materials sectors climbed 3% each, supported by signs of stabilization in the global economy. Improving economic data in the U.S. and China helped bolster these sectors. Shares of German industrial giant Siemens rose more than 10%. Linde shares jumped 19% on word that the German chemicals firm was in talks to be acquired by U.S.-based Praxair. On the other hand, mining stocks declined on falling prices for gold, silver and other precious metals. Shares of mining titans Glencore and Rio Tinto slipped.

Health care stocks suffered the largest declines, losing 4% in aggregate as drug-pricing practices came under intense scrutiny in the run-up to the U.S. presidential election. Shares of insulin provider Novo Nordisk tumbled 17% in August. Novo Nordisk, facing fierce competition in the insulin market, announced on September 1 that longtime CEO Lars Rebien Sorensen would step down.

Utilities stocks also declined 4%, weighed down by concerns about the potential for higher U.S. interest rates. The sector, which is often considered a bond proxy due to generally higher dividend yields, came under pressure after indications the U.S. might consider raising interest rates later this year. Shares of German utility company E.ON lost nearly 14%. Energy, technology and consumer-related stocks were essentially flat for the month.

In fixed income markets, European government bonds declined amid market expectations for higher U.S. rates. The yield on Germany’s benchmark 10-year note remained in negative territory, ending the month at –0.07%, up from –0.12% at the end of July. The euro traded generally steady against the U.S. dollar, but the pound sterling continued to decline on Brexit concerns. The pound fell 1% versus the dollar in August; on a year-to-date basis, the pound is down 11% against the dollar.

Asia-Pacific
Japanese equities rose slightly. A new stimulus package failed to impress investors who were hoping for more aggressive measures to stimulate growth in the economy. The MSCI Japan and MSCI Pacific indexes both gained 1%. The Japanese yen fell 1% against the U.S. dollar, but has appreciated more than 16% year to date.

Japan’s cabinet approved a ¥28 trillion fiscal stimulus package to be spent over the next two years. The program includes spending on infrastructure projects, the reconstruction of disaster zones, and subsidies for child and elder care workers. Japan’s economy stagnated in the second quarter, growing at an annualized 0.2% rate. The figure was boosted by the rise in public investment, but held back by net trade balance. The sharp appreciation of the yen earlier in the year diminished exports. Household spending fell 0.5% in June, the fifth consecutive year-over-year decline. Consumer prices declined 0.5% in July, while prices excluding food and energy rose 0.3%. The labor market remained a source of optimism as unemployment fell to 3%, a 21-year low.

Materials and telecommunication services were the top-returning sectors. Nippon Paint climbed 30% after announcing strong first-quarter earnings largely due to lower material costs. Shares of SoftBank rose 18% amid growing profits and market share from U.S. subsidiary Sprint. Printer manufacturer Brother Industries soared 47% on higher profits and an upbeat forecast for the fiscal year. Most automobile manufacturers, including Toyota and Honda, traded higher. Health care companies had some of the steepest losses in the index. Shares of Ono Pharmaceutical sank 27% after its blockbuster cancer drug unexpectedly failed a late-stage trial that would have been the basis for expanding use of the treatment. All 14 pharmaceutical companies in the index declined.
Australian equities retreated 2% amid soft economic data. The Reserve Bank of Australia cut its official cash rate by 25 basis points to 1.5%, a record low. The move followed an announcement that consumer prices increased just 1% in June, the weakest annual rise since 1999. Wage growth also hit an 18-year low in June, contributing to lower inflation expectations. The MSCI Hong Kong Index rose 1%. CK Hutchison was the top-returning stock in the index. The holding company’s earnings beat expectations, helped by higher profits at its European mobile-phone businesses.

Emerging Markets
Emerging markets stocks clinched their third consecutive monthly rise, marking the longest streak of monthly gains in two years as additional stimulus from global central banks outweighed concern the U.S. Federal Reserve may raise interest rates later this year. The Emerging Markets Investable Market Index advanced 2%, fueled by gains in the information technology and financials sectors. U.S. dollar-denominated bonds, as measured by the J.P. Morgan EMBI Global index, rose 1.8% as negative interest rates in developed countries prompted investors to search for higher yields; local currency debt, as measured by the J.P. Morgan GBI-EM Global Diversified index, was unchanged in dollar terms.

Chinese technology and financial companies notched sizeable gains, helping to drive the MSCI China IMI up 7% and into positive territory for the first time this year. Shares of e-commerce giant Alibaba soared 18% on better-than-expected results for the most recent quarter. Tencent shares surged 8% and touched a one-year high after the social media service firm exceeded second-quarter estimates for sales and profit. Investors also bid up shares of online search engine Baidu, travel services provider Ctrip.com and internet retailer JD.com. In the financials sector, Ping An Insurance shares climbed 11% on solid profit growth for the six-month period that ended in June. Several Chinese banks advanced on mid-year earnings reports that suggested loan defaults may be leveling off. The MSCI China IMI rose 5% year to date, overcoming steep losses to start the year.

Asian markets rose overall. Taiwanese stocks returned 2% as the country’s economy modestly expanded in the second quarter after three consecutive quarterly contractions. Anticipation also grew that the upcoming release of Apple’s iPhone 7 will aid Taiwan Semiconductor and other technology suppliers. South Korean stocks rose 2%, with shares of Samsung Electronics rallying to a new high on demand for its latest flagship Galaxy smartphones. Indian equities gained 2%. India’s parliament approved a goods and services tax designed to make it easier to conduct business throughout the country — a key legislative victory for Prime Minister Narendra Modi.

Brazilian stocks cooled after a run of strong returns in the previous few months. The MSCI Brazil IMI rose 1%. Dilma Rousseff was ousted as president on August 31 following a long-awaited impeachment trial that found her guilty of violating government budget laws. Her successor, Michel Temer, has proposed to overhaul the nation’s pension system and curb public spending to help improve Brazil’s fiscal situation and set the stage for economic growth. Elsewhere in Latin America, Mexican equities gained 1%. Shares of cement provider Cemex climbed 9%, lifted by better-than-expected earnings and plans to reduce debt.

The South African rand fell the most among emerging-nation currencies amid fresh political turmoil. Finance minister Pravin Gordhan became subject to a special police probe focused on irregularities at the nation’s tax collection agency that he used to head. The rand declined 6% against the dollar. Overall, the MSCI South Africa IMI slid 8%. Mobile phone operator MTN Group and gold miner AngloGold Ashanti registered double-digit declines. However, shares of media conglomerate Naspers gained, helped by strong results from Tencent, in which it owns a 34% stake.

Russian equities climbed to their highest level in a year amid growing confidence Russia’s economy is turning the corner. The MSCI Russia IMI increased 3%. An 11% rebound in the price of Brent crude also boosted sentiment and lifted shares of oil giant Lukoil.

In debt markets, Mexico sold $2.76 billion of U.S. dollar-denominated bonds in two tranches — a 10-year bond yielding 3.04% and a 30-year bond yielding 4.36%. In terms of corporate issues, Brazilian mining giant Vale placed a $1 billion dollar bond yielding 6.25%.
Developed market returns are in local currency and include net dividends. Emerging markets returns are in U.S. dollars.

Statements attributed to an individual represent the opinions of that individual as of the date published and do not necessarily reflect the opinions of Capital Group or its affiliates. The information provided is intended to highlight issues and not to be comprehensive or to provide advice. Any reproduction, modification, distribution, transmission or republication of the content, in part or in full, is prohibited.

Barclays Global Aggregate Index represents the global investment-grade fixed income markets. This index is unmanaged, and its results include reinvested distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes. This index was not in existence as of the date Class A shares became available; therefore, lifetime results are not shown.

Barclays U.S. Aggregate Index represents the U.S. investment-grade fixed-rate bond market. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

Dow Jones Industrial Average is a price-weighted index of 30 component common stocks, the components of which are determined by the Averages Committee, which is composed of the managing editor of The Wall Street Journal, the head of Dow Jones Indexes research and the head of CME Group research.

J.P. Morgan Emerging Markets Bond Index Global measures total returns for foreign-currency-denominated emerging markets bonds.

J.P. Morgan Emerging Markets Bond Index Global Diversified measures total returns for foreign-currency-denominated emerging markets bonds, employing limits on the weight of countries with large debt stocks.

MSCI EAFE® (Europe, Australasia, Far East) Index is a free float-adjusted market capitalization weighted index that is designed to measure developed equity market results, excluding the United States and Canada. Results reflect dividends net of withholding taxes. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

MSCI Emerging Markets Investable Markets Index includes large, mid-cap and small-cap segments, targeting a coverage range of close to 99% of the free-float-adjusted market capitalization of more than 20 emerging equity markets. Results reflect dividends gross of withholding taxes through December 31, 2000, and dividends net of withholding taxes thereafter.

MSCI Europe Index is a free float-adjusted market capitalization weighted index that is designed to measure developed equity market results across 15 developed markets countries in Europe. Results reflect dividends net of withholding taxes. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

MSCI Japan Index is a free-float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of Japan. Results reflect dividends net of withholding taxes. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

MSCI Pacific ex Japan is a free-float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of the developed markets in the Pacific region, excluding Japan. It consists of Australia, Hong Kong, New Zealand and Singapore. Results reflect dividends net of withholding taxes. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

MSCI United Kingdom Index is a free float-adjusted market capitalization weighted index that is designed to measure the results of the U.K. market. Results reflect dividends net of withholding taxes. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure equity market results of developed markets. The index consists of more than 20 developed market country indexes, including the United States. Results reflect dividends net of withholding taxes. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

Nasdaq Composite is an unmanaged index representing the companies traded on the Nasdaq stock market and the National Market System.

S&P/TSX Composite Index is an unmanaged market capitalization weighted index of stocks traded in the Canadian markets.

S&P 500 Index is a market capitalization-weighted index based on the results of 500 widely held common stocks. This index is unmanaged, and its results include reinvested dividends and/or distributions but do not reflect the effect of sales charges, commissions, account fees, expenses or U.S. federal income taxes.

Securities offered through American Funds Distributors, Inc.