Weekly Market Update

U.S. equities reach new highs in a quiet week

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- Modest gains during a light trading week lift the S&P 500 to two record closes.
- European, Japanese and Chinese equity indexes also finish higher.
- Fed meeting minutes imply a September time frame or beyond for an interest-rate hike.
- Labor market conditions and leading indicators are bright spots in a week of mixed U.S. economic data.
- We continue to see potential for U.S. equities to rise before a correction.

May 22, 2015

Equities

Amid light trading ahead of the Memorial Day holiday, U.S. equities were edging higher for the week despite a batch of mixed economic releases. Through mid-day trading on May 22, the S&P 500 Index was up about 0.3% for the week, setting new highs along the way without much fanfare.

Stocks also rose in Europe. Despite a slowdown in the Eurozone's services sector in May, manufacturing activity and job creation picked up, and the threat of deflation eased further.

In Asia, the Nikkei 225 Index reached a 15-year high after data showed Japan's economy grew faster than expected (+2.4%) in the first quarter. Meanwhile, Chinese equity indexes also notched record closes. In addition to funding infrastructure projects, the Chinese government has lowered interest rates and eased lending rules to boost the slowing economy.

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Fixed income

Fixed-income investors were largely focused on the release of minutes from the Federal Reserve's April 28-29 policy meeting. With the U.S. economy struggling to gain much traction, the Fed expressed a willingness to hold off on raising short-term interest rates until at least September. Fed officials also reiterated that their decision to tighten will be based on economic data and considered on a meeting-by-meeting basis. Response to the minutes was generally muted, as markets were not expecting the Fed to signal an earlier hike in rates.

U.S. Treasury prices fell, pushing up their yields. The bellwether 10-year Treasury, which began the week at 2.14%, hovered around 2.21% as of afternoon trading on May 22. Returns for "spread products" (higher-yielding, non-U.S. Treasury securities) were broadly, though not sharply, negative for the week through May 21. Despite the recent rise in longer-term Treasury yields, corporate issuance has remained high as the absolute level of rates remains attractive to borrowers and has been met with robust demand from investors as well.

Current updates are available here.

The U.S. jobs market maintains momentum

In a familiar refrain, labor market data held strong, while other economic reports were mixed. Among the week's key releases:

- **First-time unemployment claims increased** to 274,000 but stayed near a 15-year low and below the key 300,000 mark for the eleventh straight week. The less-volatile four-week average fell by 5,500, to 266,250, the lowest level since April 2000.
- The index of **leading economic indicators** published by The Conference Board climbed more than expected (+0.7% versus +0.3%) in April, supporting the view that the U.S. economy is set to improve in the second quarter.
- **Housing starts** soared 20.2% in April and were 9.2% higher compared to a year ago, although **homebuilder confidence** declined in May.
- **Existing home sales** fell 3.3% in April, while **home prices** rose in April versus March and were up 8.9% from last year, according to the National Association of Realtors.
- **Building permits,** a forward-looking indicator, hit a seven-year high in April.
- **U.S. manufacturing** slowed in May to 53.8 but stayed above the 50 mark separating expansion from contraction, according to a "flash" (preliminary) reading of Markit's Purchasing Managers' Index (PMI)
- **Core inflation**, which excludes volatile food and energy costs, jumped 0.3%, the fastest rate since January 2013.

Outlook

Beneath the S&P 500's grind to new highs are a series of sector rotations. Recently, industrial shares have rallied while transportation stocks have dropped sharply. This shift, echoing corrections in the health care, utilities, and real estate investment trust (REIT) sectors, may restrain investor sentiment and provide the backdrop for further market advances, perhaps through our intermediate target of 2,150 to, and even above, the 2,200 mark. From those levels we would not be surprised by a market correction of 5% to 10% but are of the opinion that the U.S. market will finish higher on the year. In fixed-income markets, we believe bonds remain reasonably priced at current yields.