Market Summary – May 7, 2018

For the week ending May 4

This summary is provided by BMT Wealth Management.

Markets Get a Boost from Friday's Employment Report

Equities got off to a rough start during the first few trading sessions in May and drifted lower for the majority of last week. This was in spite of a flurry of favorable earnings reports across several different economic sectors and industries.

The potential for "peak earnings" and concerns that inflationary pressures would start to adversely impact company profit margins weighed on investors' psyches before Friday's (May 4) employment report was released.

Investor sentiment shifted from pessimism to optimism after the U.S. Bureau of Labor Statistics issued the April Non-Farm Payroll report on Friday morning. While there was not anything noteworthy about the number of new jobs that were added (164,000), it was the below-consensus wage-growth reading (+2.6% year-over-year vs. the forecast of +2.7% year-over-year) that helped quell investor fears about rising inflationary pressures in the labor market.

A combination of stable growth and tepid inflation, which is what we have mostly seen over the past two years, has provided favorable conditions for equity markets.

Equity Market Recap

Similar to the last week of April, equity markets were somewhat volatile the first week of May, but ended the week nearly unchanged, with the S&P 500 Index falling -0.2%. U.S. small-cap stocks, as measured by the Russell 2000 Index, fared better, advancing 0.6%.

International equities declined for the week and were negatively affected by the recent strength in the U.S. dollar. Developed international stocks, as measured by the MSCI EAFE Index, returned -0.46%. Emerging market equities, as measured by the MSCI EM Index, declined -1.70%.

The market reacted favorably to Apple Inc.'s recent earnings release, and the stock's double-digit gain for the week helped drive the strong performance of the Information Technology sector.

The recent performance of energy stocks, which often move in tandem with crude oil prices, is worth noting. As the chart below illustrates, oil prices (gold line) rose faster than energy stock prices (blue line) during the back half of 2017. More recently, energy stocks have started to rise at a rate comparable to oil prices.

Energy Select Sector SPDR ETF (ELE)
vs. Crude Oil (WTI):
Two Years Ending 5/4/2018

Source: FactSet, Inc.

Last Week's FOMC Meeting and Fixed Income Market Overview

As expected, at its meeting last week, the Federal Open Market Committee (FOMC) elected to maintain its target range for the federal funds rates at 1.5% to 1.75%.

In our opinion, Wednesday's (May 2) FOMC statement conveyed a balanced view of the economic landscape. There was not any language that suggested the Fed would deviate from expectations of two additional rate hikes in 2018.

We find noteworthy the FOMC's inclusion of the word "symmetric" in its statement: "Inflation on a 12-month basis is expected to run near the Committee's symmetric 2 percent objective over the medium term."

Using "symmetric" (orderly, balanced, or having equal parts on both sides that match each other) to describe the Fed's 2% inflation objective is significant, because it implies the FOMC will not respond hurriedly in the short term to tamp down inflation that is modestly above its 2% target.

Treasury bond auctions were announced last week, which added more supply to the market, especially on the short end of the curve. This dynamic, along with below-consensus economic data, caused the yield curve to flatten further. The 10-year U.S. Treasury yield fell from 2.96% to 2.94%, while the two-year Treasury yield rose from 2.48% to 2.51%.

Looking Ahead

We are encouraged by the strength in corporate profits and reassured that there does not appear to be significant inflationary pressure building.

That said, the combination of a relatively fully valued market and tougher earnings comparisons will make sound individual security selection imperative.

Despite the slight pullback in intermediate-term Treasury yields, we continue to believe that interest rates across the curve will gradually rise. Therefore, we continue to favor corporate bonds and think it is prudent to limit interest-rate risk by keeping a close eye on bond durations.

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