Monthly Outlook, May, 2017: "Sell in May and Go Away?"

With the calendar turning to the month of May, we are reminded of the old adage "Sell in May and go away" and wonder whether financial markets might make this come true in 2017. Equity markets have resumed their merry making, especially as ***earnings reports*** for 1Q2017 have come in better than expected, amidst ***rapidly declining volatility*** (as measured by the VIX index).

Economic data released in the United States was reasonable: Private payrolls accounted for 194,000 of the 211,000 jobs added during the month of April. The goods producing sector added 21k jobs while the service sector gained 173k jobs in April. The monthly average of job gains over the past twelve months improved slightly to 186.4k, although this pales in comparison to that of a year ago at 219.5k and its recent cycle peak set in January 2015 at 253.5k.

The unemployment rate fell by another tenth to 4.4%, its lowest level in more than a decade. The underemployment rate (U-6 Unemployment Measure) dropped three-tenths to 8.6% in April. Average hourly earnings for private-sector workers rose 0.3% (m/m; y/y: 2.5%). The average weekly earnings figure gained 0.6% (m/m; y/y: 2.5%) suggesting that there are more signs of ***upward pressure on wages,*** especially as workers become more scarce and employers are forced to compete for essential skills.

The Bureau of Economic Analysis pegged ***US GDP growth*** at 0.7% (Seasonally Adjusted Annual Rate) for 1Q2017 compared to the 2.1% rate witnessed during the previous quarter. Personal Consumption Expenditures at 0.3% (also, SAAR) were clearly disappointing, while gross private domestic demand at 4.3% was a bright spot. This is the fourth year in a row where GDP growth during the First Quarter has been ***disappointing***. While bad weather was partly to blame in previous years, it is quite obvious that faulty seasonals might be partially responsible here and weather was not an issue.

In addition, there appears to be a sizable difference in readings between what can be termed as ***"hard data"*** (those related to spending like retail and automobile sales) and ***"soft data"*** (those in response to survey questions). While the soft data suggests expectations are sanguine, especially as corporate chieftains feel good about the current Administrations' policies on lower taxes and regulatory reform, hard data seems to imply that all is not well with the real economy.

Overseas economic data have also generally been ***positive***: UK GDP rose 2.1% (y/y) during 1Q2017 compared to 1.2% during 4Q2016. Industrial production rose 1.2% (y/y) in March compared to 0.2% (y/y) during February. In Germany, the ZEW Survey for April showed increases in both the current situation (to 80.1 from 77.3 in March) as well as the expectations component (to 19.5 from 12.8 in March).

The French populace went to the polls again last Sunday to elect the President of their Republic in a second round of voting: ***Emmanuel Macron***, a former investment banker won handily with almost 60% of the vote against 39% of the vote captured by Marine Le Pen of the right wing Nationalist Front. European markets have breathed a big sigh of relief on Macron's victory – especially as Le Pen was seen as an existential threat to the European Union project and its currency, the Euro.

While Macron's success in the Presidential election was not much of a surprise – the entire establishment was pulling for him – the real hard work begins now. Monsieur Macron's political party, Le Republican En Marche, does not have a single member in the ***National Assembly*** (the French Parliament) and for his policies to be implemented and become the law of the land, he would need to rapidly build an organization and contest most of the seats in Parliament at the elections to be held in June.

Closer to home, earnings reports for the S&P500 have come in much better than expected: With 443 companies (=86% of the total) reporting results so far, the ***share-weighted gain in earnings is 14.7%.*** Going into the quarter, expectations were for a gain in the mid-single digits. Of the companies that have reported so far, 324 (=73.1%) have beat expectations, 27 (=6.1%) have met expectations and 92 (=20.8%) have failed to meet expectations.

Among the sectors, gains in materials (+22.2%), information technology (+21.4%) and financials (+16.6%) have been the most impressive. Telecom services (-4.7%) and industrials (+0.5%) have lagged this quarter. In aggregate, the earnings per share figure for the entire S&P500 is $30.69 per share for 1Q2017 - $122.76 per share on an annualized basis! This figure of $122.76 would still suggest that the annual gain would come in slightly ***shy of current expectations*** for the year as a whole ($130 per share) if earnings did not accelerate over the rest of the year.

Financial market volatility, as measured by the VIX index, has fallen steadily for the past few quarters. The VIX (also known as a "gauge of fear") continues to plumb new lows, as implied volatility in the options markets for a wide range of strike prices post continual declines. If anything, we think that a lower VIX is also an indication of increasing complacency in the market place – as market participants believe that equity markets are likely headed higher no matter the fundamentals.

The Federal Reserve, meanwhile, left the Fed Funds Target unchanged at its meeting in April. The accompanying Federal Open Market Committee (FOMC) Statement, as well as the Beige Book going into the meeting, seemed to provide the FOMC with sufficient room to launch ***another increase*** at the upcoming meeting ***in June***. This would be the second such increase in 2017, making it the fourth overall increase since the FOMC started to move in December 2015.

Monetary policy remains quite accommodative despite fears that the FOMC might tighten again in June. We remain of the opinion that what matters more to financial markets in general and equity markets in particular is whether Congress and the Administration can deliver on the promises that markets seem to be counting on, namely, tax cuts, infrastructure spending and regulatory reform.

The House of Representatives voted last week to repeal the famous "Obamacare" legislation but the Senate is yet to take up this topic. Indeed, with time beginning to run out, we suspect that tax cuts and infrastructure spending many not see the light of day in Congress until much later this year or even next year with the actual implementation being delayed until 2019. Equity markets are not going to like this outcome as it would clearly delay the instant gratification they seem to be after!

With many cross-currents buffeting financial markets despite improving earnings fundamentals on the one hand and elevated expectations and valuations on the other hand, we do cast a wary eye at the calendar worrying that the old saw "Sell in May and Go Away" could indeed come true this year!

This report was prepared by

Suresh Raghavan, CFA
MBR Financial
2000 West Loop South, Suite 1510
Houston, TX 77027

www.mbrfinancial.com

For further information please contact us at
Voice: 832.667.8787
Fax: 281.974.2108
Email: **contactus@mbrfinancial.com**

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