POST OAK PRIVATE WEALTH ADVISORS

ADVISORY, CONSULTING & INVESTMENT MANAGEMENT

Monthly Economic & Market Update

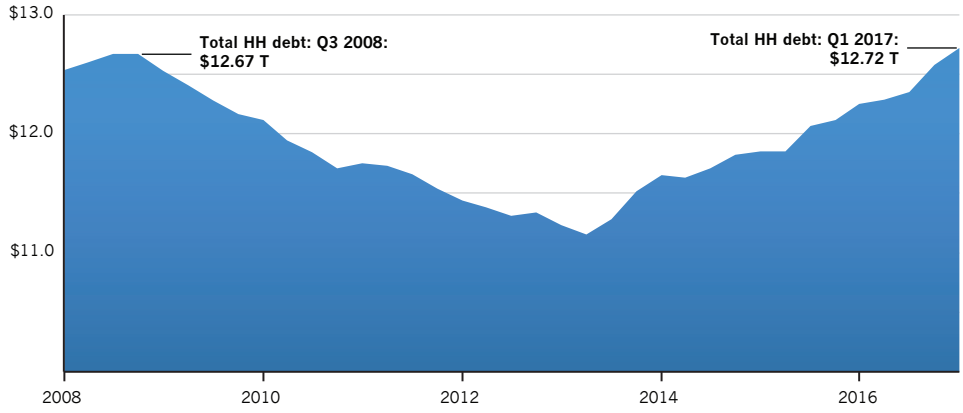
May 2017

Political risk shook U.S. stock markets for a day, but investors stayed positive and pushed the benchmark indexes to new highs. While the U.S. economy remained rosy, the bond markets see some potential for wilting.

The Economy:

The current phase of U.S. economic expansion continued to chug along through May as the eight-year anniversary of the end of the Great Recession approaches in June. From a data standpoint, the past month's economic reports showed much of the same: job growth remains robust, the unemployment rate stood at 10-year lows, and U.S. Gross Domestic Product growth was modest but positive. Much of the credit for the continuing expansion should go to U.S. consumers; personal consumption expenditures reached a year-to-date high in April as shoppers emerged from hibernation to spend their fatter paychecks. But it wasn't just income gains driving the higher spending levels – U.S. consumers also borrowed more as total household debt climbed by to its pre-financial crisis high point of $12.7 trillion. (See chart below.) While the higher levels of consumer leverage are concerning, overall delinquencies remain at post-crisis lows according to the New York Federal Reserve Bank.

Chart 1: U.S. household total debt balance: Q1 2008 to Q1 2017 ($ = trillions)



Source: New York Fed Consumer Credit Panel/Equifax, May 2017

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Equities:

It was another high-water-mark month for U.S. stock indexes, with both the broad-based S&P 500 and Nasdaq Composite indexes setting new records in May. The only hiccup in the equity rally over the past month was a one-day drop of over 1.8% on May 17—the biggest single-day decline in 8 months—as political challenges for President Trump and members of his administration piled up. It was a "buy the dip" opportunity for stock investors as the market rebounded and finished the month stronger. Total return for the S&P 500 was 1.4% for the period with large technology stocks again leading the way. The energy sector continued to suffer, declining 3.4% over the month due to ongoing weakness in oil prices. Crude oil prices climbed steadily throughout the month, rising above $50 per-barrel, but again failed to maintain momentum and dropped to around $48 per barrel by month-end.

Sector Performance:

Ranked by previous month total return best to worst

Technology	4.4%	A strong month for chip firms and hardware manufacturers.
Utilities	4.2%	Easing interest rate pressures maintained the sector's attractiveness.
Consumer Staples	2.8%	Outperformance for tobacco, personal products and soft drinks.
Industrials	1.5%	Defense firms rose on prospects of arms deals with foreign governments.
Consumer Discretionary	1.1%	Amazon continues to drive growth in online retail; restaurants also performed well.
Health Care	0.8%	Medical device firms shone while biotech declined.
Real Estate	0.7%	Another tough month for retail REITs as store closures mounted, but other areas stood out.
Materials	–0.1%	After a good run of returns, chemical firms slowed performance.
Telecom	–1.0%	Cellular price wars continue to take a toll on the sector.
Financials	-–1.2%	Big banks dropped on weakness in trading revenue and declining interest rayes.
Energy	–3.4%	Weak oil prices continue to weigh on the worst performing sector YTD.

Source for equity sector total return data: S&P Dow Jones Indices, Index Dashboard: U.S., May 31, 2017

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Bonds:

Yields on the benchmark 10-year U.S. Treasury note declined slightly in May, finishing the month at 2.20%. Interest rates for longer-term U.S. government debt (five years and beyond) increased but on the shorter end of the yield curve (bonds maturing in one year or less), interest rates rose. Benign inflation reports during the month, when both the annualized headline and core inflation rates both declined from the previous month, contributed to the flattening of the yield curve. With a muddy economic picture of low unemployment and subdued inflation, markets are now questioning whether the Federal Reserve will hike rates two more times later this year as planned. In the corporate market, demand for both investment-grade and high-yield bonds remained strong, primarily from yield-seeking investors. Effective yields for the major corporate bond indexes declined during the month. Spreads between corporate bonds and U.S. Treasuries also stood at the lowest points in a year.

The Month Ahead:

Political developments out of Washington may drive news headlines in the coming weeks, and heightened political risk could sway the financial markets and increase volatility. But investors should also have their eyes on the next Federal Open Market Committee meeting on June 14. As of this writing, a quarter-point hike at the Fed's June meeting is almost a foregone conclusion, according to current market forecasts. So the real drama should be on the Fed's outlook for additional rate hikes later this year. The Fed may stand by its previous statements, supporting three total rate increases for 2017, but the market at present is giving odds only around 50% for a third hike by the Fed's last meeting in December. Watch how the market may react to what the Fed says in its June meeting announcement.

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