May 2017

Market Index	May Change	Year-to-Date
Standard & Poor's 500	1.4%	8.7%
Dow Jones Industrial Average	0.7%	7.5%
NASDAQ	2.7%	15.8%
Russell 2000 (small company)	-2.0%	1.5%
MSCI EAFE (international)	3.7%	14.3%
Barclays Aggregate Bond Index	0.8%	2.4%

Monthly Update

More of the Same

May was yet another relatively quiet month in which large cap U.S. stocks rose. Volatility remained low, apart from one day mid-month when headlines related to Trump's firing of former FBI Director James Comey led to declines of more than 1% for most major indices. The one-day selloff exposed fear that the scandal could hinder the progress of tax reform and other legislative priorities. However, stocks recovered and moved higher as the month drew to a close. In addition to the Washington drama, stocks overcame sliding oil prices. Solid earnings reports and positive economic data provided the necessary support.

Large Cap Outperforms; Interest Rates Decline

Mid and small cap stocks fell despite gains in large cap stocks. The smaller cap indices were weighed down in part by weak performance in the financial sector, which represents a larger portion of those indices than the large cap indices. The NASDAQ was the best-performing U.S. index, demonstrating the continued leadership of technology companies. Utilities was the second-best performing sector, gaining over 4% as falling interest rates benefited high-yielding stocks investors have used as bond alternatives. Falling interest rates and waning confidence in Trump's promised deregulation were a drag on financials. Falling rates also led to bond gains. The yield on the 10-year U.S. Treasury has fallen from 2.45% at the beginning of the year to 2.21% as of the end of May.

Global Growth Continues; Fed on Track for June Hike

The global economy continues to grow. The World Bank forecasts global growth will reach a post-crisis high of +2.9% in 2018. A rebound in global trade is one factor supporting this trend, in addition to an improving employment picture and supportive policy measures. The U.S. economic expansion remains intact, and the Fed is on track to hike the benchmark rate another quarter point in June. However, expectations for several more hikes later in the year have come down. Investors will be looking for guidance from the Fed regarding further hikes later in the year, along with its plans to reduce the size of its balance sheet.

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Monthly Update (continued)

Retail Industry Continues to Evolve

While the overall economic picture is bright, the struggles of the traditional retailer have been in focus this year. The retail industry has come under increasing pressure as a result of several trends. One of these is a continuing shift in the way people shop. Internet retailers have challenged the status quo of the brick-and-mortar store model, and companies that have been slow to adapt have suffered. In addition, the ever-changing demographics of the country are impacting retail dynamics. Cities are attracting younger, wealthier residents, pushing lower-income residents out to surrounding suburbs. This has put pressure on shopping centers, and shopping malls in particular, as foot-traffic has declined. This declining foot-traffic reduces the amount of impulse buying from shoppers passing by items on display. People are also changing their eating habits, in some cases eating out less or spending less when they do.

The pace of retailer bankruptcy filings has picked up in 2017, and more could be on the way as the pressure intensifies. Apparel retailers have been hit the hardest, followed by electronics and department stores. Year-to-date stock performance of the various retail subgroups highlights these shifts:

- Internet Retail is the second-best industry group in the S&P 500 Index this year, up 31%
- Multi-line retail is down 15%
- Specialty retail and food retail are both positive, but lag the consumer discretionary sector

While the retail landscape is evolving, some companies are adapting and even thriving in the new environment. Those that have are investing in e-commerce and exploring innovative ways to market and deliver their products to consumers. Others are benefiting from the healthy economy and lower exposure to online retailing. The home improvement retailers are one example. In addition to enjoying less competition from online retailing, they continue to benefit from a favorable consumer backdrop of job gains, wage growth, low debt levels, and rising home prices.

Looking Ahead

The summer months are usually quiet in terms of stock market volatility. However, that isn't always the case. This year's low volatility and a series of new record-highs for the major indices leave less margin for error. Either way, the back half of the year provides plenty of opportunity for increased volatility, particularly as it relates to political events.

As investor expectations for quick action out of Washington have decreased, many of the "Trump trades" that surged in the wake of the election have drastically underperformed. This has been the case with cyclical stocks that would benefit from higher inflation and higher prices. Notably, this has also been the case with interest rates and sectors that are influenced by interest rates. The return of these trades to pre-election levels leaves open the possibility for a resurgence if any of the Trump agenda priorities come to fruition.

With lots of issues to tackle, there is little hope of any significant progress on the budget, taxes, the debt ceiling, healthcare, or infrastructure spending until after Congress returns from its August recess. The disagreement between the parties and within the Republican Party have stymied quick action on any topic. Distractions related to the Trump administration and international politics have also made it more difficult to focus on legislation. Investors will be looking for progress when Congress returns, particularly on tax reform.