May 2018

Monthly Market Commentary

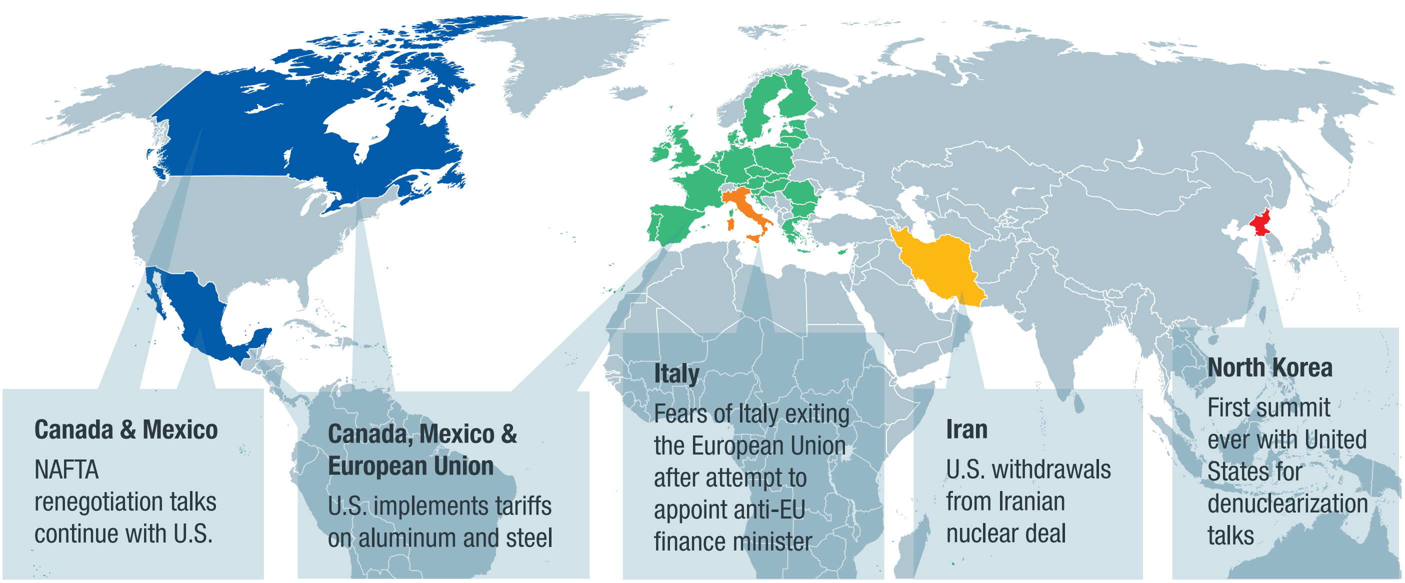
Discussion Points

- Geopolitical uncertainty looms over markets
- Signs of inflation continue to intensify
- U.S. to impose tariffs on additional countries

U.S. Economic Update

Geopolitical events continued to capture headlines and spook equity markets throughout May. However, the U.S. economy's strength was validated yet again, supporting our reason to believe that there is still "room to run" in this secular bull market. U.S. GDP expanded at 2.2% year-over-year for the first quarter of 2018, meeting analysts' expectations. Some of this productivity has been due to a resurgence of the manufacturing sector. The ISM manufacturing index beat estimates of 58.5 for May, with a reading of 58.7. The ISM also monitors the services industry with the non-manufacturing index, where the composite level of 58.6 also beat estimates. Any reading that is greater than 50 is a sign of expansion within these industries. The May jobs report exceeded expectations of adding 190,000 new jobs. Instead, 223,000 new jobs were added, which brought the national unemployment level to 3.8%, its lowest level in 18 years. The jobs report also showed a long-awaited rise in wages of 2.7% year-over-year. As the U.S. economic engine continues to run, the 10-year Treasury yield reached as high as 3.11% throughout the month before ending at 2.83%. The Fed's preferred measure of inflation, the Personal Consumption Expenditures Index (PCE), has already hovered around 2%, which has long been the Fed's target as a normal inflation expectation. This along with rising oil prices has continued to revive inflation fears. The Fed reiterated that they are committed to a gradual pace of monetary tightening even if inflation were to rise above this 2% threshold for some time. The Fed voted to leave the overnight lending rate unchanged at their early May meeting, but is expected to raise it 0.25% in June, to a range of 1.75%-2.00%.

Geopolitical Hot Spots That Could Impact Investors



Iran

On May 8th, President Trump announced that the U.S. would withdraw from the Iranian nuclear deal that was established by the Obama administration in 2015, and will restore economic sanctions on the country until they officially stop the pursuit of nuclear weapons. The president extended this action by saying, "Any nation that helps Iran in its quest for nuclear weapons could also be strongly sanctioned by the United States." Currently, Iran is the third-largest oil producing exporter and analysts have forecasted that the sanctions could restrict up to 1 million barrels of oil production per day. Following this announcement, crude oil prices experienced volatility before reaching $70 a barrel for the first time since 2014. OPEC-producing nations later confirmed that they would maintain their existing oil production cuts until the end of 2018, further increasing the likelihood of a continued rise in prices.

North Korea

Meanwhile, President Trump canceled a nuclear summit with the leader of North Korea, scheduled for June 12th. The meeting was later rescheduled for its original date just days later. The on-again, off-again meeting continues to be a topic that markets are closely watching. Although former U.S. presidents have met with North Korean leaders, there has never been a sitting U.S. president that has met with the leader of North Korea. The goal of the summit for the U.S. is to have North Korea agree to eliminate the country's nuclear capabilities in exchange for the U.S. to ease the crippling economic sanctions that have been imposed on the country. North Korea has continued to be an unpredictable threat to the national security of the U.S. and their nuclear capabilities should be taken seriously.

Italy & the European Union

Italy's two largest political parties attempted to appoint a finance minister with an anti-European Union stance. This created many concerns about potential economic implications to the EU and for investors, as Italy remains the Union's third-largest economy. Economists are concerned because Italy, unlike the U.K., converted its currency to Euros and currently maintains the third-largest amount of public debt in the world. This has the potential for more serious implications than those of Brexit. Investors of Italian sovereign debt had their fears realized when yields on the country's 10-year bond spiked from 2.6% to 3.1% in just one day.

Tariffs

In other European Union related news, the Trump administration also announced that they would implement a tariff on imports into the U.S. of 25% and 10% on steel and aluminum products, respectively. This will also be applicable to Canada and Mexico effective June 1st. Previously, Canada and Mexico were exempt from the original tariff implications as NAFTA renegotiation talks continued. As the talks have extended beyond the original deadline, the U.S. is proceeding with tariff measures. In response, Canada, Mexico and the European Union announced measures to tax specific goods from the United States that are near equal value to that of the tariff applied by the U.S. on steel and aluminum imports.

Looking Ahead

The implications of geopolitical events on financial markets are tightly intertwined, and many events around the globe could result in different short- and long-term financial implications for investors. We have learned from history that there is always someone saying "…but it's different this time," only to find out that it really wasn't. It's important for investors to take the emotion out of their investment decisions and follow a weight-of-evidence approach. This is why we will continue to apply our time-tested, disciplined investment approach with the same rigor for our clients that we have for nearly 45 years.

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MMC-MAY18 (06/18)