Reilly Financial Advisors

THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – APRIL

US Markets and Economy: US stocks sold off in early April only to recover to their all-time highs by the end of the month. The continuing economic and military crisis in Ukraine has clearly put a damper on stock prices. Russia's stealthy takeover tactics in Crimea are now being tried in Eastern Ukraine. While Europe is more directly and adversely affected by Putin's territorial ambitions, the US is still the world's only policeman, and America may be drawn in to the European crisis just as it was in the 20th century. But the latest bout of European political instability has masked some very good news on the home front: the US economy has begun accelerating from the winter doldrums: although real GDP in the year's first quarter was flat, all signs now point to a substantial pickup in growth for the rest of the year. The latest employment report (released May 2) showed a sharp drop in unemployment, and a substantial rise in hiring for the month of April. Although housing is still recovering from a frigid and snowy winter, mortgage rates remain historically low, mortgage bankers are beginning to loosen their extremely tight lending standards, and the available inventories of existing homes for sale are low in many parts of the country. Further gains in housing prices will encourage American consumers to spend more freely, and may encourage businesses to finally deploy their mountains of cash assets.

The Federal Reserve said in April that it will continue to support more rapid growth with easy money and low interest rates, even as it tapers its Quantitative Easing. The Fed is in no hurry to raise interest rates, since it is convinced that there is still much slack in the economy. Even with the official unemployment rate now down to 6.3%, the decline in labor-force participation, which continued in April, suggests that there are many workers not counted as unemployed who want jobs. The Fed also has more room to keep stimulating the economy since inflation remains very low, and wage growth is also low.

The news was not as good for corporate profits, the other long-term key driver of stock prices. April is “earnings season,” with most firms reporting profits for the first quarter of the year during the month. Although the data are not all in, it appears that earnings growth slowed to a 1-2% rate. Some of the slowdown could be attributed to the harsh winter, so there should be a pickup in profit growth in the second quarter. If corporate profit growth were to remain low in the current quarter and beyond, stocks could have more difficulty advancing to new highs.

World Markets and Economy: The Ukraine crisis has dominated the news in Europe. Ironically, the most damage to a European economy and stock market has taken place in Russia. **The Russian economy is slowing to near-zero growth, capital flight from Russia is substantial, and the Russian stock market is now down 14% for the year.** If Vladimir Putin decides to move his troops into Ukraine, the US and a reluctant Europe will have to respond with more sanctions, more restrictions on trade, and perhaps more military and economic help for the beleaguered government in Kiev. But so far European stock and bond prices have shrugged off the political crisis. German stocks actually rose in April, even though Russia is a big trading partner for Germany. British stocks also logged a good month, as economic growth picked up in England. French stocks also gained in April, and smaller markets like Greece and Italy were down only slightly. The Italians returned to the bond market, and the yield on their 10-year bond is now down to 3%, which almost equals the US 10-year rate. With economic growth beginning to return in more of the Eurozone countries, including depressed Greece and Spain, the outlook for European stocks has continued to brighten.

Asia is another story. Even as the Chinese economic juggernaut rolls on, albeit at a more sustainable 7% growth rate, Chinese stocks remain in a long-term bear market, with another weak month in April keeping stocks near their multi-year lows. Japanese stocks fell for the month, and are now down 10% for the year. Prime Minister Abe’s attempt to jolt Japan out of deflation may be working, but Japanese consumers are not happy with the sudden rise in prices on top of an increase in the national sales tax. With wages stagnant, pinched Japanese consumers could cut back on spending, which could weaken the economy yet again. Indian stocks were flat for the month, as election uncertainty continues, but Indian shares have recovered nicely from last year’s selloff.

OUTLOOK:

In the short term, stock markets around the world may be hostage to international events, as the Ukraine crisis unfolds. For the longer term, low interest rates and rising corporate profits can support further gains in US stocks.