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Market review

Brian Watts, CFA

Director of Research and Strategy,
Foresters Investment Management Company, Inc.

U.S. Treasury hits high note

Key highlights:

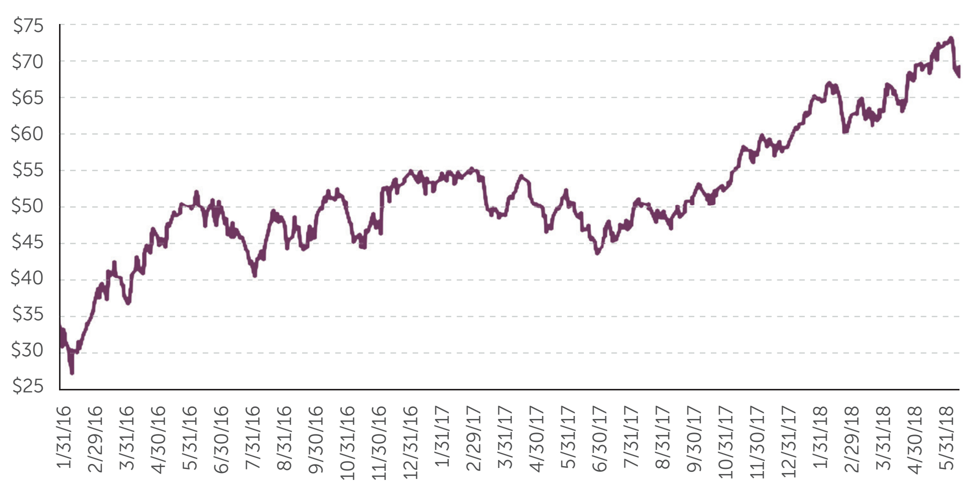
- Small-cap stocks led the pack in U.S. equity markets while the growth style dominated the month.
- Ten-year U.S. Treasury yield rose to 3.11%, its highest level in seven years.
- U.S. dollar surges during May.

U.S. equities post a solid month

U.S. stocks largely enjoyed a strong May, led by small caps returning 6.07% (measured by the Russell 2000 Index). The S&P 500 Index and the Dow Jones Industrial Average gained 2.41% and 1.41%, respectively. Headlines dominating the month were solid first quarter corporate earnings along with concerns of a potential trade war involving tariffs on steel and aluminum imports from Canada, Mexico and the European Union, the status of the North Korean summit and signs of political instability in Europe. Most U.S. companies have reported their 1Q results, posting record profits, with the S&P 500 earnings per share year-over-year growth of 24%.[1]

With regards to style, growth stocks notched a 4.33% return in May (measured by the S&P 500 Growth Index) outpacing the 0.26% of value stocks (measured by the S&P 500 Value Index). On the sector front, Information Technology (7.37%) led the pack, and benefited from strong earnings reports and several tech giants announcing that they will use tax savings to boost their stock buybacks and dividends. Energy finished second on the back of higher oil prices (see Exhibit 1). On the negative side, Consumer Staples, which is known as a defensive sector, had the worst monthly performance amongst all the sectors, down -1.53%, with disappointing earnings results being partially to blame.

Exhibit 1: Oil prices supported Energy sector during May



Source: Bloomberg, 5/31/18. West Texas Intermediate crude oil price shown as U.S. dollar/barrel.

Overseas stocks struggle *(returns are in U.S. dollars)*

International equities significantly lagged the U.S. market in May as all the major international regions posted losses in local currency terms, as the resurgent U.S. dollar further drove down performance (see Exhibit 2). Developed international equity markets (measured by the MSCI EAFE Index) lost -2.11% in May. Recent dollar strength combined with investors' risk aversion hurt emerging markets more than developed countries. Emerging market equities (measured by the MSCI EM Index) lost -3.52% in May. Latin America, dragged down by Brazil, was the weakest region in May with the MSCI EM Latin America Index losing -14.01% for the month. Notably, beginning in June, the MSCI EM Index will include a number of China A-share stocks that were previously only available to Chinese investors. A second phase of inclusion will occur in September, and although the initial weightings will be very small, this move is expected to have a significant impact on long-term inflows into Chinese securities.

[1] *Source: Bloomberg, 5/31/18.*

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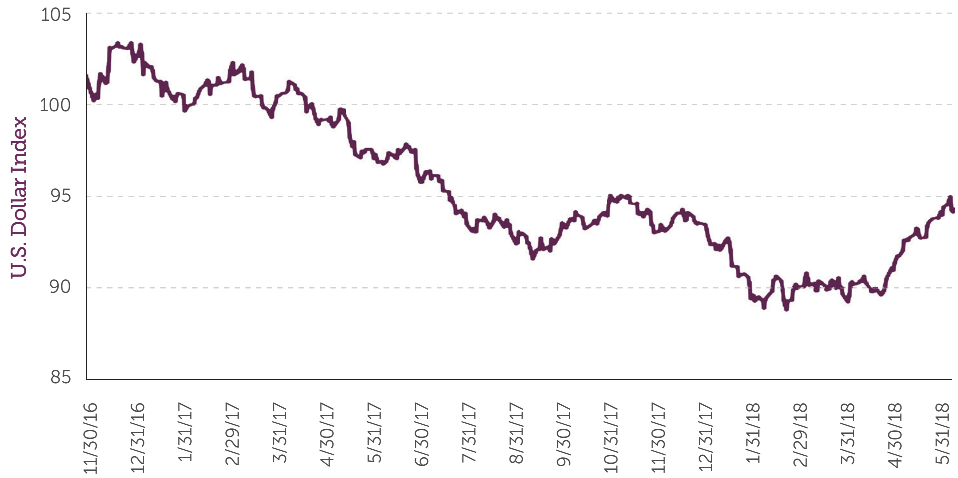
Exhibit 2: Bounce back for the dollar

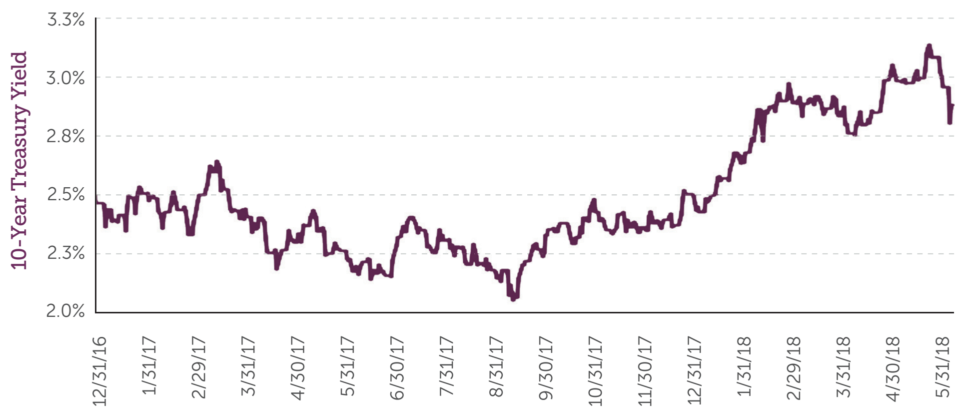


Source: Bloomberg, 5/31/18.

Most U.S. fixed income sectors show positive performance

Most domestic fixed income markets, with the exception of high yield bonds, produced positive performance in May. The broad U.S. fixed income market (measured by the ICE BofA ML U.S. Broad Market Index) gained 0.70% in May. U.S. Treasury bonds (measured by the ICE BofA ML Treasury Master Index) gained 0.91% for the month as longer-dated U.S. Treasurys outperformed shorter-dated issues. The 10-year U.S. Treasury yield rose to 3.11%, its highest level in seven years (see Exhibit 3), but Federal Reserve meeting minutes, which suggested that the Fed is likely to maintain its pace of gradual policy tightening with a probable 25 basis point rate hike in June, and geopolitical risks drove the yield lower by month's end.

Exhibit 3: Yields rose in the U.S. last month



Source: Bloomberg, 5/31/18.

Investment grade corporate bonds (measured by the ICE BofA ML Corporate Master Index) lagged their U.S. Treasury peers, returning only 0.45% due to widening bond yield spreads and reduced demand from offshore investors. Municipal bonds (measured by the ICE BofA ML Municipal Securities Master Index) returned 1.17% for the month, partly aided by significant slowdowns in issuance. Leveraged loans (measured by the Credit Suisse Leveraged Loan Index) gained 0.19% in May. This asset class, owing to its typical low duration and floating coupon, tends to perform better than other fixed income sectors in rising interest rate environments. The high yield market (measured by the ICE BofA ML US HY Cash Pay Index) was marginally negative for the month.

Glossary

The **Russell 2000 Index** measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that Index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership.

The **Standard & Poor's 500 Index (S&P 500)** is a capitalization-weighted index of 500 stocks. The Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The **Dow Jones Industrial Average** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. Earnings per share serves as an indicator of a company's profitability.

The **Standard & Poor's 500 Growth Index (S&P 500 Growth)** is a capitalization-weighted index of 500 stocks that exhibit strong growth characteristics.

The **Standard & Poor's 500 Value Index (S&P 500 Value)** is a capitalization-weighted index of 500 stocks that exhibit strong value characteristics.

The **MSCI EAFE (Europe, Australia, Far East) Index** is a free float-adjusted market capitalization index that is designed to measure developed foreign market equity performance, excluding the U.S. and Canada. The Index consists of 22 developed market country indices.

The **MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure emerging markets equity performance. The index consists of 24 emerging market country indices.

The **MSCI Emerging Markets (EM) Latin America Index** captures large and mid cap representation across five EM countries (Brazil, Chile, Colombia, Mexico, and Peru) in Latin America. With 109 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The **ICE BofA Merrill Lynch U.S. Broad Market Index** tracks the performance of U.S. dollar denominated investment grade debt publically issued in the U.S. domestic market, including U.S. Treasury, quasi-government, corporate, securitized and collateralized securities.

The **ICE BofA Merrill Lynch Treasury Master Index** measures the total return performance of U.S. Treasury bonds with an outstanding par that is greater than or equal to $25 million.

The **ICE BofA Merrill Lynch U.S. Corporate Master Index** is an unmanaged index comprised of U.S. dollar-denominated investment grade corporate debt securities publicly issued in the U.S. domestic market with at least one year remaining to final maturity.

The **ICE BofA Merrill Lynch Municipal Securities Master Index** measures total return on tax exempt investment grade debt publicly issued by U.S. states and territories, and their political subdivisions, including price and interest income, based on the mix of these bonds in the market.

The **Credit Suisse Leveraged Loan Index** tracks the investable market of the U.S. dollar-denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries.

The **ICE BofA U.S. Cash Pay HY Constrained Index** tracks U.S. dollar, Canadian dollar, British Pound, and Euro denominated debt rated BB+, BB, or BB- issued in major domestic or Eurobond markets. Qualifying securities must have 12 month or more until maturity, a fixed coupon, and a minimum outstanding of $100mm. Index constituents are capitalization-weighted based on current amount outstanding, the current market price, and accrued interest.

These views represent the opinions of the Director of the Research & Strategy Group and are not intended as investment advice or to predict or depict the performance of any investment. These views are as of the close of business on June 4, 2018, based on the information available at the time and are subject to change at any time based on market or other conditions. We disclaim any responsibility to update such views.

All investing involves risk, including possible loss of principal. Equities are subject to market risk (the risk that the entire stock market will decline because of an event such as deterioration in the economy or a rise in interest rates), as well as special risks associated with investing in certain types of stocks, such as small-cap, global and international stocks. International investing may be volatile and involve additional expenses and special risks including currency fluctuations, foreign taxes and geopolitical risks. Emerging and developing markets may be especially volatile. Fixed income investing includes interest rate risk and credit risk. Interest rate risk is the risk that bonds will decrease in value as interest rates rise. As a general rule, longer-term bonds fluctuate more than shorter-term bonds in reaction to changes in interest rates. Credit risk is the risk that bonds will decline in value as the result of a decline in the credit rating of the bonds or the economy as a whole, or that the issuer will be unable to pay interest and/or principal when due. There are also special risks associated with investing in certain types of bonds, including liquidity risk and prepayment and extension risk, or investing in high yield (junk) bonds. There are additional risks associated with the use of derivatives. **Past performance does not guarantee future results.**

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