JUNE 2018 MARKET RECAP: STOCK BUYBACKS HELP BUOY VOLATILE MARKET

July 2, 2018 | Gene Walden, Senior Finance Editor

As lawmakers ushered the new tax bill into law last year, one of the expectations they expressed was that corporations would use their tax break to increase wages and invest in capital improvements.

While we have seen an uptick in capital expenditures since the tax cut, wage growth has continued to be relatively tepid – despite an extremely low 3.8% unemployment rate.

However, one early impact of the tax law has been an acceleration in corporate stock buyback activity. Through the first quarter of 2018, U.S. corporations set a record for most shares purchased for a quarter at $189.1 billion – a 38% increase from the previous quarter, according to a report from the S&P 500 Indices. Then in May, they set a new monthly high, with $173.6 billion in stock buyback announcements.

Corporations use stock buybacks to reduce the number of shares outstanding, thus boosting the relative value of the remaining shares. While the share buybacks can benefit shareholders, they have no impact on wages or productivity.

But the buybacks have helped buoy the stock market amidst a challenging economic period, as a global trade and tariff war has created uncertainty in the markets. (See Trade “War of Words” Adds to Economic Uncertainty)

For the month of June, the S&P 500 Index edged up 0.48%. It was up 2.88% for the second quarter and 1.67% for the first six months of 2018. (The S&P 500 Index is a market-cap-weighted index that represents the average performance of a group of 500 large-capitalization stocks.)

Here are some other highlights from the past month covered in more detail later in this report (Exhibit 1):

- **Retail sales up again.** Retail sales improved for the third consecutive month, with a 0.8% increase in May, according to the U.S. Department of Commerce.

- **Manufacturing stays strong.** U.S. manufacturing levels have continued to increase nearly across the board, according to the Institute for Supply Management.
• **10-year yields nearly unchanged.** Interest rates on 10-year U.S. Treasuries stayed about even in June, finishing the month at 2.85%. The Federal Reserve approved a 0.25% rate hike at its June meeting.

• **Oil roars back.** After a drop in oil prices in May, increasing global demand and a drop in inventories pushed prices back up in June.

• **International stocks slump.** Economic and political issues across Europe continue to affect equities in the global markets, as the MSCI EAFE Index dropped 1.39% in June. (The MSCI EAFE tracks performance of developed-economy stocks in Europe, Australasia and the Far East.)

What’s ahead for the economy and the markets? See *Trade "War of Words" Adds to Economic Uncertainty* by Mark Simenstad, Chief Investment Strategist

Drilling Down

**U.S. Stocks Edge Up**

The S&P 500 moved up 0.48% in June to finish the month at 2,718.37 – up from 2,705.27 at the May close (Exhibit 2).

The total return of the index (including dividends) was 0.62% in June. Through the first six months of 2018, the total return of the S&P 500 was 2.65%.

The NASDAQ Index had another positive month, up 0.92% in June, after posting a gain of 5.32% in May. Year to date, the NASDAQ is up 8.79%. For the second quarter, the NASDAQ was up 6.31%. (The NASDAQ – National Association of Securities Dealers Automated Quotations – is an electronic stock exchange with more than 3,300 company listings.)

**Retail Sales Continue Positive Trend**

Retail sales increased by 0.8% in May from the previous month, and by 5.9% year-over-year, according to the advance monthly retail sales report issued June 14 by the U.S. Department of Commerce.

With gasoline prices rising, gas station sales rose 2.0% for the month and 17.7% year-over-year. Nonstore retailers (primarily online) were up 0.1% for the month and 9.1% over a year ago. Building and garden supplies and equipment were up 2.4% for the month and 5.2% year-over-year.

**Employment is Strong**

The U.S. unemployment rate dropped 0.1% to 3.8% in May – the lowest level since December 2000, according to the U.S. Bureau of Labor Statistics Employment Situation Report issued June 1. The economy added 223,000 new jobs during the month. It was the 92nd consecutive month of job growth.

**Manufacturing Expansion Continues**

Of the 18 manufacturing industries tracked by ISM, 17 reported growth in May, led by textile mills, wood products, non-metallic mineral products, printing and related support activities, electrical equipment, and appliances and components.

Energy Stocks Lead Market in Second Quarter

The S&P 500 Energy sector was up 13.48% in the second quarter, leading all sectors of the market. Energy was up 6.81% for the year.

The Consumer Discretionary sector leads all sectors for the year, up 11.52%, followed by Information Technology, up 10.87%. The worst sectors this year have been Consumer Staples, down 8.55%, and Telecom Services, down 8.35%.

Exhibit 3 shows the results for all 11 sectors for the past month, second quarter and year-to-date.

Treasury Yields Flat

The market yield on 10-year U.S. Treasuries stayed fairly flat in June, inching up from 2.83% at the end of May to 2.85% at the close of June (Exhibit 4). The yield is still up more than 0.4% for the year after closing 2017 at 2.41%. It is up 0.11% for the second quarter after closing the first quarter at 2.74%.

The Federal Reserve Board, as expected, approved a small rate hike of 0.25% at its June meeting. That followed a 0.25% hike in March. The Fed has gradually raised the rate from approximately 0% to a target of 1.75% to 2.00% through seven rate hikes from December 2015 through June 2018.

Equity Earnings Climbing

Corporate earnings projections have been moving up steadily, with the industry consensus 12-month forward earnings estimate for the S&P 500 increasing 4.39% in the second quarter, from $161.73 at the end of March to $168.83 at the end of June (Exhibit 5). For the year, earnings projections are up 14.57% from $146.86 at the end of 2017.

As earnings have increased and market prices have stagnated, the forward 12-month price-earnings ratio (P/E) for the S&P 500 has also dropped. It closed 2017 at 18.2 – the highest level since 2004 – and dropped to 16.14 at the close of June (Exhibit 6).
The forward 12 months earnings yield for the S&P 500, which is the inverse of the P/E, ended the second quarter at 6.21% after ending the first quarter at 6.12% (Exhibit 7). It is well above the 5.47% yield at the end of 2017. The 12-month forward earnings yield can be helpful in comparing stock earnings yields with current bond yields. The equity earnings yield is still significantly higher than the 2.85% market rate of 10-year U.S. Treasuries.

**Dollar Mixed**

The U.S. dollar has strengthened versus the Euro in 2018, but has weakened versus the Japanese yen. The Euro was down 2.77% versus the dollar through the first half of 2018 (Exhibit 8).

The dollar has dropped 1.67% versus the Yen through the first half of 2018 (Exhibit 9).

**Oil Prices Rebound**

Oil prices bounced back in June after slipping in May, ending the month at $74.15 per barrel for West Texas Intermediate (a grade of crude oil used as a benchmark in oil pricing), a 10.61% increase from the May closing price of $67.04 (Exhibit 10). For the year, oil is up 22.72% after closing 2017 at $60.42.

Prices rose last month as the supply of domestic crude dropped by 9.9 million barrels in the week ending June 22, according to the U.S. Energy Information Administration. That was the largest weekly drop this year. Prices have also been rising due to increasing global demand and as a response to sanctions on sales of Iranian oil. Saudi Arabia has vowed to increase its production to at least partially offset the dip in oil sales from Iran.

**Gold Declines**

The price of gold slipped in June, down 3.85% (Exhibit 11). For the year, the price of an ounce of gold has dropped 4.19% from $1,309.30 at the close of 2017 to $1,254.50 on June 29.
International Equities Continues Slump

The MSCI EAFE Index dropped 1.39% in June, as Europe and Asia faced challenging economic conditions, including trade and tariff concerns (Exhibit 12). For the second quarter, the index was down 2.34%, and was down 4.49% for the first six months through June 30.

What’s ahead for the economy and the markets? See Trade "War of Words" Adds to Economic Uncertainty by Mark Simenstad, Chief Investment Strategist

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