MarketUpdate

Markets start to spring back

U.S. markets rebounded in April after two turbulent months. The S&P 500 Index gained 0.38 percent, the Dow Jones Industrial Average was up 0.34 percent, and the Nasdaq Composite posted a 0.08-percent return.

Strong fundamentals supported the rebound. According to FactSet, as of April 30, the estimated first-quarter earnings growth rate for the S&P 500 was 23.2 percent—more than twice the consensus forecast of 11.4 percent as of December 31, 2017. Clearly, businesses are benefiting from lower corporate tax rates introduced by the Tax Cuts and Jobs Act.

Technical factors were mixed. Although the Dow and Nasdaq stayed above their 200-day moving averages, the S&P 500 closed below this threshold on April 2 before moving back up quickly.

International markets also were mixed. Developed markets were strong in April, with the MSCI EAFE Index up by 2.46 percent. Much of this improvement came from decreased political risks in Europe and continued stimulus from the European Central Bank. Technical factors also remained supportive.

Emerging markets pulled back, though. The MSCI Emerging Markets Index declined 0.29 percent in April, as the strengthening dollar hurt markets' competitiveness. Technical weakness also showed up: the index closed below its 200-day moving average on April 25 but finished above the trend line for the month.

Fixed income also had a turbulent month. Notably, the 10-year U.S. Treasury yield cracked 3 percent for the first time since 2014. As bond prices drop when rates rise, the Bloomberg Barclays U.S. Aggregate Bond Index suffered a 0.74-percent loss. High-yield fared better, with the Bloomberg Barclays U.S. Corporate High Yield Index gaining 0.65 percent for the month.

Economic data shows signs of blooming

April's economic news was better than expected, easing fears of an economic slowdown. Retail sales grew by 0.6 percent in March, even better than high expectations of 0.4 percent. On the heels of tax reform and a healthy labor market, it would not be surprising to see consumer spending growth pick up steam.

Business investment also improved. Durable goods orders, a proxy for business confidence, grew by 2.6 percent in March. Meanwhile, industrial production grew 0.5 percent. This result was driven by increasing exports and strong business investment.

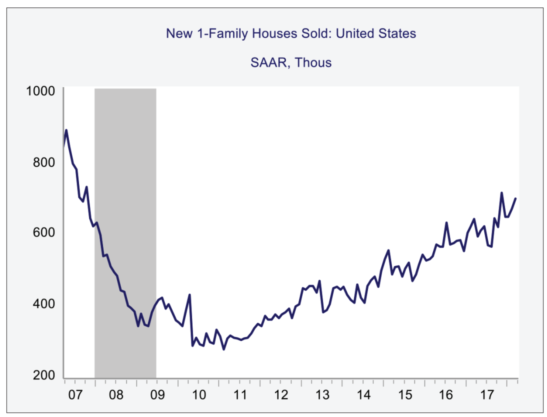
Finally, the first estimate of economic growth for the first quarter of 2018 came in at 2.3 percent, above estimates for 2-percent growth. Combined with the rebound in April's data, this suggests that economic growth may increase moving forward.

Housing erases slow start to year

Housing was another sign of strength, particularly after its slow start. The National Association of Home Builders survey showed that home builders are still very confident. The April housing starts figure bore this out with 1.32 million starts—well above expectations of 1.27 million.

Existing and new home sales were also stronger than expected. The rebound in new homes sales was especially pronounced (see Figure 1), helping to calm fears about a potential slowdown.

Figure 1. New 1-Family Houses Sold, April 2007–March 2018



Source: Census Bureau, Haver Analytics

Inflation risk on the rise

With economic growth sound, one of major risks to the markets is the recent uptick in inflation. In March, core producer prices grew at their fastest pace in seven years. And for the first time in years, the Federal Reserve's (Fed's) preferred inflation measure—the core personal consumption expenditures price index—grew by 2 percent annualized. This puts inflation at the Fed's target and, along with the upward trend, suggests that the Fed is likely to keep raising rates this year. This has the potential to rattle markets.

Political risks fade, for now

Political risks—in particular, the potential effects of the Trump administration's tariffs—led to increased market volatility earlier this year. These perceived risks receded in April, however, as there has been little follow-through since the tariffs were announced, and close trade partners have received exemptions.

Tensions with North Korea appear to have calmed as well. The meeting between North and South Korean leaders, and another potential meeting between North Korea and the U.S., was seen as a step toward easing diplomatic tensions.

A good start to second quarter

April was a good month. Looking forward, business and consumer confidence levels remain high, and the major concerns—namely, a slowdown in housing and increasing political tension—appear to have diminished. Fundamentals are strong, and the economy appears to be growing at a sustainable pace.

As we have seen recently, though, this recovery, while promising, does not guarantee smooth sailing ahead. So, we must continue to watch the risks, including rising inflation. A well-diversified portfolio designed to meet long-term goals remains the best way to approach markets going forward.

All information according to Bloomberg, unless stated otherwise.

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