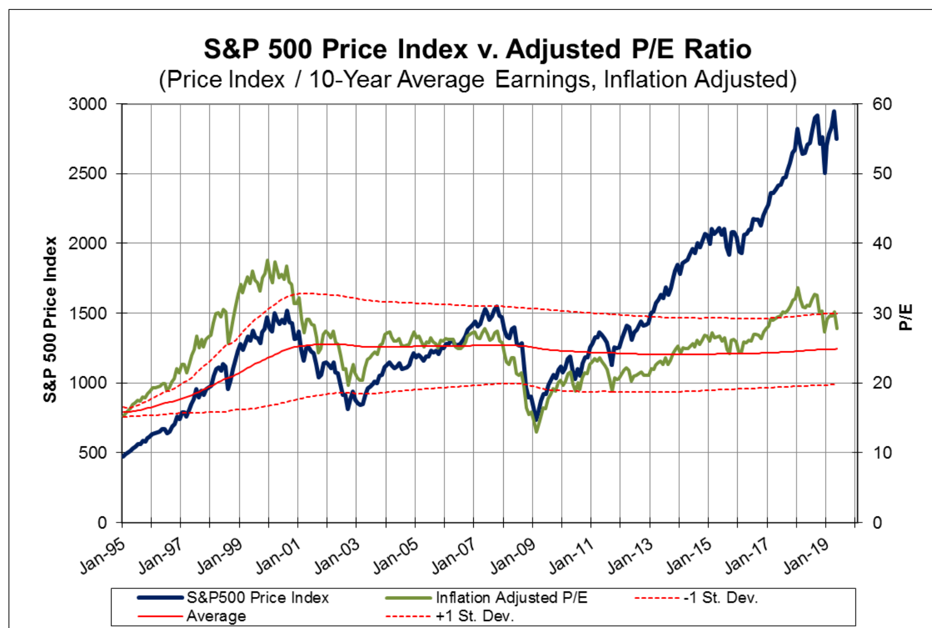
Monthly Market Comment
June 1, 2019

After such good performance in April, it was hard to stomach the renewed volatility in stocks and other riskier assets in May. Stock prices posted their biggest decline since last December, and commodity prices posted their biggest drop since November. Fortunately, real estate and bond values rose, providing welcome diversification to portfolios that included them.

Stocks

The big problem for stocks and risk assets in May was the administration's effort to weaponize import tariffs against China, Mexico, India, and even Australia. With investors unsettled by the potential for a sudden, massive disruption of supply chains and decreased investment, the S&P 500 price index plummeted 6.6% on the month, leaving it just 1.7% higher than at the end of May 2018. Taking into account dividends, the total return on the S&P 500 was a negative 6.4% in May and a positive 3.8% over the last year.

Looking forward, we remain thankful that the Federal Reserve stopped hiking interest rates at the end of last year. We think that's a key reason why stock prices had generally been rising this year until May. However, even though the overall economy is continuing to grow, we worry that the inflation and rate hikes though 2018 have already done their damage. Some economic sectors are clearly still weakening, which could eventually offset the good trends in the labor market. The chaotic, disruptive trade threats are therefore coming at a particularly bad time. Besides, slowing economic growth in China and Europe could also be a problem, not so much because U.S. exports might fall, but because foreign production and sales are so important to large U.S. companies. There is also some risk that geopolitical tensions and trade disputes could worsen again. Overall, we see continued headwinds for corporate profits and stock prices in the coming months, especially if the Fed is slow to cut rates from here.



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Technical indicators have also weakened over the last month. At the end of May, the S&P 500 index stood below its 200-day simple moving average (SMA), its 50-day SMA, and its 20-day SMA, all of which points to a decided downtrend in stocks. In addition, the share of S&P 500 stocks trading above their own 200-day SMA has now fallen to only about 50%, and the Dow Jones Transportation Index has recently been weakening even more than the overall market. The only major technical indicators that suggest some reason for optimism are the key short-term momentum gauges (such as the "moving average convergence/divergence," or MACD). Those indicators suggest stocks had become over-sold by the end of May and therefore could be in a position to rebound at some point. If the S&P 500 continues to fall from here, we think its next significant support levels would be at approximately 2,706 and 2,640. If the S&P 500 instead starts to rebound, we think it would find its next significant resistance levels at approximately 2,876 and 2,945.

S&P 500 Stock Price Index + "MACD" Momentum Indicator

Source: BigCharts.com

Bonds

As investors panicked about the potential impact of the trade war during May, safe-haven bond buying surged, prices jumped, and yields plummeted. The yield on the benchmark 10-Year Treasury Note plunged to a 20-month low of 2.14%, compared with 2.51% at the end of April. As measured by the S&P U.S. Aggregate Bond Index, the total return on investment-grade bonds was 1.5% in May and 5.5% over the last year.

Because of the various economic and political headwinds discussed above, we are now much more confident that the policymakers at the Fed will be able to hold off on any further rate hikes for the foreseeable future. If the incoming data eventually confirm that the economy really has been damaged by the inflation and rate hikes to date or the on-going trade war, the policymakers' next move would likely be to cut rates. In other words, we think the balance of risks for bonds is toward flat-to-falling interest rates well into the future. In that case, the current rich pricing for bonds would seem justified, and it would likely make sense to hold longer-maturity obligations as opposed to the shorter maturities that we were favoring in 2018. Likewise, we continue to think the slowing economy and reduced inflation pressures argue for significantly reducing exposure to inflation-protected securities and favoring conventional, non-adjusted obligations.

Real Estate and Commodities

In May, publicly-traded real estate investment trusts (REITs) benefited from the fall in bond yields, as is often the case. By the end of the month, the FTSE NAREIT Price Index had risen 0.4% from its level at the end of April, leaving it 11.6% above its level at the end of May 2018. Reflecting their relatively high dividends, the total return on publicly-traded REITs was 0.6% in May and a strong 16.1% over the last year. Looking ahead, we believe REITs' operational dynamics will probably remain healthy as long as the overall economy keeps growing, while steady-to-falling bond yields will continue to help their price performance.

The concerns about trade disruptions were especially problematic for commodities during May, with the S&P GSCI Total Return Index dropping a sharp 8.2% from its level at the end of April. That left the index down a full 14.1% from May 2018. The decline in the commodity index during May came mostly from lower prices for economically sensitive goods like crude oil and its derivatives, natural gas, and industrial metals. In contrast, safe-haven buying helped boost the value of gold. Perhaps most interesting, agricultural commodities like wheat and corn surged in value, as investors feared that heavy rain and flooding this spring would reduce planting and cut into supplies. Looking forward, we see a fairly high risk that the overall commodity complex outside of gold and agriculture will continue to weaken, especially if sky-high U.S. oil inventories and production lead to an oversupply of oil.

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Lead Portfolio Manager

Asset Class	Index	Ending Reading, Latest Month	1-Month Change	3-Month Change	12-Month Change
U.S. Stocks	S&P 500 Price Index	2,752.06	-6.6%	-1.2%	1.7%
Non-U.S. Stocks	MSCI All-Cap World Ex-U.S. Price Index	269.60	-5.9%	-3.5%	-8.8%
REITs	FTSE NAREIT All-Equity Price Index	730.17	0.4%	3.9%	11.6%
Commodities	S&P GSCI Total Return Index	2,391.41	-8.2%	-4.1%	-14.1%
Bonds	S&P U.S. Aggregate Bond Index	201.46	1.5%	3.1%	5.5%

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