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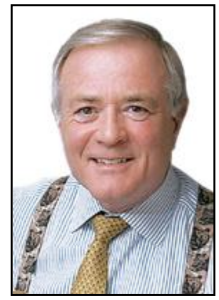

William Rutherford

This month, the market could go anywhere

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Sell in May and go away. This mantra has been a market staple for years. It used to have a solid basis, but not so much anymore. For instance, the market has been up in May for three of the past five years, so what will this year bring?

This year a disappointing start was followed by a strong rally to get the market to essentially break even by March 11. The market as of May 3 is 3.2 percent off of its all-time highs reached on May 21, 2015, but doesn't seem to be able to mount a breakout. Telecommunications and utilities have been the best performing sectors year to date, and health care and financials the worst.

Various headwinds have stalled the markets: This recovery is long in the tooth. It is the second longest bull market in U.S. history, surpassed only by the boom after World War II. From its low in March 2009, the recovery is now over 2,600 days old and counting. It has been a weak recovery with GDP recently barely growing more than 1 percent. Indeed, GDP growth was 0.5 percent in the first quarter of 2016 – the lowest in two years as consumer spending disappointed. Consumer spending makes up about 70 percent of the economy, so it's very important. Inflation has been missing Federal Reserve targets.

The market is fully priced at around 23 times earnings versus a normal price to earnings ratio of 15.59 percent.

Earnings are weak. Including energy, expectations are for an earnings decline of 8.9 percent for this year's first quarter. That certainly is not encouraging; however, Thomson Reuters reports that Q1 earnings are exceeding the consensus estimate and should substantially improve by the end of earnings season. However, these earnings reports were coupled with many layoff announcements.

According to the Atlanta Federal Reserve, its GDP model now forecasts real GDP growth (seasonally adjusted annual rate) in the second quarter of 2016 to be 1.8 percent, on May 2 – unchanged from April 29. Last year, as soon as the Fed began talking of four rate increases, the Fed futures market priced in those rate increases and the housing market began to decelerate. Now housing is in full retreat in some markets. New home sales fell 1.5 percent in March.

The current rally in equity markets began only when it became clear that the Fed would not raise rates more than twice this year. Although they talk like they want to raise rates, even some of the rate hawks are changing their mind or toning down their rhetoric.

Overseas markets still present risks to the global economy. It is up to the U.S. to be the engine of growth to keep the world economy growing; so far we are whiffing.

Futures markets are pricing in a less than 20 percent chance of a June rate hike, with December being the first time the probability reaches even 40 percent. The Fed will likely keep the rate hike option on the table, but until there are sound economics, it is just talk. Political uncertainty is also a drag. There are so many factors that are weighing on the markets. On the positive side last week, for the first time since September 2014, all 10 S&P 500 sectors were above their 200-day moving averages. Financials remain negative for the year but have gained more than 12 percent over the past three months; they were the last group to cross over.

Going through such a long period of running below the trend line is unusual, as is having the entire index move above it after being below for more than a year. However, in three of the four instances since 1993 when each sector had cleared the 200-day average, it was a "profoundly bullish" market sign, according to Bespoke Investment Group.

Remember that the markets climb a wall of worry. A healthy degree of skepticism is good, because it prevents the market from being overly frothy.

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