MARKET
NOTES

Week of May 1, 2017

Global Stocks Rise on French Relief Rally, Strong Earnings

The U.S. economy delivered mixed results last week. On the plus side, three important economic benchmarks—new home sales, pending home sales and wholesale inventories—beat investors' expectations. Those positive developments were countered by poorer-than-expected results in initial jobless claims, consumer confidence and durable goods orders.

Internationally, economic data remained robust:

- German inflation (CPI) and the Ifo German Business Climate Index came in ahead of expectations.
- Italy's manufacturing and consumer confidence indices beat estimates.
- Japan's All-Industry Activity Index—a broad measure of the country's business activity—exceeded expectations on stronger-than-anticipated industrial production and commercial construction.

In the U.S. equity market, healthcare stocks—medical device makers and biotechnology firms, in particular—were the top performers last week, driven by stronger-than-expected first-quarter earnings. Shares of industrial companies—particularly aerospace and defense contractors—posted gains on the prospect of higher defense spending going forward.

In contrast, energy company stocks continued to suffer from lower oil prices, while REITs underperformed due to increased prospects for rising interest rates.

Overseas, European stock markets experienced strong "relief rallies" following the results of the first round of the French Presidential election, which were in line with investors' expectations.

Interest rates rose last week, putting pressure on bond prices. Long-duration bonds, which are particularly sensitive to interest rate changes, underperformed shorter-duration fixed-income securities. Municipal bonds also lost ground, as investors worried that the Trump administration's proposed tax plan would limit the tax deductibility of muni bond interest. However, bonds with exposure to equity markets—such as convertible bonds, high-yield bonds and preferred stocks—outperformed the broader fixed-income market as equities rallied.

continued on next page >

GAIN: Active Asset Allocation

Global equity markets rose last week in the wake of pro-growth results of the first round of the French elections. In particular, European markets posted strong gains—helping foreign stocks outpace the U.S. market for the week. In addition, growth stocks once again beat value stocks.

The Gain portfolios benefited from these developments. The portfolios have direct positions in Europe and emerging markets, while avoiding Japan, and we expect those overweights to remain. In addition, the portfolios' overweights to growth stocks were beneficial.

In the bond market, U.S. interest rates rose as pro-growth rhetoric from Washington D.C. about tax reform and deregulation continued. Corporate credits handily outperformed Treasuries, and the Gain portfolios' overweight to credits was beneficial in that environment.

PROTECT: Risk Assist

Investors last week adopted a pro-equity, "risk on" attitude that pushed stock prices higher, causing volatility to fall for the second consecutive week. The CBOE Volatility Index (or VIX) dropped below 11, down from 15 two weeks ago. This suggests investors anticipate lower volatility going forward.

The Risk Assist portfolios remained fully invested and therefore participated fully in the stock market rally.

SPEND: Real Spend

Global stocks continued to increase their performance advantage over fixed income last week, following the first round of French elections. Stocks outperformed the broad-based bond market by more than 3%, and have now outpaced bonds by more than 13% during the past 12 months.*

Real Spend portfolios not only maintain larger allocations to equities than do target date funds, but also have exposure to non-U.S. equity markets. For example, international stocks currently make up approximately 25% of Real Spend's equity exposure. That positioning benefited the portfolios last week.

Meanwhile, the yield on the 10-year U.S. Treasury note rose, pushing down bond prices overall and acting as a headwind for portfolios with sizable allocations to fixed-income. Market expectations for inflation also rose, due in part to speculation that pro-growth government policies could boost inflation.

* MSCI All Country World Index vs. Bloomberg Barclays Aggregate Bond Index