MAINSTREET ADVISORS

FINANCIAL MARKET UPDATE

5/20/16

THE WEEK IN REVIEW

U.S. stocks traded choppy for a second week in a row as the Fed's most recent meeting minutes revealed an interest rate hike is back on the table. Previously, the market had priced in low odds of this occurring, which bolstered risk assets. The U.S. bond market was lower this week as price declines accelerated after the release of the Fed's minutes. Relatively positive economic data and improving inflation readings also impacted the bond market as bond yields moved higher. The 10-year U.S. treasury yield ended the week above 1.8%, up from 1.7% last week, while the 2-year U.S. treasury yield rallied to 0.9% from 0.76%.

The release of the Fed minutes from its April 26-27 meeting showed a less dovish outlook than market participants had expected. Investors have been closely monitoring Fed language for any changes that may signal further interest rate increases. Specifically, the minutes stated, "Most participants judged that if incoming data were consistent with economic growth picking up in the second quarter, labor market conditions continuing to strengthen, and inflation making progress toward the Committee's 2% objective, then it likely would be appropriate for the Committee to increase the target range for the federal funds rate in June." Based on the market's reaction, it seems as though current and expected data may indeed be close to meeting those objectives.

Inflation readings increased in April, according to the Labor Department on Tuesday. The all-items index rose 0.4%, the strongest rise in more than three years, while the core index (excluding food and energy) rose 0.2%. On a year-over-year basis, the all-items index increased 1.1% while the core index increased 2.1%. Although the readings are still low by historical standards, the current trends indicate an escalation in momentum. With the headwinds from the stronger dollar and significantly weaker energy prices fading, inflation readings appear to be making progress toward the Committee's 2% inflation objective.

Japan's economy expanded at an annualized rate of 1.7% in the first quarter of 2016 after contracting in the last quarter of 2015. The new data complicates Prime Minister Shinzo Abe's plan for another large stimulus package and sales tax increase. Abe already postponed the second tax increase once, and stated last year he would not delay it again unless Japan has an economic shock on par with the global financial crisis. Abe first raised the tax in 2014 to 8% from 5%, which many economists blame for pushing the economy into recession. Raising the sales tax is part of Abe's plan to reduce government debt which has risen to 229% of GDP. Abe is also planning a fiscal stimulus package for later this year to boost Japan's weak economy which has contracted four times in the last two years.

INDEX	LEVEL	WEEK	YTD	12 MO
DJ Industrial Average	17,500.94	-0.20%	0.44%	-4.01%
NASDAQ	4,769.56	1.10%	-4.75%	-6.28%
S&P 500 LargeCap	2,052.32	0.28%	0.41%	-3.47%
S&P 400 MidCap	1,450.11	0.66%	3.68%	-5.93%
S&P 600 SmallCap	680.89	0.53%	1.36%	-5.19%
MSCI EAFE	1,619.49	-0.75%	-5.64%	-16.45%
MSCI Emerging Markets	781.84	-1.79%	-1.55%	-24.54%
Barclays Aggregate US		-0.60%	3.26%	3.48%
Bloomberg Non-US Govt Bond		-1.15%	5.11%	1.56%
Bloomberg US Treasury Index		-0.71%	2.97%	4.09%
Bloomberg High Yield Index		-0.05%	7.34%	-0.98%
FTSE/NAREIT All REIT Index		-2.43%	3.22%	1.99%
Bloomberg Commodity Index		0.47%	8.03%	-17.56%

KEY BOND RATES	WEEK	1 MO AGO	1 YR AGO
3-Month T-Bill	0.33%	0.23%	0.02%
2-Year Treasury	0.89%	0.80%	0.60%
5-Year Treasury	1.38%	1.32%	1.57%
10-Year Treasury	1.85%	1.85%	2.26%
30-Year Treasury	2.63%	2.66%	3.06%
Municipal Bond Yields (10 Yr)	1.60%	1.63%	2.34%

Price returns as of the last available closing data. Source data: Bloomberg and Morningstar are believed to be correct but not verified. Returns include reinvestment of dividends, if any and there is no guarantee they will continue.

UPCOMING WEEK

The second reading of first quarter U.S. economic growth will be released next Friday. Economists are forecasting first quarter growth to be revised higher to 0.8% from the initial reading of 0.5%. Durable goods orders for April will be released Thursday and are expected to have risen for a second consecutive month. Orders have not had two consecutive months of growth since last summer. Other notable economic data releases next week include new home sales and consumer sentiment.