

Market Update



Markets start to spring back

Markets rebounded in April after two turbulent months, and all three major U.S. indices began the second quarter in the black. The S&P 500 Index gained 0.38 percent, the Dow Jones Industrial Average was up 0.34 percent, and the Nasdaq Composite rounded out the pack with a 0.08-percent return.

The rebound was supported by strong fundamentals. According to FactSet, as of the end of April, the first-quarter earnings growth rate for the S&P 500 was estimated to be 23.2 percent. If companies do as well as expected, this would be the highest earnings growth rate since the third quarter of 2010 and more than twice the consensus forecast of 11.4 percent as of December 31, 2017. Clearly, businesses are benefiting from the lower corporate tax rates introduced by the Tax Cuts and Jobs Act.

Though fundamentals remained strong, technical factors were more mixed during the month. The Dow and Nasdaq stayed comfortably above their 200-day moving averages, but the S&P 500 closed below this threshold on April 2—the first time since 2016. Although the index quickly moved back above this important risk indicator, further tests of the trend line will be worth watching.

While U.S. markets crept forward, international markets were mixed. Developed markets were strong in April, with the MSCI EAFE Index up by 2.46 percent. Much of this improvement was due to decreased political risks in Europe and continued stimulus from the European Central Bank. Technical factors also remained supportive for the index during the month.

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

Fixed income also had a turbulent month. Notably, the 10-year U.S. Treasury yield cracked 3 percent for the first time since 2014. It ended the month just under this threshold at 2.95 percent. As bond prices drop when rates rise, the Bloomberg Barclays U.S. Aggregate Bond Index suffered a loss of 0.74 percent for April. High-yield, which is typically less affected by interest rate volatility, fared better. The Bloomberg Barclays U.S. Corporate High Yield Index gained 0.65 percent for the month.



Economic data shows signs of blooming

April's economic news was largely better than expected, easing fears of an economic slowdown. Although consumption growth slowed in the first quarter, consumer confidence remained high and wages continued to grow—a sign that consumers should be able to spend more going forward. Retail sales grew by 0.6 percent in March, even better than already high expectations of 0.4 percent. It appears that the dual tailwinds of tax reform and a healthy labor market are now working, and it would not be surprising to see consumer spending growth pick up steam as the year progresses.

Business investment also improved. Durable goods orders, which are often used as a proxy for business confidence, grew by 2.6 percent in March, against expectations for more modest

growth of 1.6 percent. Industrial production also exceeded expectations, growing 0.5 percent on a monthly basis, against an expected 0.3 percent. This result was driven by increasing exports and strong business investment and suggests that the first-quarter weakness may be passing.

We also received the first estimate of economic growth for the first quarter of 2018. It came in at 2.3 percent, above estimates for 2-percent growth. Although this is a pullback from the previous quarter, it is a reasonably healthy growth rate. Further, on a year-on-year basis (which is a better indicator), growth remains at a multiyear high. Combined with the rebound in April's data, this suggests that economic growth may increase moving forward.

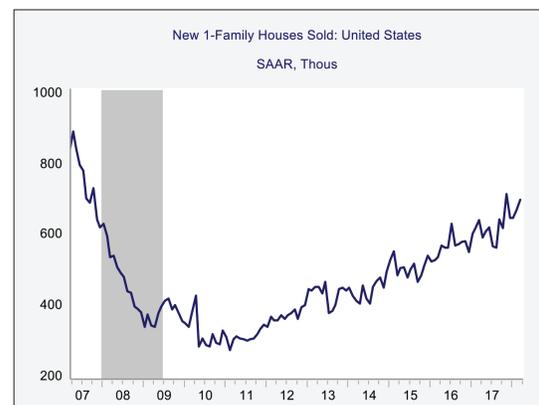


Housing erases slow start to year

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, although that confidence may be moderating. The April housing starts figure bore out this confidence with 1.32 million starts—well above expectations of 1.27 million. This is a healthy development, as supply remains constrained while demand is strong and picking up as we enter spring.

This high demand for homes was demonstrated by the stronger-than-expected results for existing and new home sales. Both came in well above expectations, despite bad weather, suggesting that rising mortgage rates have not yet hurt housing demand. As illustrated in Figure 1, the rebound in new home sales was especially

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



Source: Census Bureau, Haver Analytics

pronounced and helps to calm fears from earlier in the year about a potential slowdown.



Inflation risk on the rise

With economic growth sound, one of major risks to the financial markets is the recent uptick in inflation, which is driven by that growth. Both producer and consumer inflation came in above 2 percent on an annualized basis in March. Producer inflation was especially notable, as core producer prices grew at their fastest pace in seven years.

From a policy perspective, this is concerning. In fact, for the first time in years, the Federal Reserve's (Fed's) preferred measure of inflation—the core personal consumption

expenditures price index—grew by 2 percent on an annual basis in March. This puts inflation at the Fed's inflation target and, along with the upward trend, suggests that the Fed is likely to keep raising rates this year.

The market currently expects two to three more rate hikes in 2018. If inflation continues to rise, however, these expectations could increase to include more rate hikes. This will be important to watch, as higher rates have rattled markets already this year.



Political risks fade, for now

Political risks—in particular, from the Trump administration's proposed tariffs and international trade—led to increased market volatility earlier this year. These perceived risks receded in April, however. Although the tariffs remain a concern, there has been little follow-through since they were announced. In addition, exemptions for many close trade partners have alleviated the immediate concerns of a global trade war.

Tensions with North Korea, another point of concern, appear to have calmed. The meeting between North and South Korean leaders was seen as a step toward further diplomatic efforts. Meanwhile, the potential for a direct meeting between North Korea and the U.S. could help soothe tensions even further. That said, North Korean leaders have made promises to curb their nuclear ambitions in the past, to no avail, so risks certainly still remain.



A good start to second quarter

Overall, April was a good month for the markets and the economy, as both ticked back up after a weak stretch. Looking forward, business and consumer confidence levels remain high, and the major concerns from March—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.

While rising inflation and additional rate hikes may slow growth, and tariffs remain an active

concern, continued strong fundamentals should help insulate the markets from external pressures. As we have seen in the past couple of months, though, this month's recovery, while promising, does not guarantee smooth sailing in the future. So, we must continue to watch the risks. 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.

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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