US Markets and Economy: US stocks struggled to make small gains in April, leaving markets only slightly ahead for 2015. Each sharp rally this year has been followed by a sharp decline, as volatility has increased. Neither the bulls nor the bears have been able to land a knockout punch: very low interest rates (bullish) have been parried by very slow growth in corporate profits (bearish). Short and long-term interest rates remain extremely low because the Fed does not want to choke off the economic recovery by raising rates too far too soon. It is possible that the first quarter-point interest rate will take place in September, but it is unlikely that short-term rates will rise more than 50 basis points this year. These low rates are still very stimulative and a strong positive for stocks. Stock prices are also driven by economic growth and corporate profits, and here the news was poor: the economy had a bad first quarter, exhibiting almost zero real growth. A brutal winter, the effects of a West Coast dock slowdown, and a strong dollar were the chief culprits. All of these factors also hurt corporate profits, along with the additional drag from the energy sector, which on balance is hurt by low oil prices. It is likely, though, that the economy will bounce back in the remaining three quarters of the year, and economic growth should approach a respectable 3% in real terms. Inflation remains very tame, which will give the Fed extra leeway when and if it begins raising rates. Falling oil prices have been the main driver of the good inflation news, and if the price of oil stabilizes at current levels, inflation could pick a bit in the second half of the year. Any speedup in inflation would give the Fed the cover it needs to begin the slow process of returning interest rates to historically normal levels.

World Markets and Economy: Europe’s economy continues to struggle, and the Greek drama adds uncertainty. Although Greek stocks were ahead for the month, they are still down over 30% in the last 12 months. The Greek government will face a cash crunch very soon if its lenders are unwilling to provide additional bailout loans. Negotiations are stymied by German insistence on more Greek economic reforms which the Greek government seems unwilling to undertake. Although most Greek debt is now held by official institutions, a breakdown in negotiations, leading to a Greek default, could rattle markets in Europe and even the US. If a chaotic default
led to Greece’s departure from the Eurozone, even more financial volatility could result. In spite of these fears, bond and stock investors, aided by ECB QE, pushed prices upward in Europe in early April. Stocks did sell off later in the month as the Greek crisis continued without resolution, but European stocks have far outperformed the US this year: German and French indexes are both up over 15% so far. Heavily indebted Spain (+10%) and Italy (+20%) have also done well. QE has also lifted bond prices sharply and reduced yields to levels unimaginable just a few years ago: 10-year bonds issued by Italy were yielding about 1.5% at the end of the month, which is lower than the US 10-year yield. The German 10-year bond yield fell as low as 0.1% during April, and the Swiss 10-year bond yield was less than zero for most of the month.

Negative nominal yields reflect the unusual conditions in Europe: very slow growth, falling prices (deflation), and steady bond-buying by the ECB, which convinces traders that bond prices can go even higher. The Swiss also have a currency which could continue to appreciate against the euro, offsetting the negative nominal yield. The dollar is also likely to stay strong against the euro because of the interest rate differential. If the ECB were to end QE, however, European bonds would likely sell off sharply.

Asia is hot. The Japanese market is still in rally mode, with the Nikkei breaching 20,000 during April, a new recovery high. Japanese stocks are up over 10% this year, and QE there is mostly responsible. Economic growth in Japan is still sluggish at best, and Abe has yet to deliver on his economic reform package.

Chinese stocks continued to soar, with the Shenzhen Index up over 30% for the year, and up over 115% in the last 12 months. These stupendous gains are encouraging ordinary Chinese to open millions of new brokerage accounts to play a stock market they shunned just a few years ago. Since Chinese growth is still slowing down, the impetus is clearly coming from easing monetary policy. The PBOC (the Chinese version of the US Fed), has been cutting reserve requirements for banks, an aggressive form of monetary easing. Some of this additional bank liquidity is no doubt finding its way into the booming stock market.

**OUTLOOK:** In the short term, US stocks can continue to rally, as long as the economy strengthens with inflation and interest rates remaining low. US bond prices could face pressure if the Fed does indeed begin raising rates. While rates will remain extremely low in Europe and Japan, with QE pushing both stocks and bonds higher, further gains in stocks will probably require a resumption of economic growth. Europe’s financial markets also face more potential uncertainty as the Greek drama continues without resolution. Asian stocks may continue to boom in the short run, driven by easy money.