# April 2016

## Market Review

The market trudged ahead in April, even if economic data was tepid at best. Individual stock performance was somewhat bifurcated: already-expensive defensive names joined the more speculative stocks in rallying, while many quality stocks with strong fundamentals lagged. Small-cap stocks continued to outperform their large-cap peers, with the Russell 2000 Index returning 1.6% versus 0.4% for the S&P 500.

Domestic economic data has been good but not great. While manufacturing data from the Institute of Supply Management showed that the Purchasing Managers Index (PMI) remained above 50, indicating expansion, the indicator seems to be running out of steam. After jumping to 51.8 in March, the PMI fell to 50.8 in April.

If manufacturing data is tepid, the consumer isn't any more ebullient. While oil and gas prices have rallied substantially, they remain far below their highs, yet this quasi-tax cut hasn't translated into increased spending. Part of the answer may be explained by a lag effect, as some experts believe that it may take consumers 12-18 months of lower fuel prices to modify their spending habits.

More likely, there is something deeper at work. According to the University of Michigan survey, consumer confidence remains moderately positive, yet has declined 2.2% month-over-month (MOM) and 7.2% year-over-year (YOY). Perhaps more alarmingly, consumers' outlook in terms of their expectations has fallen by nearly 5% MOM and more than 12% YOY. And while the unemployment rate held steady at 5%, nonfarm payrolls rose by a seasonally adjusted 160,000 in April, the weakest gain since September.

Against this backdrop, a recent Barron's Big Money Poll showed that 66% of respondents expect stocks to fall by 10% or more in the next 12 months. Nearly one-quarter (23%) see earnings disappointments as the biggest threat, while another 21% point to the potential of an economic slowdown or recession in the U.S.

Developments overseas also suggest that the risk to the global economy is to the downside. While Europe finally surpassed its pre-crisis GDP level, unemployment remained above 10%. Consumer prices were down 0.2% in April, and while the decline is small, this figure also suggests economic stagnation. Perhaps more worrisome is talk of "Brexit," as voters will head to the polls on June 23 to decide whether or not the U.K. should leave the European Union.

Nor does it seem that emerging economies, once the world's growth engine, will be coming to the rescue anytime soon. True, China does continue to advance, but at a muted rate. Despite fiscal and monetary stimulus, the Middle Kingdom managed just a 1.1% quarter-over-quarter increase in GDP, the lowest increase since the 2009 recession. In addition, an increasing share of new credit is being used just to roll over and service existing debts, rather than financing new projects and investment. Meanwhile, resource-dependent economies are struggling to adapt to lower commodities prices.

Given these developments, it was no surprise to see the Federal Reserve leave interest rates unchanged in April. The Fed did, however, leave the door open to a potential rate hike in June.

In politics, the two front-runners, Secretary Clinton and businessman Donald Trump greatly solidified their positions in their respective political races. While both potential nominees may be viewed as more pro-business than several of their former challengers, each has shown populist leanings, with one looking to build a wall, and the other claiming a tough stance towards Wall Street. Although the market may appreciate the greater clarity in the race, both candidates are still ambiguous with respect to policy details. After what has been a fairly contentious primary season, the general election could get particularly nasty.

Stocks finished April at 2065 on the S&P 500 Index, just over 17.1 times estimated 2016 earnings of $120. That's an above average valuation level—but it could be justified if earnings accelerate to the upside. The recovery of energy prices and weakness of the U.S. dollar are steps in the right direction. Faster GDP growth beginning this quarter would be another positive development. Investors have moved to more economically sensitive stocks recently. If they are correct and growth follows, stocks could extend recent gains before year-end.

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