# Market Review

## May 2017

Stocks were mixed in May, as investors digested assorted political and economic developments. While North Korea and the U.S. continued missile tests, fears of political instability in Europe have largely abated. China saw its credit rating downgraded due to high debt levels, yet avoided a major selloff. Domestically, concerns grew over the ease of enacting President Trump's reforms, given a desire by some elements of the Republican Party to limit additional deficit spending. Although large-cap stocks (as measured by the S&P 500 Index) rose 1.4%, small-cap stocks (as measured by the Russell 2000 Index) declined 2.0%. Growth outperformed Value, with the Russell 1000 Growth index rising 2.6%, versus a decline of 0.1% in the Russell 1000 Value Index.

Encouraging economic news included a revised estimate of 1.2% annualized growth in first quarter gross domestic product (GDP), up from the Commerce Department's earlier estimate of 0.7%. The release cited stronger than expected consumer spending and a less-dramatic pullback in government spending compared to earlier estimates. In the case of the former, personal consumption expenditures—the Federal Reserve's preferred inflation measure—rose 0.4% in April, reflecting a similar increase in incomes, while the personal-saving rate held steady at 5.3%.

Consumer confidence remains strong, but relatively unchanged month-over-month, according to a University of Michigan survey. The current conditions component of the survey fell slightly, while the index of consumer expectations rose 0.8% over April, and 3.3% year-over-year. Business sentiment exhibited similar characteristics, remaining strong, yet seeing little monthly change, with the Institute for Supply Management's Purchasing Managers Index increasing just 0.1% from April.

The unemployment rate fell to 4.3% in May, reaching a 16-year low. Pessimists focused on the fact that employers added only 138,000 jobs (seasonally adjusted), suggesting that the labor market is near full employment. On the plus side, the wage inflation typically associated with full employment has yet to materialize, as the Labor Department reported that non-management wages rose just 2.4% from a year earlier.

While members of the Organization of the Petroleum Exporting Countries (OPEC) indicated that they would look to extend June's production cuts, investors holding out hope for even deeper cuts were disappointed. Oil spiked on news that Saudi Arabia, Egypt, Bahrain, and the United Arab Emirates cut political ties with Qatar, yet the rise proved to be short-lived, as the island nation is not a major oil producer.

At the time of writing, the Fed decided to raise the federal-funds rate by 0.25% and suggested that it may raise rates again by year-end if the economy performs as expected. This stance did not cause market turbulence, as the decision was widely expected. The Fed also outlined some details of its plan to trim its balance sheet, including plans to let some bonds in its portfolio mature without reinvesting the proceeds.

Concerns over both monetary and fiscal stimulus have led some to worry about the stock market's valuation. Others may argue that slow-and-steady growth actually offers a better backdrop for the stock market than faster growth which risks causing the economy to overheat. Our approach is to instead analyze individual investments—rather than the market in aggregate—considering both relative valuations and the ability to exceed expectations.

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