MarketUpdate

Positive month for markets as risks recede

The three major U.S. stock indices did well in May. The Dow Jones Industrial Average finished May with a 0.71-percent gain, and the S&P 500 Index rose 1.41 percent. Leading the pack was the Nasdaq, which was up 2.67 percent.

Improving fundamentals drove gains. FactSet reported that, as of May 26, 98 percent of S&P 500 companies had announced first-quarter earnings. Year-over-year, the blended average earnings growth was 13.9 percent. Technicals for the three indices were positive, with all three staying well above trendlines.

On the international front, the MSCI EAFE Index rose 3.67 percent, and the MSCI Emerging Markets Index gained 2.98 percent. Faster global growth and diminishing political risks encouraged investors to allocate assets abroad. Both indices spent the month above their 200-day moving averages.

Driven by declining interest rates, the broader fixed income market, represented by the Bloomberg Barclays Aggregate Bond Index, was up 0.77 percent. Lower inflation data pulled the 10-year Treasury rate down, from 2.33 percent at the start of May to 2.21 percent by month-end.

The market expects the Federal Reserve to raise interest rates in June. An increase would reflect confidence in the economy. Currently, markets consider increases beyond June less probable, which also helped lower Treasury rates.

The high-yield market, as measured by the Bloomberg Barclays U.S. Corporate High Yield Index, was also positive, gaining 0.87 percent. High-yield spreads compressed in May, driving prices higher.

Economic slowdown fades

First-quarter U.S. gross domestic product growth was revised upward, from 0.7 percent to 1.2 percent. Much of the increase was due to positive revisions in personal consumption and business investment data. This led to expectations of faster growth for the rest of 2017.

Consumers spend more

Faster growth requires the ability to spend and the confidence to do so. The ability to spend comes from jobs, and jobs data reported in May was relatively strong.

Roughly 138,000 jobs were added in May. Wage growth was up, and unemployment and underemployment rates were down. With personal income improving, the consumer's ability to spend is there.

During May, the confidence necessary for spending growth was there as well. Both major consumer confidence measures remained near 14-year highs. For the first time in 2017, job growth and confidence led to higher consumer spending. Retail sales rose in April, and the low March levels were revised upward.

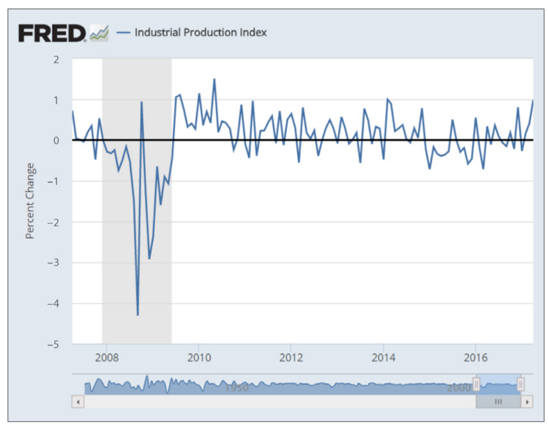
Business hard data begins to catch up

The ISM Manufacturing and Non-Manufacturing surveys had been in healthy expansionary territory, but investment had lagged. In May, the gap started to close. First-quarter investment data was revised upward.

Significant gains in industrial production were also reported. May growth was the fastest in more than three years (see Figure 1). The increase was widespread; manufacturing and mining led the way.

Durable goods orders—a proxy for business confidence—decreased a bit in April. The decline was offset by upward revisions to previous data.

Figure 1. Industrial Production Monthly Change, 2007–2017



Source: Board of Governors of the Federal Reserve System (US)

Housing slows down

Home builder industry confidence bumped up in May, though housing sales were below expectations. This may seem inconsistent, but the driver for both rests in strong demand combined with low supply.

Political risks bear monitoring

Political risks remain, though recent risks haven't been as damaging as feared—in particular the French elections. But the U.S. situation is an area of concern. The ability of the Trump administration to move forward on policy goals is unproven.

North Korea is still a flash point as well. Also, the potential Italian election later this year is raising concerns similar to those raised before the French plebiscite.

Future growth appears likely

Faster growth in consumer and business spending suggests that domestic economic growth should continue. Market resilience despite political uncertainty indicates that strong fundamentals support potential further gains. Other countries are doing well, which has led to the first synchronized global expansion since the financial crisis.

With hard economic data catching up to strong confidence levels, we could see a virtuous cycle. Increased confidence leads to increased spending, which leads to higher levels of confidence and so forth.

In the short and intermediate terms, political and economic risks remain. Even with positive trends, we will experience volatility. Investors should note and brace for that possibility. A well-diversified portfolio aligned with financial goals is still the best way to prepare for the future.

All information according to Bloomberg, unless stated otherwise.

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 Dow Jones Industrial Average is a price-weighted average of 30 actively traded blue-chip stocks. 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 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.

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