

# MONTHLY ECONOMIC UPDATE

June 2018

## MONTHLY QUOTE

“Never put off ‘til tomorrow what you can do today.”

- Lord Chesterfield

## MONTHLY TIP

The best time to save for retirement may be right after college graduation. Small, regular monthly contributions to retirement accounts have the potential to grow into large retirement funds, thanks to compound interest. An early start to saving means more compounding.

## MONTHLY RIDDLE

This word has six letters; the first and last letters are Es. Take away either the first or last letter, and you can pronounce the five letters left to sound the same as the six-letter word. What word is this?

### Last month's riddle:

Suzanne, a hair stylist, says that given the choice, she would prefer to cut and style the hair of two redheads instead of one brunette. She says there is a logical reason why. What is it?

### Last month's answer:

She can make more money from two haircuts than she can from one.

## THE MONTH IN BRIEF

In May, investors were left to interpret mixed geopolitical and financial signals. The historic U.S.-North Korea summit was on, then off, then possibly on again. An apparent truce emerged in the U.S.-China tariffs battle, but it did not last. Oil rallied, but then prices fell. Federal Reserve policy meeting minutes indicated central bank officials would accept above-target inflation for a while. Other economic signals were clear: new and existing home sales were down, consumer confidence was back up, and consumer spending was strong. In the end, the markets took all this in stride – the S&P 500 rose 2.16% for the month.<sup>1</sup>

## DOMESTIC ECONOMIC HEALTH

On May 19, Secretary of the Treasury Steven Mnuchin told the media that the U.S.-China trade war was “on hold.” Both nations agreed to refrain from imposing new import tariffs, and China announced plans to lower taxes on imported cars and trucks from 25% to 15%. Ten days later, the U.S. surprised economists, journalists, and investors by electing to proceed with the 25% tariffs on \$50 billion of Chinese imports it had proposed in April. The Chinese government indicated it was ready to institute tariffs in response. On May 31, the Trump administration said that it would move forward with its planned steel and aluminum tariffs against Mexico, Canada, and the European Union, as well as extend short-term exemptions no further. Mexico and the E.U. quickly announced retaliatory taxes for U.S. imports.<sup>2,3</sup>

What did the Federal Reserve mean when it used the word “symmetric” in the minutes of its May meeting? The text referred to its “symmetric inflation objective,” and that obscure adjective (meaning “showing symmetry”) was used nine times. Market participants did learn that Fed policymakers were willing to let inflation briefly top the central bank’s 2% target rate. The Fed held interest rates steady last month, but a June rate hike seemed a distinct possibility: “Most participants judged that if incoming information broadly confirmed their current economic outlook, it would likely soon be appropriate [to] take another step in removing policy accommodation.”<sup>4,5</sup>

Looking at inflation gauges and other core economic indicators kept by federal government departments, the positives seemed to outnumber the negatives. Consumer prices were up 2.5% annually through April, just 0.1% above the March reading, and yearly wholesale inflation fell to 2.6% from the 3.0% advance measured in the third month of the year. The Core PCE Price Index showed 2.3% year-over-year inflation through April, as opposed to 2.5% through March. Hard goods orders were down 1.7% in April, but rose 0.9% minus defense industry orders. Retail sales improved another 0.3% for April, and that gain held up even with auto sales removed. Another report showed consumer spending advancing 0.6% in April, consumer incomes 0.3%. Gross domestic product in the first quarter was evaluated at 2.2%.<sup>5,6</sup>

Unemployment dropped to 3.9% in April and 3.8% in May, according to the Department of Labor. That was a low unseen since 2000. Wages grew 0.1% in April and 0.3% a month later; net job creation was at 159,000 in April and 223,000 in May. The U-6 rate, tracking both unemployed and underemployed workers, fell to 7.6% in May; it was 0.2% higher a month before.<sup>5,7</sup>

The Institute for Supply Management's purchasing manager indices showed slightly slower industry growth in April than in March; both benchmarks lost 2.0 points. The manufacturing PMI was at 57.3; the non-manufacturing PMI, at 56.8.<sup>8</sup>

Lastly, the Conference Board's consumer confidence index rose 2.4 points in May, reaching a lofty 128.0. The University of Michigan's consumer sentiment index declined 0.8 points from its initial May mark to 98.0.<sup>5</sup>

## **GLOBAL ECONOMIC HEALTH**

Political turmoil in Southern Europe made investors uneasy as May concluded. Italian President Sergio Mattarella effectively prevented the formation of a coalition government in late May. Populist parties managed to establish a new government as May ended, but investors and economists worried that the populists could try to push Italy out of the European Union. Spanish Prime Minister Mariano Rajoy was ousted by a parliamentary vote and replaced by new Prime Minister Pedro Sanchez, who headed a coalition including Catalan separatists.<sup>9,10</sup>

An analysis by Bloomberg pointed to a moderate deceleration in the Chinese economy. Bloomberg Economics concluded in late May that the P.R.C. was indeed on pace for 6.5% growth in 2018, parallel with official estimates. That would represent a drop from the nation's 6.9% GDP in 2017. Meanwhile, new data showed the Japanese economy contracting 0.6% the first quarter, displaying its first negative GDP reading in more than two years. In its May economic report, Japan's Cabinet Office maintained that the world's third-largest economy was "gradually recovering."<sup>11,12</sup>

## **WORLD MARKETS**

Away from America, the TSX Composite achieved the standout gain of the month, rising 2.91%. Nearly matching Canada's leading stock benchmark, the United Kingdom's FTSE 100 advanced 2.25%. Taiwan's TSE 50 improved 1.09%. There were other, minor index improvements: the Shanghai Composite rose 0.43%; the Sensex, 0.46%; the MSCI World, 0.31%.<sup>13,14</sup>

Losses were widespread in a month with much geopolitical and trade uncertainty. The West saw two of the biggest drops: a 7.64% slump for Mexico's Bolsa and a 10.87% fall for Brazil's Bovespa. Political tension in Spain drove the IBEX 35 5.16% lower. Singapore's Straits Times index slipped 5.14%, and Malaysia's Kuala Lumpur Composite took a 6.94% fall. France's CAC 40 lost 2.21%; the Nikkei 225, 1.45%; the Hang Seng, 1.10%. The MSCI Emerging Markets index retreated 3.75%.<sup>13,14</sup>

## **COMMODITIES MARKETS**

In the middle of May, light sweet crude seemed poised for a major monthly gain. Although the NYMEX price surpassed \$72 at one point, things reversed: oil ended up losing 2.09% on the month, settling at \$67.15 on May 31. Natural gas was the leader among major energy futures, up 6.62%. Heating oil rose 2.22%, while unleaded gasoline gained 1.94%. Crops were led by cotton, which jumped 11.10%, and sugar, which surged 11.02%. Coffee futures advanced 2.74% in May; wheat, 1.79%; corn, 0.32%. Soybeans retreated 1.93%, and cocoa dropped 13.60%.<sup>15</sup>

Ending May at a COMEX close of \$1,298.00, gold was down 1.17% for the month. Other key metals advanced: silver gained 1.14%; platinum, 1.25%; copper, 0.30%. (Silver futures closed out the month at \$16.45.) The U.S. Dollar Index stood at 94.07 at the close on May 31, having added 2.43% for the month.<sup>15,16</sup>

## **REAL ESTATE**

Mortgage rates may have soared in April, but they stabilized in May. On May 31, Freddie Mac's Primary Mortgage Market Survey found the mean interest rate for a conventional home loan at 4.56%, which was 0.02% lower than on April 26. (At the end of May 2017, the average interest rate on a 30-year ARM was 3.95%.) The average rate for the refiner's favorite, the 15-year FRM, rose 0.04% to 4.06%

between April 26 and May 31; the average rate for the 5/1-year ARM increased 0.06% to 3.80%.<sup>17,18</sup>

Home buying fell off in April. According to National Association of Realtors research, there was a 2.5% retreat in the pace of existing home sales. What homes did sell spent an average of 26 days on the market. The median sale price (\$257,900) was up 5.4% in April from the start of 2018. Census Bureau data showed new home sales slowing 1.5% in the fourth month of the year, and while the median sales price for a new residence declined 7.9% during April, that median price (\$312,400) was not exactly in starter-home territory in many parts of the country.<sup>18</sup>

The March S&P CoreLogic Case-Shiller home price index arrived, displaying a 6.8% overall annualized improvement for housing values across 20 metro areas; the increase matched that seen in the February edition. The NAR's pending home sales index declined 1.3% for March. Builders went to work on 3.7% fewer projects in April than they had in March. Mirroring the decline in starts, the Census Bureau also recorded a 1.8% dip in building permits.<sup>5</sup>

### LOOKING BACK...LOOKING FORWARD

What really attracted equity investors in May? Tech and small-cap shares. Both the Nasdaq Composite and Russell 2000 had a great month. The Nasdaq surged 5.32%; the Russell, 5.95%. (The Russell, incidentally, ended May at +6.39% YTD.) The S&P 500 posted a fine 2.16% gain, while the Dow Jones Industrial Average rose a respectable 1.05%. The CBOE VIX lost 3.14% for the month. When the closing bell rang on May 31, the Dow settled at 24,415.84; the Nasdaq, 7,442.12; the S&P, 2,705.27; the Russell, 1,633.61; the VIX, 15.43.<sup>1,19</sup>

% CHANGE	Y-T-D	1-YR CHG	5-YR AVG	10-YR AVG
DJIA	-1.23	+16.22	+12.31	+9.32
NASDAQ	+7.80	+20.06	+23.07	+19.50
S&P 500	+1.18	+12.17	+13.18	+9.32
REAL YIELD	5/31 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.76%	0.40%	-0.05%	1.58%

Sources: wsj.com, bigcharts.com, treasury.gov – 5/31/18<sup>1,20,21,22</sup>

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends. 10-year TIPS real yield = projected return at maturity given expected inflation.

Tariffs are now being levied on imported steel and aluminum, and the trading partners affected by these taxes are responding or planning to respond with tariffs of their own on U.S. goods. Could stocks stall out because of this? An impeded flow of international trade would certainly impact the GDP of the world's major economies and exert a drag on corporate earnings. The uneasiness about the brewing trade war gives some investors pause; the potential scope of it seems too large to price in. It is hard to imagine any kind of summer rally if the measures and countermeasures taken by various countries escalate. Not all investors appear to be worried, though – witness what happened in May even as the distinct possibility of trade wars emerged. The blue chips were hurt, but the tech sector and the small caps held up. Do these shares have further room to advance, and will investors retain their bullishness about them? June presents significant questions for investors worldwide, and we may see equities tested as threatened tariffs become reality.

**UPCOMING ECONOMIC RELEASES:** Here is what is ahead for June: the May ISM services PMI (6/5), the May Consumer Price Index (6/12), a Federal Reserve interest rate decision and the May Producer Price Index (6/13), May retail sales (6/14), May industrial production and the preliminary June consumer sentiment index from the University of Michigan (6/15), the Census Bureau's latest look at housing construction activity (6/19), May existing home sales (6/20), a new Conference Board index of leading indicators (6/21), May new home sales (6/25), the latest Conference Board consumer confidence index (6/26), May pending home sales and hard goods orders (6/27), the third estimate of Q1 growth from the federal

government (6/28), and May personal income and personal spending, the final June University of Michigan consumer sentiment index, and a new PCE price index (6/29).

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The SSE Composite Index is an index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. The MSCI World Index is a free-float weighted equity index that includes developed world markets, and does not include emerging markets. The BSE SENSEX (Bombay Stock Exchange Sensitive Index), also-called the BSE 30 (BOMBAY STOCK EXCHANGE) or simply the SENSEX, is a free-float market capitalization-weighted stock market index of 30 well-established and financially sound companies listed on the Bombay Stock Exchange (BSE). The Mexican Stock Exchange, commonly known as Mexican Bolsa, Mexbol, or BMV, is the only stock exchange in Mexico. The Bovespa Index is a gross total return index weighted by traded volume & is comprised of the most liquid stocks traded on the Sao Paulo Stock Exchange. The IBEX 35 is the benchmark stock market index of the Bolsa de Madrid, Spain's principal stock exchange. The Straits Times Index (STI), maintained & calculated by FTSE, is the most globally recognized benchmark index and market barometer for Singapore. The FTSE Bursa Malaysia KLCI Index (Kuala Lumpur Composite) is a major stock market index which tracks the performance of 30 largest companies by full market capitalization listed on the Main Board of the Bursa Malaysia. The CAC-40 Index is a narrow-based, modified capitalization-weighted index of 40 companies listed on the Paris Bourse. Nikkei 225 (Ticker: ^N225) is a stock market index for the Tokyo Stock Exchange (TSE). The Nikkei average is the most watched index of Asian stocks. The Hang Seng Index is a free float-adjusted market capitalization-weighted stock market index that is the main indicator of the overall market performance in Hong Kong. The MSCI Emerging Markets Index is a float-adjusted market capitalization index consisting of indices in more than 25 emerging economies. 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