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Monthly Market Commentary
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US Economy

During most of an economic cycle, favorable economic and earnings growth accompanies relatively persistent equity-market appreciation (with the exception of modest pullbacks from time-to-time). It is not unusual to experience a mid-cycle pullback when earnings growth prospects are very good. Most frequently, however, those periods of year-over-year corrections or flatness occur alongside rising inflation and Fed tightening.

Today, the growth we have been experiencing, and the growth we expect for 2018, are moderate – and signs of problematic inflation are difficult to find. We do not expect the Federal Reserve (Fed) to act aggressively in the foreseeable future. We expect the S&P 500 Index to move back toward our 2800 – 2900 year-end 2018 target range (2650, as of this writing) as US gross domestic product (GDP) continues to climb at a healthy 2.9% pace, with only a moderate 2.4% inflation rate. That being said, we do expect higher (and more normal) volatility this year, even as fundamentals continue to improve.

US Markets

The US equity markets trended sideways during April, while the volatility we experienced in February and March, abated somewhat. As mentioned above, we do anticipate the US equity markets to move higher before year-end, however, we do believe that volatility could persist in the near-term. Summer-time is almost upon us and, historically speaking, summer tends to be a volatile time of year for the markets (both to the upside and to the downside). In addition, the mid-term elections will be held in November, and market volatility historically has risen prior to these elections. However, after most elections, equity markets tend to rally as election results become clear and the uncertainty of the elections is wiped away. As such, we would not be surprised the markets move sideways through summer and then trend higher after the elections. This potential volatility may present those investors with sidelined cash an opportunity to put some of their cash to work.

Fixed Income

Higher interest rates have been a welcome development for investors who have been forced to deal with exceptionally low-rate choices for short-term investments. While many investors are focused on the impact (and opportunity) surrounding an interest-rate increase, it is also important to consider the effect of this change on borrowing costs. Borrowing costs are tied to interest rates, and they are increasing for many borrowers as the Fed raises rates.

For borrowers, the most immediate impact of higher rates will be on loans tied to short-term or floating-rate debt. Higher costs and an increase in debt payments for outstanding balances are the new realities for borrowers with debts that adjust based on an underlying short-term reference rate (e.g. prime rate). Higher rates are also likely to impact fixed-rate debt costs for those looking to borrow. Fixed-rate mortgages closely track longer-term interest rates, such as 10- or 30-year Treasury yields. While we do not anticipate a dramatic increase in longer-term rates, rates are moving higher. Given our expectation for slowly increasing longer-term rates, we expect these rates to continue to climb over time.

International Markets

The European Central Bank (ECB – akin to the Federal Reserve) met in April and, as anticipated, opted not to raise interest rates. However, investors were searching for clues from ECB President Mario Draghi about when the bank may begin phasing out its €30 billion ($37 billion) per month bond purchases, which are currently slated to run through September. The ECB has stated they would only consider raising interest rates once the bond-buying has ceased.

Similar to the Fed's Quantitative Easing programs (in which the Fed purchased billions of dollars of Treasury securities and mortgage-backed securities, in an attempt to support the US economy), the ECB also purchased billions of euros worth of European bonds to support the European economy. Investors will be looking for clues as to when the ECB will begin tapering their bond purchases and begin raising interest rates. With the recent rhetoric surrounding tariffs and weaker signals from the European economy, the ECB may delay withdrawing its stimulus. As a result, barring any major advancements, we would anticipate that the ECB will maintain its short-term interest rate benchmark near zero and bond-purchasing program in place for the foreseeable future.

Commodities

Tensions, tariffs, and sanctions have brought steel, aluminum, soybeans, and sorghum into the national narrative. Aluminum prices shook off the proposed 10% tariff on aluminum imports that the US administration announced in March. Yet they surged nearly 30% on April news of US sanctions against one of the world's largest aluminum suppliers. Since then, prices have dropped 13% from that peak (as of this writing) as the US extended the deadline for sanction compliance until October (versus June) and provided criteria for the US to consider lifting the sanctions.

Unlike aluminum, steel was not able to shake off news of a proposed US import tariff, and prices spiked. China, in a retaliatory move, indicated that it would respond with several tariffs on US imports, including soybeans and sorghum. These actions can have a sizeable impact on prices of individual commodities. Yet, the impact on the overall commodity space is typically more limited. Unless trade wars, sanctions, and tensions escalate to the point that global economic growth is threatened, the impact to the commodity complex as a whole could be muted.

What Does This Mean To Me?

Despite our belief that the US equity markets could be volatile in the near-term, the US economy is still on solid footing. The unemployment rate continues to drop, wage prices are rising, the housing market continues to do well, businesses continue to be profitable, and commodity prices continue to remain in check. As such, we continue to advise investors to stay the course and remain vigilant, as we believe the markets could end the year higher. In regards to rising interest rates, for those with debt tied to short-term or floating rates, we believe that now is the time to analyze your balance sheet to determine whether your debt structure is appropriate for your situation.

If you have any questions or concerns, please do not hesitate to reach out to us at any time.

Sincerely,

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Stocks offer long-term growth potential, but may fluctuate more and provide less current income than other investments. An investment in the stock market should be made with an understanding of the risks associated with common stocks, including market fluctuations.

Investing in commodities is not suitable for all investors. Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. The prices of various commodities may fluctuate based on numerous factors including changes in supply and demand relationships, weather and acts of nature, agricultural conditions, international trade conditions, fiscal monetary and exchange control programs, domestic and foreign political and economic events and policies, and changes in interest rates or sectors affecting a particular industry or commodity. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks, including futures roll yield risk.

There are special risks associated with an investment in real estate, including credit risk, interest rate fluctuations and the impact of varied economic conditions.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. Investing in emerging markets accentuates these risks.

Investments in fixed-income securities are subject to market, interest rate, credit and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and/or principal. This risk is heightened in lower rated bonds. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity

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