April 2018

Market Index	April Change	Year-to-Date
Standard & Poor's 500	0.4%	-0.4%
Dow Jones Industrial Average	0.3%	-1.6%
NASDAQ	0.1%	2.7%
Russell 2000 (small company)	0.9%	0.8%
MSCI EAFE (international)	2.6%	0.9%
Barclays Aggregate Bond Index	-0.7%	-2.2%

Monthly Update

Stocks Post Small Gains Despite Rising Interest Rates

Stocks traded within a relatively narrow range in April and managed to finish in positive territory despite some ugly days early in the month. The early-April selling came in part as a result of rising interest rates as the ten-year Treasury yield broke above 3% for the first time in four years. Still, the S&P 500 Index and the Dow Jones Industrial Average remain just slightly negative for the year. International stocks had a strong April but still are only modestly positive in 2018. Rising interest rates led to price declines in the bond market as well. Even with interest rates rising, however, the losses in bonds remain small relative to what would be considered a bad year for other asset classes, especially stocks.

Conflicting Signals Lead to Sideways Trading

Rising interest rates are typically a sign that investors and policymakers have confidence in the health of the global economy. The data have mostly continued to support this, and there is little debate that the economy is in the expansion phase. However, there have been signs that the pace of growth is slowing. For example, consumer spending recently hit a five-year low, an important indicator given the large impact of the consumer on the U.S. economic equation.

This slowdown in growth has generated concern about how long the expansion will last, and as a result has been a headwind for the stock market. At nearly ten years in length, we are in the midst of one of the longest economic expansions and bull markets in history. But it is commonly accepted that expansions and bull markets don't "die of old age," but that some outside force is required to kill them. One of those forces historically is rising interest rates. Another is rising inflation, and the two often coincide.

Another risk is a policy mistake by the Federal Reserve, which could either raise rates too fast, choking off growth, or not fast enough, allowing inflation to flare up. The Fed has managed to successfully walk this fine line so far, and is telegraphing further rate hikes in the coming quarters. Barring one of these risks coming to fruition, the economy is likely to keep expanding in the coming months.

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Monthly Update (continued)

Mixed Takeaways from Earnings Reports

The first quarter earnings season has been solid in terms of revenue and earnings growth. But some of the commentary from corporate executives about the outlook only served to reinforce concerns about the economic cycle. Some companies, including several global industrial bellwethers, worried openly that the economic cycle may be reaching a peak, potentially setting the stage for lower sales and sagging profit margins in the coming quarters. Meanwhile, the surge in earnings and lack of gains in stocks have made valuations less frothy, providing some support that could limit further losses unless earnings growth begins to slow.

Global Trade Issues Remain in Focus

The U.S. and China have persisted in their back-and-forth over trade policy. Several top U.S. officials made the trip to Beijing for direct talks with Chinese officials. The talks failed to produce any material progress. This increases the likelihood that both countries will move forward with implementation of tariffs on the other's imports, which would likely reduce trade volumes. For now the issue is more of a headline risk that could drive short-term volatility, but the real fallout of any changes will take a long time to play out.

Oil Back in the Headlines

Oil prices have moved higher in 2018, rising more than 10% in the last month to over $70 per barrel for the first time since 2014. Supply and demand dynamics coupled with increased geopolitical risks have boosted prices. The Organization of Petroleum Exporting Countries (OPEC), particularly Saudi Arabia, has been focused on restraining supply in an effort to drive prices higher. Higher oil prices boost revenues, helping to balance the budget for oil-producing countries. Saudi Arabia has indicated it wants oil prices closer to $80 per barrel.

In early May, President Trump announced the U.S. would be pulling out of the Iran nuclear deal agreed to under the prior administration, creating fresh uncertainty about the direction of oil prices in the near term. While European countries opposed the move, both Israel and Saudi Arabia expressed support, a reminder that there is plenty of division between the world's major players in the oil market. Meanwhile, potential rapprochement between the U.S. and South Korea with North Korea is drawing much attention, further disrupting the recent status quo of international politics.

Going forward, investors will keep a close eye on oil prices and the effect on consumer spending, which represents nearly 70% of U.S. economic activity. If prices move higher quickly it would likely put a damper on spending, particularly for those with lower incomes. Meanwhile, the energy sector has been a beneficiary of these price increases, and is the leading sector in the second quarter by a wide margin.

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