MarketUpdate

Mixed May for Markets

Equity markets started off strong in May, but volatility later in the month led to a partial pullback. The early gains brought the S&P 500 and Dow Jones Industrial Average (DJIA) to all-time highs. The Nasdaq Composite suffered from additional volatility due to its heavy technology weighting. The S&P 500 gained 0.70 percent, and the DJIA saw a 2.21 percent return. The Nasdaq Composite fell by 1.44 percent.

Markets were supported by improved fundamentals during the month. According to Bloomberg Intelligence, as of May 21 with 95 percent of companies having reported, the first-quarter earnings growth rate for the S&P 500 stands at 53.1 percent. This strong result is better than analyst estimates for a more modest 23.9 percent growth rate. While the large year-over-year growth figure is partially due to comparisons to last year's pandemic-influenced first quarter, this better-than-expected result shows that businesses have been recovering at a faster pace than analysts originally expected. Improving fundamentals drive long-term market performance, so this strong start to the year is a good sign for equity markets.

Markets were also supported by technical factors during the month. All three major U.S. indices remained above their respective 200-day moving averages. This marks 11 consecutive months where the indices have finished above trend. Prolonged breaks above or below the 200-day moving average can signal shifting investor sentiment for an index. So, this continued technical support indicates that investors are optimistic about the prospects for U.S. markets.

The story was much the same internationally. The MSCI EAFE Index gained 3.26 percent during the month. The MSCI Emerging Markets Index saw a 2.34 percent gain. Both international indices have finished above their respective 200-day moving averages for seven straight months.

Fixed income markets also saw gains, supported by a moderate decline in long-term interest rates. The 10-year U.S. Treasury yield fell from 1.65 percent at the end of April to 1.58 percent at the end of May. This result marked two months of declining long-term rates. The Bloomberg Barclays U.S. Aggregate Bond Index gained 0.33 percent.

High-yield fixed income, which is less driven by interest rate movements and more aligned with equities, also had a positive month. The Bloomberg Barclays U.S. Corporate High Yield Index gained 0.30 percent in May. High-yield credit spreads increased modestly but remain below pre-pandemic levels, signaling continued investor appetite for higher-yielding, riskier securities.

Medical Risks Decline

May saw further progress in containing the spread of COVID-19. Daily new case counts continued to fall and finished the month at levels not seen since last summer. There were similar improvements in the number of hospitalizations and deaths during the month. The improvements we saw in May amid nationwide reopening efforts are a positive sign that another wave of infections is unlikely in the near term.

Much of this progress can be traced back to the continued vaccination efforts throughout the country. We finished the month with more than 40 percent of the population fully vaccinated and more than 50 percent having received at least one shot. This is up from 30 percent fully vaccinated and 43 percent having received an initial shot at the end of April. While the continued increase is encouraging, the pace of vaccinations has slowed. With that said, the continued improvement on the medical front showed that the long-term trends remain positive.

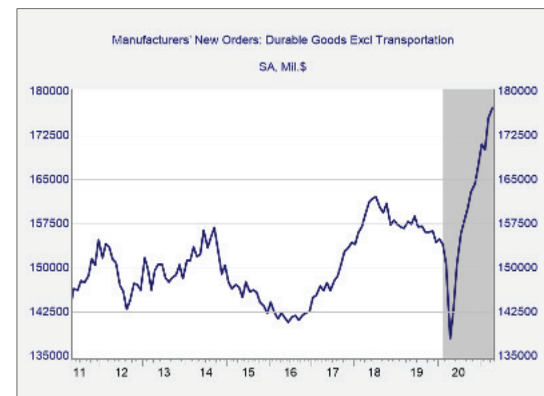
Economic Recovery Continues

The economic data releases in May largely pointed toward continued growth, but there were some signs of a slowdown in the data. April's job report was a prime example. The 266,000 jobs added during the month were a noted step down from the 770,000 jobs added in March. Slower growth is still growth, however.

Consumer confidence and spending remained near post-pandemic highs, supported by the lingering effects of the most recent federal stimulus and continued reopening efforts across the country. Personal spending increased by 0.5 percent in April, following an upwardly revised 4.7 percent stimulus-fueled surge in March.

Business confidence and spending also showed signs of continued growth. The Institute for Supply Management Composite index fell from 63.8 in March to 62.5 in April. But even so, this result left the index at its second-highest level on record. Businesses also continued to spend during the month, with core durable goods orders rising by more than expected. As you can see in Figure 1, core durable goods orders have rebounded well past pre-pandemic levels, signaling strong business investment.

Figure 1. Core Durable Goods Orders, May 2011–Present



Source: Census Bureau/Haver Analytics

The housing market also continued to grow during the month. Low supply of homes for sale and rising prices served as a headwind for faster sales growth, however. Sales of existing homes fell by 2.7 percent in April. On a year-over-year basis, sales of existing homes were up by 33.9 percent. While the slowdown in the pace of sales was slightly disappointing, the strong year-over-year growth shows the relative strength of the housing sector. Significantly faster levels of sales growth may be hard to come by due to the price and supply constraints, but sales near current levels would still represent a marked improvement compared with the pre-pandemic pace of sales.

Despite Progress, Risks Remain

We continued to make progress on the economic and public health fronts during the month, but the market volatility served as a reminder that risks remain. May saw rising concerns about inflationary pressure against a backdrop of reopening efforts that increased consumer demand while supply chain constraints hindered suppliers. These concerns led to market volatility and are likely to persist in the short term, given the Federal Reserve's (Fed's) focus on supporting the labor market recovery.

In addition, though we have made progress with the pandemic, we are not yet out of the woods. The pace of vaccinations has slowed, largely due to the fact that many of the people who were likely to receive a vaccine already have. Encouragingly, the results so far have supported the recent medical improvements, but a slowdown in the pace of vaccinations will likely delay any attempts to achieve herd immunity throughout the country. Given the improvements so far this year, though, the question now seems like a matter of when, not if, we will return to more normal conditions.

Finally, political risks remain and should be monitored. Domestically, much of the focus will be on Washington, where proposals for further fiscal spending and potential tax changes will likely garner considerable attention throughout the rest of the year. Investors will also be focused on the Fed and any potential changes to monetary policy that could rattle markets. Internationally, risks remain as well, especially in areas of the world that have seen less progress in getting people vaccinated and back to work.

Although we are in a much better place than we were a few months ago, very real risks remain. While the most likely path forward is continued recovery and growth, the pace of the recovery is uncertain, which may lead to additional market volatility. A well-diversified portfolio that matches investor goals and timelines remains the best path forward for most investors. If you have concerns, contact your advisor to review your financial plan.

All information according to Bloomberg, unless stated otherwise.

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