ECONOMIC UPDATE MAY 2018

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US stocks were only able to muster small gains in April leaving many indices in negative territory on a year-to-date basis. The S&P 500 posted a gain of 0.4% for the month making its year-to-date return -0.4%. Small cap stocks in the Russell 2000 index were up 0.9% for the month bringing them into the black year-to-date with a 0.8% return. International stocks in the MSCI EAFE index fared better and were up 2.3% for the month and 0.7% year-to-date. Emerging market stocks had positive performance during the first quarter but were down -0.6% in April and were able to hang onto a slight gain of 0.5% year-to-date. Yields on the 10-year US Treasury bond climbed to 2.95% from 2.74%. Because of the increase in yields, bond prices fell resulting in a -0.8% loss for the Barclays Aggregate Bond Index in April increasing their loss in 2018 to -2.3%.

The initial estimate for first quarter GDP growth came in at 2.3%. Although this figure was lower than it has been the previous three quarters, it was higher than the 1.8% initially projected. Business investment was solid, inventory levels were rebuilt, government spending was stronger, and the trade deficit declined which all added to economic growth. Consumer spending was weaker and grew at its slowest pace in five years, but many analysts believe that the slowdown is only temporary. The strong labor market and tax reform are expected to help push full year GDP growth to around 3%. Plus, consumer confidence remains high even with the volatility and political uncertainty we have seen in 2018. Business confidence is also high and capital spending is expected to accelerate based on capex announcements made by corporations.

Corporate profits have also been strong. So far, of the companies in the S&P 500 that have reported first quarter earnings, 79% have beat their estimates for earnings and 72% have beat their revenue estimates. Earnings of the S&P 500 are expected to be up 20% or more from first quarter last year which will be the strongest earnings growth in seven years. The growth is not limited to just a few sectors as 13 out of the 16 Zacks sectors had double digit earnings growth in first quarter. Some volatility in the market resulted from fears that earnings growth has peaked. However, Strategas Research feels the effects of tax reform are not yet being realized by companies so we are not at peak earnings growth yet.

The Federal Reserve has increased the Fed Funds Rate once so far this year. Most analysts expect another two and possibly three rate increases in 2018. The 10-year Treasury bond yield reached 3% in April before settling back down to 2.95% at month end. Strategas Research projects the 10-year Treasury bond will reach 3.2% by year end. Rising inflation and the strengthening economy supports continued rate hikes.

Bonds have not provided a hedge recently in stock market selloffs as yields have also trended upward. However, fixed income is still prudent to have as part of a well-diversified portfolio. A bad day in bonds is usually nowhere near as detrimental to account values as a bad day in stocks can be. Once most of the move up in yields has occurred, bonds will likely add to performance again with their higher yields and reduced depreciation. Views are mixed as to whether US stocks or international markets will perform better and whether small cap or large cap will outperform so a well-diversified portfolio will likely include each of those asset classes. If you have any questions about your account, please do not hesitate to contact us. Also, if your situation has changed, please let us know that too as investment changes may be necessary.