ECONOMIC HIGHLIGHTS

U.S. Real GDP Growth came in at 2.2% for the first quarter of 2018, in line with consensus estimates. The GDP Price Index came in at 1.9%, also in line. All of the manufacturing indexes (PMI, ISM and Chicago) were nicely expansionary for May, at data points ranging from 56.7-62.7. Consumer spending and construction spending for April were up 1.8% and 7.6%, respectively. Finally, the U.S. Unemployment Rate came in at a new low of 3.8% for May.

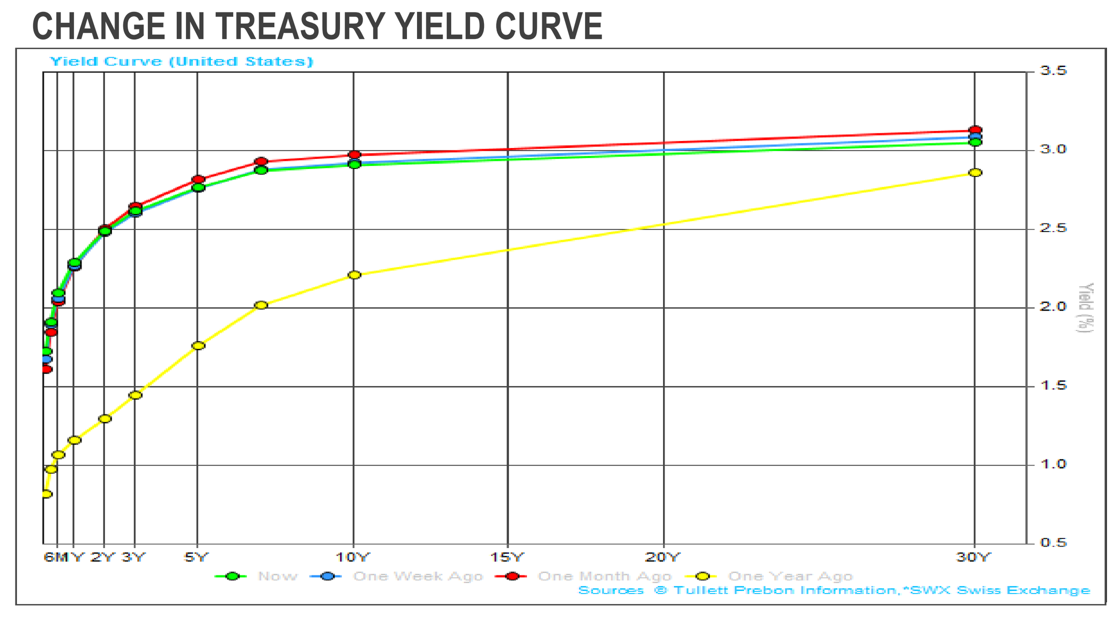
FIXED INCOME

The shape of the U.S. yield curve may be one of the most talked about topics in fixed income for the coming week. After a mid-May pause, the curve-flattening has roared back. The gap between yields on two- and ten-year notes shrunk to as little as 40 basis points last week, the smallest since 2007, as traders rebuilt bets on Federal Reserve rate hikes in 2018. With little in the way of significant economic data or debt auctions this week, and no Fed speakers, traders will be left to focus on the central bank's path with a looming widely expected rate hike coming at the next Fed meeting on June 13. That means the rejuvenated flattening trade could keep chugging along. The catch is that for some analysts, the curve is approaching levels that may worry policymakers, because an inversion has historically been a reliable indicator of a coming recession. Last week, St. Louis Fed President James Bullard attributed the spread narrowing to the Fed's rates normalization. He said the central bank doesn't have to "be so aggressive as to invert the yield curve." But Friday's robust jobs report may extend the flattening trade, by keeping alive the possibility of four hikes this year. The overnight index swaps market is pricing in 55 basis points of tightening for the rest of the year, versus 51 basis points before the jobs report was released. The benchmark ten-year yield ended last week at 2.90%, after rebounding from the biggest tumble since 2016 as traders moved past some of the political concern emanating from Europe. "Flattening has been something of a simmering trade," said Aaron Kohli, a rates strategist at BMO Capital Markets. Investors are "thinking about the Fed's reaction not at zero, but the approach to zero, and when participants really start to sweat because at that point you're basically a hair away from inversion." For Kohli, the curve area around 40 basis points is important to watch, because it's a support level that's held three times since April. A drop below there could push the market toward 20 basis points, Kohli and fellow BMO strategist Ian Lyngen wrote in a note to clients last Friday.

CURRENT GENERIC BONDS YIELDS

TREASURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	1.91%	3 mo	1.96%	3 mo	2.28%	3 mo	1.46%
6 mo	2.09%	6 mo	2.05%	6 mo	2.37%	6 mo	1.52%
1 yr	2.26%	1 yr	2.15%	1 yr	2.47%	1 yr	1.58%
2 yr	2.47%	2 yr	2.49%	2 yr	2.74%	2 yr	1.73%
5 yr	2.75%	5 yr	2.80%	5 yr	3.17%	5 yr	2.06%
10 yr	2.90%	10 yr	3.23%	10 yr	3.66%	10 yr	2.59%
30 yr	3.05%	30 yr		30 yr	4.09%	30 yr	3.50%

CHANGE IN TREASURY YIELD CURVE



EQUITY

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	-0.38%	0.69%
S&P 500 (Large Cap)	0.54%	3.13%
S&P 400 (Mid Cap)	0.63%	3.68%
Russell 2000 (Small Cap)	1.32%	7.85%
NASDAQ Composite	1.65%	9.96%
MSCI EAFE (International)	-0.31%	-0.44%
iShares Real Estate	1.74%	-2.34%

In a holiday-shortened trading week, U.S. stocks stayed range bound, continuing to essentially move sideways for another week. The closing prices of the past three weeks have been within 1% of each other. For the week, Energy stocks were the market leaders gaining over 2% while Financials fell the most declining -1%.

For the month of May, the S&P 500 gained 2.43%, but other asset classes were the major winners for the month. The Russell 2000 ended up gaining 6.16% while Small Cap Growth stocks rallied 7.11%. Continued strengthening in the U.S. dollar continued to favor domestic stocks. Outside the U.S. May performance was fairly lackluster – Brazil, Spain, Italy, and Mexico all declined at least -9%.

U.S. stocks on Tuesday fell sharply after political uncertainty in Europe weighed on global markets. Italy's president rejected a populist candidate for finance minister and instead called on a former IMF official to lead a technocratic government. The populist candidate was rejected for fear that he would lead Italy out of the EU. On Friday Spain's Prime Minister was ousted in a no-confidence vote, with Socialist leader Pedro Sanchez taking over as the new prime minister.

There was more talk of new tariffs from the Trump Administration last week. Reuters reported on Tuesday the U.S. will release a list of $50 billion worth of Chinese goods that will be subject to a 25% tariff by June 15. On Thursday the White House announced plans to reimpose tariffs against the EU, Canada, and Mexico impacting steel and aluminum imports. Canadian officials promptly retaliated announcing their own tariffs on U.S. steel and aluminum along with whiskey, orange juice, and other food products.

Shares of General Motors rallied sharply on Thursday after SoftBank Vision Fund agreed to invest $2.5 billion in GM for its Cruise autonomous vehicle unit, valuing the division at $11.5 billion.

The recent sideways movement in U.S. stocks is starting to have an impact on several breadth indicators. Bespoke noted last week that about 66% of the 24 S&P 500 industry groups have rising 200 day moving averages – a trend following indicator which measures whether prices are moving up or down. Over the shorter-term, the picture looks worse as only 33% of industry groups have rising 50 day moving averages. A decisive move from the market either up or down would likely push these breadth readings in a clearer direction. For now these levels suggest more sideways churning in the short-term.

For the week ahead, things are pretty quiet on the earnings front with only a handful of companies set to release results. There are several brokerage conferences so expect numerous upgrades and downgrades to be announced. Economic releases of note this week include PMI's out mid-week with Trade Balance on Wednesday.

Since the S&P 500 stayed range bound last week, the support and resistance levels we are watching did not materially change. We continue to watch support at 2675, 2660, and 2650 – first resistance remains at 2800. The S&P 500 closed last week at 2734.

ASSET ALLOCATION

CURRENT SENTIMENT	
Cash	Neutral
Short Fixed Income	Neutral
Intermediate Fixed Income	Neutral
Inflation-Adjusted Fixed Income	Unfavorable
High Yield Fixed Income	Neutral
International Fixed Income	Neutral
Equity Income	Favorable
Large Cap Equity	Favorable
Mid Cap Equity	Favorable
Small Cap Equity	Neutral
International Equity	Neutral
Emerging Markets Equity	Favorable
Real Estate	Favorable
Commodities	Unfavorable

Below is a summery of our current stance on most asset classes:

Cash - Holding as little as possible given the miniscule yields in money market instruments. Any exposure is for defensive positioning.
Short Term Bonds - Relative to Intermediate Bonds, the reduced duration is preferable given the outlook for higher interest rates.
Intermediate Term Bonds - The current trading range of intermediate bonds warrants a neutral position with limited upside potential. Some opportunities still remain present in spread products.
Inflation-Adjusted Bonds - Low inflation expected in near-term providing zero real return.
High Yield Bonds - Spreads have tightened; however, still remain attractive versus Treasuries.
International Bonds - Emerging market bonds offer good diversification qualities while providing higher yield opportunities relative to domestic fixed income.
Equity Income - High quality and higher-dividend-paying companies remain attractive for long-term investors given their favorable risk-adjusted profile and current yield curves.
Large Cap Stocks - A favorable weighting is recommended. Growth has reemerged as a more favorable style and should be overweighed versus Value.
Mid Cap Stocks - Mid cap exposure along with a value tilt is preferred. Mid cap stocks continue to provide the "sweet spot" of market capitalization - large enough to provide stability, but small enough to be more nimble.
Small Cap Stocks - In broad market corrections, small cap stocks will suffer most with increased volatility. However, a recent divergence of relative strength between small caps and large caps warrants a neutral exposure.
International Stocks - Given most foreign investment is in developed markets and European countries, until sovereign debt concerns are alleviated, an underweight to neutral weight is recommended.
Emerging Market Stocks - Stronger balance sheets, less debt, and better growth potential make emerging markets more fundamentally attractive than developed countries longer-term. Recent relative performance versus developed markets support the stronger fundamental backdrop and positions have been added.
Real Estate - Pricing has stabilized and long-term valuations appear attractive. Real Estate has performed well of late and should continue to be a strong alternative to other asset classes.
Commodities - Global demand should support higher prices if the global recovery remains on track. Although, volatility will be higher and commodities will be susceptible to short-term price shocks, if used in conjunction with other asset classes, risk can be reduced substantially to a diversified portfolio. However, used alone is not recommended as the short-term outlook is not favorable.

Sources of statistical information are Bloomberg and Ned Davis Research.