MarketUpdate

Another great month for stock markets

The major U.S. indices posted impressive gains in February, with the S&P 500 Index, Nasdaq, and Dow Jones Industrial Average up 3.97 percent, 3.91 percent, and 5.17 percent, respectively. The three set multiple all-time highs during the month.

The rally was bolstered by better fundamentals and improving sentiment. As of February 24, with 92 percent of S&P 500 companies having reported, the blended earnings growth rate for the fourth quarter of 2016 was 4.9 percent, rising from 3.1-percent growth forecasted at the end of last year.

Consumer and business sentiment also improved last month. Technically, the news was good, with the three U.S. indices remaining comfortably above their 200-day moving averages throughout February.

The MSCI EAFE Index gained 1.43 percent in February on better economic news across Europe. Additionally, the MSCI Emerging Markets Index rose 3.07 percent, spurred by improving commodity markets and uptrends in economies around the globe. On the technical side, both indices stayed above their 200-day moving averages throughout the month.

Fixed income markets had a strong February, with the Bloomberg Barclays Aggregate Bond Index up a healthy 0.67 percent and the Bloomberg Barclays U.S. Corporate High Yield Index gaining 1.46 percent.

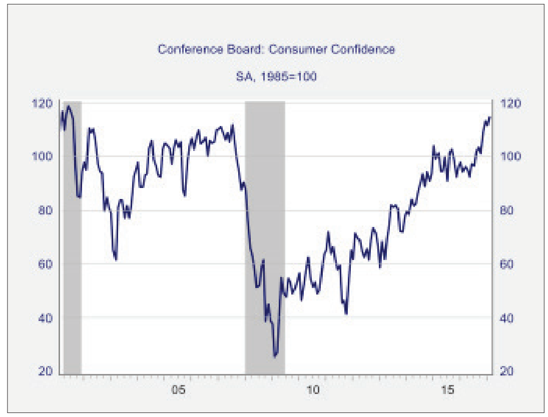
Consumers able and willing to spend

After signs of a slowdown in January, economic indicators rebounded and now point toward possible faster growth ahead. Hiring continued strong, with a surprising 227,000 jobs created in January. The labor-force participation rate also grew, and wages rose during the period.

Both measures of consumer confidence were near multiyear highs in February. The Conference Board metric reached levels not seen since 2001, as illustrated in Figure 1.

The impact of the healthy job market and increased consumer confidence has begun trickling down through the economy, with consumer spending and retail sales beating expectations last month.

Figure 1. Conference Board: Consumer Confidence, 2001–2017



Source: The Conference Board/Haver Analytics

Business confidence and housing market strong

The ISM Manufacturing and Non-Manufacturing indices remained in solid expansionary territory during February. U.S. durable goods orders posted strong growth in January, though much of the growth was due to increased aircraft orders.

Housing was also on the upswing. Existing and new home sales rose, with the former reaching levels last seen in early 2007. Housing starts were also up in February, indicating that faster growth in housing is a distinct possibility.

Even the Federal Reserve remains optimistic

The probability of a rate hike announcement after the March 14–15 Federal Open Market Committee meeting rose to roughly 80 percent by February's end. An increase would signal confidence in continued economic improvement, though it could lead to some market volatility.

International risks are on the rise

International risks may play a growing role in future market volatility. Elections in Europe—namely, parliamentary elections in the Netherlands in March and the French presidential election in April—have the potential to shake global financial markets.

In Asia, concerns about the relationship between the U.S. and China persist. The yuan is still near multiyear lows against the dollar, driving trade tensions with the U.S. and capital flight by China's citizens. Moreover, tensions surrounding China's development on islands in the South China Sea continue to rise.

Recovery picking up speed

Despite the risks, the U.S. economy continues to recover and may be accelerating. The improving economic fundamentals released in February strongly suggest that January's slowdown was fleeting. In fact, high levels of consumer and business confidence seem to be having a positive impact on spending, which could lead to faster growth in 2017.

With markets setting records, it is natural to be optimistic about the future but also concerned about whether the good times will last. In the short run, prospects look good; however, even if the risks engender a pullback, the solid economic conditions should limit the downside. The possibility of short-term volatility is present, but a well-diversified portfolio with a time horizon matching client goals can be the best way to achieve financial goals.

All information according to Bloomberg, unless stated otherwise.

Disclosure: Certain sections of this commentary contain forward-looking statements based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. Diversification does not assure a profit or protect against loss in declining markets. All indices are unmanaged and investors cannot invest directly into an index. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The Nasdaq Composite Index measures the performance of all issues listed in the Nasdaq Stock Market, except for rights, warrants, units, and convertible debentures. The Dow Jones Industrial Average is a price-weighted average of 30 actively traded blue-chip stocks. The MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets Index is a market capitalization-weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin. It excludes closed markets and those shares in otherwise free markets that are not purchasable by foreigners. The Bloomberg Barclays Aggregate Bond Index is an unmanaged market value-weighted index representing securities that are SEC-registered, taxable, and dollar-denominated. It covers the U.S. investment-grade fixed-rate bond market, with index components for a combination of the Bloomberg Barclays government and corporate securities, mortgage-backed pass-through securities, and asset-backed securities. The Bloomberg Barclays U.S. Corporate High Yield Index covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below.

Co-authored by Brad McMillan, senior vice president, chief investment officer, and Sam Millette, investment research associate, at Commonwealth Financial Network.