THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – MAY

US Markets and Economy:

US stocks finished May right about where they started. A one-day selloff in mid-month, triggered by a statement from former FBI Director Comey, was reversed within days, and the markets recovered to finish the month near their all-time highs. (In early June, all indexes rallied further and reached new all-time highs.) Although stock traders worry occasionally about the prospects for the Trump agenda of deregulation and lower taxes, most traders and investors are concentrating on the renewed upward trend in corporate profits. The first quarter of the year was strong, even though overall economic growth was still slow at a (revised) 1.2% for real GDP. Economic growth should rebound in the remaining quarters of the year, which could push corporate profits still higher. American consumers and businesses are optimistic about their current economic prospects, and this growing optimism should lead to more spending by households and more investing by businesses. The US housing market continues to improve, with prices rising in much of the country, and this continued uptrend increases the wealth of homeowners and also makes them more willing to spend. All of these positives have led many forecasters to expect a second quarter growth rate of 3% in real terms, which would make the quarter one of the strongest in recent years.

The US labor market continues to show strength too, even though monthly gains in employment have tapered to the 100,000-150,000 range. Unless more Americans suddenly re-enter the labor force, the current rate of employment growth is sufficient to keep the unemployment rate on a gradual downward trend. The latest jobs report for May (issued in early June) showed unemployment at 4.3%, the lowest rate in ten years. This is close to what most economists think is “full” employment, the rate at which wage gains begin to accelerate, as businesses battle to attract workers, and prices begin rising faster as these businesses pass on their increased labor costs. Normally the Federal Reserve’s Open Market Committee (FOMC) would try to choke off this incipient inflation with higher interest rates, but US inflation remains surprisingly tame: the favored inflation measure of the FOMC is increasing at only at 1.6% rate, which is actually *below* the FOMC’s stated target of 2%. What this means is that the Fed will be relatively slow to increase its benchmark Fed Funds rate this year as it returns slowly to “normal” interest rates. A gradual increase in short-term rates (perhaps two more ¼-point increases this year) will still be accommodative monetary policy and should not hinder the bull market.

The US dollar weakened further in May, and is now well below its peak set in January. The best measure of the dollar's value, which weights other currencies' exchange rates by their importance in US trade, is down about 4% for the year. This decline is a positive for US companies which rely on exports, since a declining dollar makes their products look cheaper to the rest of the world. Stronger exports can thus provide an extra boost to US economic growth.

World Markets and Economy:

Much of the weakness of the dollar has been caused by strength in the euro. The election of Macron in France has reassured Europeans that the Eurozone and the European Union are safe for now, even with the impending exit of the British from the Union. The euro gained almost 4% for the month; it was also buoyed by further signs that European economic growth might be finally picking up speed after years of unprecedented monetary stimulus by the European Central Bank (ECB). In fact, the ECB may be considering reducing the amount of monetary stimulus in coming months, which would be seen as evidence that the economic recovery may finally be self-sustaining. European stocks did not gain for the month, however, since stock traders had already "priced-in" a victory by Macron in the runoff. French stocks were flat, after a big runup in April, and the EUROSTOXX 50, the broadest measure of blue-chip European stocks, was also flat for the month. German stocks outperformed the rest of Europe again in May, and achieved a new recovery high. The DAX Index is now up over 10% for the year, with a gain of 25% in the last 12 months. Leading the way up have been SAP SE, an enterprise software maker, and Siemens, a conglomerate.

Japanese stocks gained in May, and the Nikkei is now approaching its recovery high of 20,700 set in 2015. Stocks are being pushed upward by the Japanese economy, which is showing continued signs of growth after decades of stagnation.

OUTLOOK:

The US bull market continues to move forward, with only brief hiccups. While the political outlook in the US may remain uncertain, the economic outlook has been brightening and should be strong enough to propel the market upward in the rest of the year. The one-day plunge in May reminds investors that the road upward is rarely smooth.