May 2018

Market Index	May Change	Year-to-Date
Standard & Poor's 500	2.4%	2.0%
Dow Jones Industrial Average	1.4%	-0.2%
NASDAQ	5.5%	8.3%
Russell 2000 (small company)	6.1%	6.9%
MSCI EAFE (international)	-2.1%	-1.2%
Barclays Aggregate Bond Index	0.7%	-1.5%

Monthly Update

Stocks Move Higher, Led by Tech

U.S. stocks rallied in the beginning of May as trade war concerns faded and corporate earnings continued to impress. A late slump trimmed those gains, but the S&P 500 still finished with its best month since January, led by the tech sector yet again. Strong earnings results and positive management outlooks buoyed investor confidence in the sector. Energy stocks also moved higher as oil prices rose. Corporate earnings overall exceeded expectations for the first quarter, with companies generally reporting strong profit growth supported by healthy profit margins. Management teams are also optimistic about growth prospects for the remainder of the year, despite several big picture headwinds, which emerged in the final days of May.

Overseas Developments Spark Volatility

Several developments led to a reversal in the latter part of May, most of which related to developments outside of the U.S. Political turmoil in Italy and Spain sparked further fears of fractures in the European Union. In recent elections anti-EU parties gained influence in both countries. The EU experiment has so far managed to survive these episodes, but these election results prove that there is still plenty of skepticism about its future.

Stocks were also weighed down by volatility in emerging markets toward the end of the month. The ongoing monetary policy normalization in the U.S. has led to higher interest rates and a stronger U.S. dollar. Both of these are a problem for countries with high levels of U.S.-dollar-denominated debt. Turkey and Argentina in particular have experienced sharp declines in their currencies, with Argentina's peso down more than 20% versus the U.S. dollar in 2018.

Another drag on sentiment late in the month was the cancellation of the summit involving President Trump and North Korean dictator Kim Jong Un. It has since been revived, but the initial cancellation created fresh uncertainty about the situation in the Korean peninsula. The meeting itself is important, but perhaps more impactful to the market is any negative fallout that could result related to the ongoing negotiations between the U.S. and China on trade matters.

Monthly Update (continued)

Trade Uncertainty Continues

The tough talk on trade continued, and further action was taken in May. The White House announced that Canada, Mexico, and the European Union would not be exempted from the tariffs on steel and aluminum imports initially announced in March. At first those countries had been granted an exemption from the tariffs. Many of these countries retaliated immediately with threats or tariffs of their own, creating fresh uncertainty about the global trade backdrop. Direct talks between the U.S. and China are ongoing, but so far little tangible progress has been made, and both sides have shown a willingness to stand firm to protect their own interests.

Interest Rates Drop, Reversing Year-to-Date Trend

Until mid-May, bond yields in the U.S. had been rising this year, which has supported the rising dollar and added pressure on emerging market countries. However, the flare up of concerns mentioned above reversed the trend in rates. Investors shifted toward safe-haven assets at the end of May, driving interest rates down on U.S. bonds. Interest rates on longer-term bonds fell further than on short-term bonds, leading to further flattening of the yield curve. This flattening has at times been a signal of a weakening of the economy. However, most of the economic data continue to point to a healthy economic picture.

U.S. Economic Growth Still Solid, Fed Planning More Hikes

The U.S. economic expansion remains intact, and many signs point to a solid economy that has some time left before the next recession. Labor market indicators are particularly strong, and wages have continued to rise. Consumer and business confidence also remain elevated. The picture is less positive overseas, with growth harder to come by, and the recent emerging market issues are an additional headwind. Rising energy prices are also something to keep an eye on. Even with these international issues, the U.S. picture is likely still bright enough for the Fed to continue with interest rate hikes in the coming months.

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