ECONOMY: Slow & Steady

Winter weather cuts economic growth in Q1, while housing remains mixed and employment continues to improve.

FROM SLIGHT GROWTH TO CONTRACTION
The Commerce Department revised estimate of Q1 GDP showed the economy contracted by 1%, down from an initial estimate of 0.1% growth. This marks the first contraction in GDP in three years, though most economists view it as temporary due to the harsh winter weather conditions.

HOUSING...THE GOOD NEWS
New home sales rose to an annual rate of 433,000 in April following an upward revision in March to 407,000. The rate of existing home sales improved in March, and April housing starts came in much stronger than expected.

HOUSING...THE NOT SO GOOD NEWS
Many housing related indicators remain at historically low levels of sales and construction activity. While housing only makes up a modest portion of U.S. GDP, it is a good indicator of consumer confidence which drives the demand for other goods and services and ultimately economic activity.

BUYBACKS IN VOGUE
Stock buybacks are on track to reach their second highest level on record. With over 90% of the S&P 500 having reported, 119 companies reduced their share count by at least 1%.

REPORTS ON BUSINESS
According to the Institute for Supply Management (ISM), economic activity in the manufacturing sector expanded for the 12th consecutive month. Respondents noted generally steady growth, but some concerns over raw materials pricing and supply tightness. The non-manufacturing sector grew in May for the 52nd consecutive month. The majority of respondents’ comments indicated that there is steady incremental growth and project a positive outlook on business conditions.

LOWER UNEMPLOYMENT APPLICATIONS
Weekly applications for unemployment benefits dropped to a seasonally adjusted 300,000 according to the Labor Department. This is near a seven year record low reached in early May, and suggests that employers are not concerned with a longer term economic slowdown.

A LONG ROAD BACK
The U.S. economy needs to create just 113,000 to hit the break even point and recover all of the jobs lost in the financial crisis. It took two years to wipe out nearly 8.7 million American jobs, and more than four years to recover them all. That marks the longest jobs recovery on record since the Department of Labor started tracking the data in 1939.

ALL ABOUT THE FED
The minutes from the April Federal Reserve meeting referred to discussions around policy normalization. Fed Chair Yellen continues to insist that a return to normal will be driven by actual and projected progress towards fulfilling the Fed’s dual mandate; full employment and stable prices. The consensus was that the weak Q1 GDP report was driven by bad weather. Market consensus and the Fed’s projections point to the first interest rate hike in the middle to second half of next year.

EASIER POLICIES FOR EUROPE?
The growth in the Markit Composite Purchasing Managers Index slowed in May, despite prices falling for the 26th consecutive month. Prices fell to 0.5%, versus the ECB preferred target of 2% inflation, increasing the risk of deflation. ECB policymakers may examine various options, to combat deflationary measures at their next meeting.

CHINA STABILIZING
China’s factory and services sectors had their best showing in months in May as demand rebounded strongly. This is welcome after a rough start to the year, as data showed an slowdown in investment, retail sales, and factory output, feeding concerns of a slowing Chinese economy.
GLOBAL EQUITIES: Strong Global Markets

GLOBAL EQUITIES UP IN MAY
Stocks across the developed world generally rallied in May as the MSCI All Country World Index was up 2.1%. Similarly, emerging markets equities also rallied as easing tensions in Ukraine and the landslide victory of a reformist candidate in India helped the MSCI Emerging Markets Index rise 3.5%. Specifically, the MSCI Russia and India indices were up 12.2% and 9.6% respectively.

SMALL CAP SLUMP CONTINUES
U.S. stocks recorded modest overall gains in May as investors welcomed better-than-expected corporate earnings. Small cap equities continued to underperform, even as the large-cap indexes established new records late in the month. Reversing recent patterns, growth generally outperformed value for the month.

ASIA AND EUROPE BOTH STRONG
Developed and emerging economies in both Asia and Europe generated strong performance in May. In Japan, economic data showed that wages were rising, which could impact consumer demand. China’s PMI recorded it’s best level in months, which could indicate the economy is stabilizing after a difficult first quarter. In Europe, persistently low inflation and high unemployment remain serious problems. Many economists are forecasting additional monetary police itiatives by the ECB which will attempt to weaken the Euro, strengthen economic growth, and fend off deflationary fears. In May, equity markets in Spain and Germany led the way.
SAFE HAVENS AMID SLOWER GROWTH

U.S. Treasuries and other safe-haven government bonds rallied amid signs of slowing global economic growth. The yield on the 10-year U.S. Treasury note closed as low as 2.44%, as broad market expectations have been for an increase in interest rates.

TREASURIES ATTRACTIVE?

A roaring rally in the prices of U.S. and European government bonds sent yields on Treasury’s and other ultra safe debt to fresh 2014 lows, underscoring continued investor uncertainty over the pace of global economic growth. The yield difference between U.S. and German 10-year debt fell to about 1.15%, a historically large premium. Moreover, yields on bonds issued by economically weaker European nations such as Spain, Italy and Portugal have also declined. Spain’s 10-year yield fell as far as 2.79%, a new record low.

EMERGING RALLY CONTINUES

Emerging markets bonds generated strong returns, extending their rally that followed the sell-off in the debt and currencies of developing markets at the beginning of the year. The geopolitical tension between Russia and the West over Ukraine decreased as Russian President Vladimir Putin seemed to make efforts to de-escalate the situation. Moreover, investors seemed indifferent about political unrest in Thailand, where the military declared martial law and removed the elected government.

SUPPLY & DEMAND IN THE MUNI MARKET

Continued strong demand for municipal debt and low levels of new issuance provided plenty of support for municipal bond prices. Longer-maturity municipals, which offer higher yields, attracted investors and performed particularly well in the low-rate environment.
ALTERNATIVES: Commodities Fall

**SMALL GAINS FOR HEDGE FUNDS**
Hedge funds posted modest gains for the month of May, with the HFRX Global Composite gaining 0.5% and the HFRX Event Driven Index gaining 0.7%. The HFRX Macro Index posted a gain of 0.8% for the month of May, the best monthly gain since July 2012. The HFRX Macro: Systematic Diversified Index gained 0.9% with contributions from long fixed income, equity and currency exposure, complemented by short exposure to commodities.

**COFFEE FALLS, BUT PRICES MAY STILL RISE**
Infrastructure and REIT’s continued their momentum upwards, while many commodity sectors took sharp steps backwards. On the commodity side, energy and metals commodities were mixed as inflation remained subdued, with declines in gold, silver and natural gas offset by gains in oil, copper and platinum. Agricultural commodities posted sharp declines led by coffee, wheat, corn and cotton. The DJ UBS Sub Coffee index fell 13.87%, but is still up 55.9% YTD. Most recently, J.M Smucker became the first major U.S. coffee roaster to lift coffee prices in three years. The company announced a 9% average increase in the cost of popular supermarket brands such as Folgers and Dunkin’ Donuts.