THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – APRIL

US Markets and Economy:

American stocks were weak in April right up to the first round of the French election. Relief that Macron finished ahead of Le Pen, making him the favorite in the runoff, set off a powerful 2-day rally that brought US indexes back to their all-time highs set in early March. While the Dow Jones and S+P 500 hovered at their old highs, the NASDAQ Index actually broke through the 6,000 barrier and continued to set even more all-time highs.

US stocks also benefitted from a relatively strong first-quarter earnings season, which suggests that corporate profits may again be marching upward, providing new propulsion to the bull market. On the other hand, domestic economic activity, as measured by first-quarter US real GDP growth, was a disappointing low 0.7%, but the outlook for the rest of the year is considerably brighter. The US Department of Commerce must adjust quarterly data to reflect seasonal patterns in economic activity, and these adjustments are an inexact science at best. In recent years, the first quarter GDP number often turns out to be the lowest for the year, so we should see a snapback in the second quarter. In fact, the consensus forecast is for 2.7% growth, and the Atlanta Fed, which has its own forecasting system, is expecting 4% growth. This would be a welcomed change from the slow rate of growth which has persisted for the last five years. More rapid growth, as long as it does not set off higher inflation, would drive up American incomes, and also corporate profits.

The Federal Reserve's policy-making body, the FOMC, is watching the rate of inflation closely. Their favorite measure of inflation is the Personal Consumption Expenditure (PCE) Deflator with food and energy removed, since these components are very volatile. The PCE Deflator is now at about 2%, which just happens to be the Fed's announced target for inflation (The Fed's target is set a bit above zero inflation, since falling below that target would increase the risk of deflation, which is just as dangerous as inflation). The Fed is also sticking to its current plan to raise short-term interest rates two more times this year, which would put the Fed Funds rate at about 1.25% at the end of the year. Stocks have already "priced in" these two ¼-point hikes, so it is unlikely they will derail the bull market. If inflation were to move above the Fed's target, however, the FOMC could decide to raise rates at a faster pace. This could create an extra headwind for stocks.

The other consistent tailwind for stocks has been the prospect of deregulation of the business sector, and sharp cuts in business and personal taxes. While the process has started, particularly with rollbacks of EPA regulations, the Trump administration has had difficulty getting Congress to pass bills to further the Trump agenda. “Repeal and Replace” Obamacare has already taken much longer than anticipated, and the US Senate does not appear ready to accept any health bill passed by the more conservative House. This resistance could also slow the progress of tax reduction and corporate tax reform, and any plans for a massive infrastructure spending program. The policy uncertainty thus created could slow the bull market’s ascent.

The US dollar weakened a bit in April, as the French election helped push the euro up strongly for the month. The dollar is still up 20% since 2014, which does make it harder for our exporters to sell abroad, at the same time that it keeps the prices of imports low. Our trade deficit, a favorite target of the Trump administration, tends to grow if the dollar rises, and it will also grow if the US economy does indeed pick up speed, as rising economic activity pulls in more imports. Tariffs are one (dangerous) way to try to reduce this deficit. But White House support for a US “border-adjustment tax” has eroded, which may mean that a tariff war, that would damage the growth of all countries, including the US, can be avoided.

World Markets and Economy:

French stocks were the stars of the month. The rally after the Macron win propelled the CAC 40 Index to a new recovery high above 5,200. The relief was felt all over Europe, as the blue chip EUROSTOXX 50 rallied even more sharply than the French index. Greek stocks also rallied strongly as international lenders agreed to release additional funds to the Greek government as part of their multi-year bailout. British stocks did lag their continental counterparts, however, as the painful and expensive process of Brexit begins to move forward.

Japanese stocks also joined the world rally after the French election. Japan’s economy may have expanded at a 2% annual rate in the first quarter, which would be a sign that the long Japanese nightmare of stagnation and deflation could finally be ending. However, some of the Japanese strength is coming from exports, especially to the US, and this could inflame protectionist sentiments in the US.

OUTLOOK:

The US bull market has held on to its first quarter gains. If corporate profits continue their recent strong growth, the stage will be set for more gains in stocks, especially if the Fed raises rates gently this year, and the Trump administration gets its pro-business agenda through Congress.