

Investment Committee Market Commentary

May 26, 2014

U.S. EQUITIES

U.S. stocks after three straight days of advances finished the week with solid gains, sending the S&P 500 above the 1,900 level for first time on a closing basis. For the week, the S&P 500 benchmark was up +1.25%, the Dow rose by +0.76% and the NASDAQ advanced by +2.33%.

- a) **Dow Jones +0.76% MTD +0.46% YTD +1.18%** b) **S&P 500 +1.25% MTD +1.09% YTD +3.68%**
c) **NASDAQ +2.33% MTD -1.90% YTD +0.22%**

Drivers: I) **After nearly six months of alternating gains and losses, all three major U.S. stock indexes are showing positive returns for the year at the same time.** On Friday, the Dow Jones Industrial Average showed a gain of +0.2% and is up +1.18% for the year, while the NASDAQ Composite Index was up +0.76% and YTD is higher by +0.22%, and the S&P 500 Index climbed +0.42% on Friday and finished up +3.68% for the year.

II) **Sales of new single-family homes rose last month, a sign that the market is becoming firmer after falling earlier this year. The annual rate of new single-family home sales rose +6.4% to 433,000 in April,** the U.S. Commerce Department reported. **Economists had forecast that the annual rate hit 429,000** in April from an original estimate of 384,000 for March. Last Friday, the government revised March's pace to 407,000.

III) **U.S. manufacturing picked up to a 3-month high in May,** according to the flash purchasing managers index released by Markit last Thursday. **The manufacturing PMI rose to 56.2 compared to the 55.4 in April.** Readings for output and backlogs saw accelerated growth, while new orders, new export orders and employment expanded at a slower pace than April. **The report provides further confirmation that industry will aid a rebound in U.S. GDP in Q2,** and other indicators from the survey suggest that **the sector has solid momentum heading into the summer and beyond.**

IV) **The leading economic index for the U.S. rose +0.4% in April to 101.4, the Conference Board reported last Thursday. Despite a terrible winter which brought the economy to a halt, the overall trend in the leading economic index has remained positive.** The coincident index which measures current conditions edged up +0.1% in April, while the lagging index rose +0.2%. In March, the increase in the index was revised up to show a +1.0% increase instead of +0.8%.

V) **Equity prices in May have turned primarily positive, with Large-Cap and Growth stocks along with Technology, Communication, and Healthcare leading equity price performance. The laggards for the month are Utilities and Financials.**

Capitalization: **Large-Caps +1.31% (YTD +3.65%),** Mid-Caps +1.27% (YTD +3.56%) and Small-Caps +1.73% (YTD -0.39%). Style: **Value +0.92% (YTD +3.73%)** and **Growth +2.08% (YTD +2.29%).** Industry Groups (Leaders): **Utilities -0.74%** (YTD +10.50%), Energy +0.97% (YTD +7.20%), **Healthcare +1.59%** (YTD +6.56%), Basic Materials +1.47% (YTD +4.98%) and Technology +2.30% (YTD +4.80%). (Laggards): **Communication +0.67%** (YTD +3.75%), **Financial Services +1.69%** (YTD -1.60%) and Consumer Cyclical +1.81% (YTD -2.57%).

EUROPEAN EQUITIES

The Stoxx Europe 600 Index was stronger last week rising from 338.99 to 341.76, to close up +0.82%. European stocks finished higher after U.S. housing data spurred a positive mood on both sides of the Atlantic, while a fall in German business confidence prompted investors to assess the chances of action by the ECB. For the year the Stoxx Europe 600 is up +4.11%.

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Drivers: I) **German business confidence declined more than expected in May, a closely watched business survey showed Friday, suggesting that Europe's largest economy is slowing down after a robust start to the year.** The Ifo index fell to 110.4 from April's 111.2, below the 111.0 forecast in a Wall Street Journal survey of analysts. The current conditions indicator fell to 114.8 from 115.3, while the expectations reading fell to 106.2 from 107.3. **The overall Ifo is still at elevated levels, but it has clearly been shaken by the recent events in Ukraine and the lackluster pace of recovery in the euro zone as a whole.**

II) **Business activity in the Euro zone declined in May from April, marking a two-month low, according to the Markit report from last Thursday. The "flash" Euro zone PMI composite output index was at 53.9 in May, down from 54.0 in April.** Analysts had expected a reading of 53.8, according to a consensus estimate compiled by FactSet. The manufacturing PMI hit a six-month low of 52.5 down from 53.4 in April. **Although the reading for May's composite index pulled lower, the Euro zone PMI remains on track for its best quarter in three years.**

III) **Performance of European Indexes for the week, month-to-date and year-to-date. The EuroStoxx 600 Index rose by +0.82% for the week (MTD +2.02% YTD +4.11%)**

ASIAN EQUITIES

Equity markets in Asia were mostly higher last week, following a positive U.S. lead, while the Thai markets fell after the country's military took control in a coup. For the week the Dow Jones Asia-Pacific Index was higher by +1.07%.

Drivers: I) **Thailand's military forcefully removed the nation's elected government two days after declaring martial law, posing new risks to a U.S. ally that is rapidly losing appeal to the investors and tourists who have fueled its economic growth.** Army leader General Prayuth Chan-Ocha formally seized power last Thursday, taking over the duties of Prime Minister after failing to broker an end to a seven-month feud pitting the government against protesters who sought to replace it with a royally-appointed administration.

II) **Another Bank of Japan meeting has come and gone with no action from the Policy Board.** As widely expected, there was no change to the central bank's easing programs. But at least it did offer some details on its current outlook, as opposed to last meeting's incredibly short statement. **Specifically, the central bank said today that "business fixed investment has increased moderately as corporate profits have improved," but "public investment has more or less leveled off at a high level."**

II) **Performance of Asian Indexes for the week, month-to-date and year-to-date. The Nikkei was higher by +2.59% (MTD -2.75% YTD -11.23%), the Hang Seng Index advanced by +1.11% (MTD +3.02% YTD -1.46%) and the Shanghai Composite was higher by +0.40% (MTD +0.18% YTD -3.85%).**

FIXED INCOME

Treasury prices were down a bit last week as the sales of U.S. new single-family homes came in higher than expected and U.S. manufacturing showed improvement as well.

Performance: I) **The 10-year yield rose last week, ending at 2.536% up from 2.525%. The 30-year yield was higher last week rising from 3.348% to 3.398%.**

II) **Performance for the week, month-to-date and year-to-date. Barclays US Agg Bond was flat at +0.00% last week, MTD +0.76% and YTD +3.49%. The Barclays US MBS TR rose by +0.18% last week, MTD +0.87% and YTD +3.41%. The BofAML US HY Master II was higher last week by +0.05%, MTD +0.60% and YTD +4.38%.**

COMMODITIES

The DJ-UBS Commodity Index was slightly higher last week climbing from 135.230 to 135.710, as commodity prices were supported by improving economic data out of the U.S.

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Performance: I) **Oil prices saw a gain of +2.2% for the week** and gasoline futures settled at their highest in a month with **traders betting on stronger energy demand as the summer-driving season began last weekend**. West Texas Intermediate Crude for the week was higher climbing from \$102.18 to \$104.39 per barrel.

II) **The ICE USD Index, a gauge of the greenback's movement against six other major currencies, rose from 80.06 to 80.35 for the week. The USD was higher for the week supported by positive U.S. data and increased speculation that the European Central Bank could ease in the coming month.** For the week the Yen weakened falling from ¥101.51 to ¥101.97 and the Euro declined from 1.3694 to 1.3630 against the USD.

III) **Gold prices settled lower last week prompted by better than expected data on new U.S. home sales and strength in U.S. equities.** Gold fell from \$1292.80 to \$1292.30.

HEDGE FUNDS

Hedge funds in May are mixed, with the core strategies Event Driven and Relative Value higher for the month, while Macro/CTA and Equity Hedge are down for the month.

Performance: I) **The HFRX Global Hedge Fund Index is lower at -0.19% MTD and +0.19% YTD.**

II) **Macro/CTA is down -0.30% MTD and -1.89% YTD.**

III) **Event Driven has risen MTD +0.14% and +2.27% YTD.**

IV) **Equity Hedge is lower -0.95% MTD and is down -1.14% YTD.**

V) **Relative Value Arbitrage has risen by +0.37% MTD and +1.16% YTD.**

ECONOMIC DATA WATCH AND MARKET OUTLOOK

Heading into next week the three main U.S. stock benchmarks are finally positive for the year, and the S&P 500 closed Friday at a record above 1,900. **But strategists are very focused on the holding pattern stocks seem bound to, blaming a lack of confidence in the economic recovery.** Good economic news is supportive but it is not so convincing to cause a break out. **Much of the uncertainty about stocks comes from their record-high valuations, muted earnings growth in the weather-beaten Q1 and questions about how much the economic recovery is based on hope versus solid fundamentals.** Though we said positive data last week from the rise in existing home and new single family home sales last week, **economists expect that the Commerce Department will revise the moribund +0.1% GDP growth figure to a -0.6% decline for the quarter.** If this happens, it will be the first quarterly GDP decline since the first quarter of 2011, and **leaves us hoping the economy will rebound in Q2 based on the strong economic data we are seeing in the quarter thus far**

On the economic data front possible economic data that could affect stocks this Memorial Day-shortened week include: April durable goods orders (estimated is drop from +2.50% to -0.70% due to the decline in defense aircraft orders), **the Case-Shiller (expected to fall from 12.90% to 11.90% YOY) and FHFA home price indexes, May consumer confidence (projected to increase slightly from 83.2 to 83.5 due to tepid employment growth) on Tuesday.** In addition, April pending home sales (forecast to grow at +1.0% down from +3.4% due to decreased inventory and high mortgage rates) and jobless claims report on Thursday. **April personal income (estimated to fall from March's +0.5% to +0.3%), consumer spending data (projected to decline from +0.9% to 0.0%), Chicago PMI, and the University of Michigan consumer sentiment index (expected to improve from 81.8 to 82.0) all come out on Friday.**

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