DETALUS ADVISORS

2017: A First Quarter Review

The opening quarter of 2017 was a historic one for Wall Street as the Dow Jones Industrial Average topped 20,000 for the first time. Equities rallied through January and February, then lost momentum in March; even so, the S&P 500 gained 5.53% YTD at quarter end. The Federal Reserve ("the Fed") raised the federal funds rate for only the third time in a decade in response to strengthening inflation pressure and other signals of economic acceleration. Consumer confidence remained high. Commodities had a decidedly mixed quarter. New home sales improved, while existing home sales tapered off. The United Kingdom took another step toward its Brexit, and the United States left the Trans-Pacific Partnership. Wall Street kept its hopes up for tax reform and lighter business and banking industry regulation.[1,2]

DOMESTIC ECONOMIC HEALTH

As the stock market climbed, so did the Consumer Confidence Index (CPI). By March, it had reached an astonishingly high mark of 125.6. The University of Michigan's household sentiment index declined from 98.5 to 96.9 across the quarter, but remained well above its historical average of 86.0.[3,4]

Factory and service sectors expanded nicely during Q1, according to the Institute for Supply Management. The Arizona-based organization's manufacturing purchasing manager index (PMI) was at 56.0 in January, 57.7 in February, and 57.2 in March. Its service sector PMI came in at 56.5 in January and 57.6 in February. All these numbers indicate solid growth.[5,6]

One other sign of economic growth, of course, is inflation. In Q1, it became more palpable. By February, the CPI had risen 2.7% in a year (the annualized advance on the core CPI was 2.2%). Producer prices were up as well. The headline Producer Price Index (PPI) showed a 2.2% yearly advance in February, with core prices gaining 1.5% over 12 months.[3]

Available data shows tepid consumer spending at the beginning of 2017. Personal spending was up just 0.2% in the opening month of the year and only 0.1% in February. Consumer incomes, however, rose 0.5% in January, then 0.4% in February. Households sent headline retail sales 0.6% higher in January, but only 0.1% a month later. There were gains in durable goods orders in both January (2.3%) and February (1.7%).[3,7]

January's Department of Labor jobs report showed the headline jobless rate at 4.8% and the U-6 rate measuring underemployment at 9.4%. A month later, those unemployment rates were respectively lower at 4.7% and 9.2%, respectively. Hiring was strong in both January and February, with 238,000 net new jobs added to payrolls in the first month and 235,000 net new jobs added in the second.[8]

All this data encouraged the Fed to make its first interest rate move of the year. On March 15, it announced a widely expected, quarter-point hike, taking the federal funds rate to a target range of 0.75-1.00%. As Fed chair Janet Yellen told the media after the announcement, "The simple message is, the economy is doing well." Two incremental rate increases are still projected before year-end.[9]

President Donald Trump signed an executive order commissioning a review of the Dodd-Frank Act. As Q1 ended, hearings on portions of Dodd-Frank were set to start in early April, with a chance of reform legislation being introduced in Congress during Q2.[10]

GLOBAL ECONOMIC HEALTH

In late March, the United Kingdom formally triggered Article 50 of the Lisbon Treaty as the beginning of "Brexit. It now has until April 2019 to negotiate the terms of its departure from the European Union ("E.U."). Will the United Kingdom retain single market access after the Brexit, so its citizens can continue working and living in E.U. countries without visas? Or will it make a “hard” Brexit, a divorce dictated by court decisions and/or World Trade Organization rules that would cause its people to lose E.U. citizenship rights? In April, the negotiations begin. The euro area jobless rate stood at 9.5% as of February, a low unseen since May 2009. Eurostat estimated an inflation rate of 1.5% for the euro area for March, an 0.5% decline from February.[11,12]

As the United States left the Trans-Pacific Partnership during the quarter, Asia-Pacific nations seeking a regional trade pact turned to Plan B – the Regional Comprehensive Economic Partnership. This free trade agreement now in negotiation would bring China, Japan, and India into an accord with 13 other Asia-Pacific neighbors, including some of the region’s poorest nations, such as Myanmar and Laos. Asia-Pacific manufacturing purchasing manager indices improved as Q1 ended, with China’s official PMI advancing 0.2 points to 51.8 in March for its best reading since April 2012. Japanese and Indian factory activity also accelerated in March, with India’s PMI hitting a 5-month high.[13,14]

WORLD MARKETS

As of March 31, the five best YTD performers among global stock indices were Argentina’s MERVAL (+19.8%), Spain’s IBEX 35 (+11.9%), India’s Sensex (+11.2%), the MSCI Emerging Markets (+11.1%), and Singapore’s Straits Times (+10.2%). Other big gains include: Brazil’s Bovespa (+7.9%), Germany’s DAX (+7.2%), Italy’s FTSE MIB (+6.5%), the Euro Stoxx 50 (+6.4%), the Global Dow (+6.3%), Hong Kong’s Hang Seng (+9.6%), and South Korea’s Kospi (6.6%).[15,16]

In fact, it is hard to find a marquee stock index that retreated in Q1. Scrutiny reveals two: Russia’s RTS slipped 3.3%, and Japan’s Nikkei 225 lost 1.1%. To round out the numbers, China’s Shanghai Composite gained 3.8% in Q1; the United Kingdom’s FTSE 100 gained 2.5%; and the MSCI World gained 5.9%.[15,16]

COMMODITIES MARKETS

For metals investors, the first quarter brought much to cheer. Palladium rose 17.46%, and aluminum was close behind at 14.87%. COMEX silver ended the quarter at $18.28, gaining 14.50%. COMEX gold futures advanced 8.64% to settle at $1,247.40. Lastly, copper gained 5.84%, and platinum gained 5.21%. Cotton led the way in ag futures with a 9.46% Q1 improvement with rice following with a gain of 5.77%. CBOT wheat futures rose 4.53%, while corn futures added 3.48%.[17,18]

The quarter also saw double-digit drops, including orange juice futures (-20.75%), natural gas (-14.85%), and sugar (-14.10%). Other setbacks occurred for heating oil (-8.89%), soybean oil (-7.67%), WTI crude (-5.81%), soybeans (-5.07%), tin (-4.56%), oats (-1.86%), cocoa (-1.46%), and nickel (-1.39%). Oil finished the quarter at a NYMEX price of $50.85.[17,18]

REAL ESTATE

Mortgage rates descended in the first quarter. On December 29, the average interest rate on a conventional home loan was 4.32%, according to Freddie Mac’s Primary Mortgage Market Survey. By the March 30, the Survey was just 4.14%. Similar declines were seen for the average rate on the refinancer’s favorite, the 15-year fixed rate mortgage (3.55% to 3.39%), and the average rate on the 5/1-year adjustable rate mortgage (3.30% to 3.18%).[19,20]

Census Bureau data showed new home sales rising 5.3% in January and another 6.1% in February. Resales wavered, increasing 3.3% for January and decreasing 3.7% the next month, according to the National Association of Realtors.[3]

Regarding the sales numbers that matter most (the annualized ones), existing home sales were up 5.4% in the year ending in February, and new home sales were up 12.8%. In the second month of 2017, the median price for an existing home was up 7.7% from a year ago at $228,400. The median new home price was up at $329,900 as of December, but it had fallen to $296,200 by February.[21,22]

Housing starts and building permits, other key real estate indicators, went in opposite directions. Starts fell 1.9% in January, then rose 3.0% a month later. Permits advanced 4.6% for January, but retreated 6.2% in February. The National Association of Realtors' pending home sales index rose 5.5% to 112.3 in February after slipping 2.8% in January. Finally, January's 20-city S&P/Case-Shiller home price index arrived, revealing a 0.2% monthly improvement and a 5.7% annualized advance.[3]

LOOKING BACK … LOOKING FORWARD

On March 31, the key U.S. equity indices settled at these levels: Dow, 20,663.22; Nasdaq, 5,911.74; S&P 500, 2,362.72; Russell 2000, 1,385.92. The Russell did not quite gain as much as the big three in Q1 – it was up 2.12% YTD when March concluded. The CBOE VIX finished Q1 down 11.89% YTD – in fact, it was the worst performer among significant indices. The PHLX Housing Index was the quarter's best performer, gaining 11.96%; the Nasdaq 100 was a close second, advancing 11.77%.[2]

Some truly remarkable things happened in Q1. The Dow closed at a record high for 12 straight trading days – a feat that last occurred in 1987. The blue chips also went on an 8-session losing streak for the first time since 2011.

With this great quarter now history, investors wonder what to expect from Q2. While a bullish outlook still predominates on Wall Street, questions linger regarding current market valuations, technical trading levels, and the upcoming earnings season. The stock market has once again outperformed the economy, but that has not troubled Wall Street to significant degree. This old bull market already surpassed analyst projections. In March, Fortune reported that the consensus forecast for 2017 improved to a yearly gain of somewhere between 4-10%. Perhaps the bulls run all through this next quarter and even for several more to come. As CFRA chief investment strategist Sam Stovall recently commented, "Bull markets don't die of old age, they die of fright. And what they are most afraid of is recession." With no hint of recession on the near-term horizon, the upward stock market trend may continue through spring.[26]

Some years, the market really surprises to the upside. Perhaps this will be one of those years. As it unfolds, feel free to call us with any questions or concerns you have and, as always, thank you for the opportunity to work with you.

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