

**ECONOMIC HIGHLIGHTS**

U.S. Final Demand PPI came in at +0.1% for April and up 2.6% for the year ended April. Core PPI was up 2.5% for the year ended April. Consumer Prices were up 0.2% for April and up 2.5% for the year ended April. Otherwise, it was a fairly slow week for economic data.

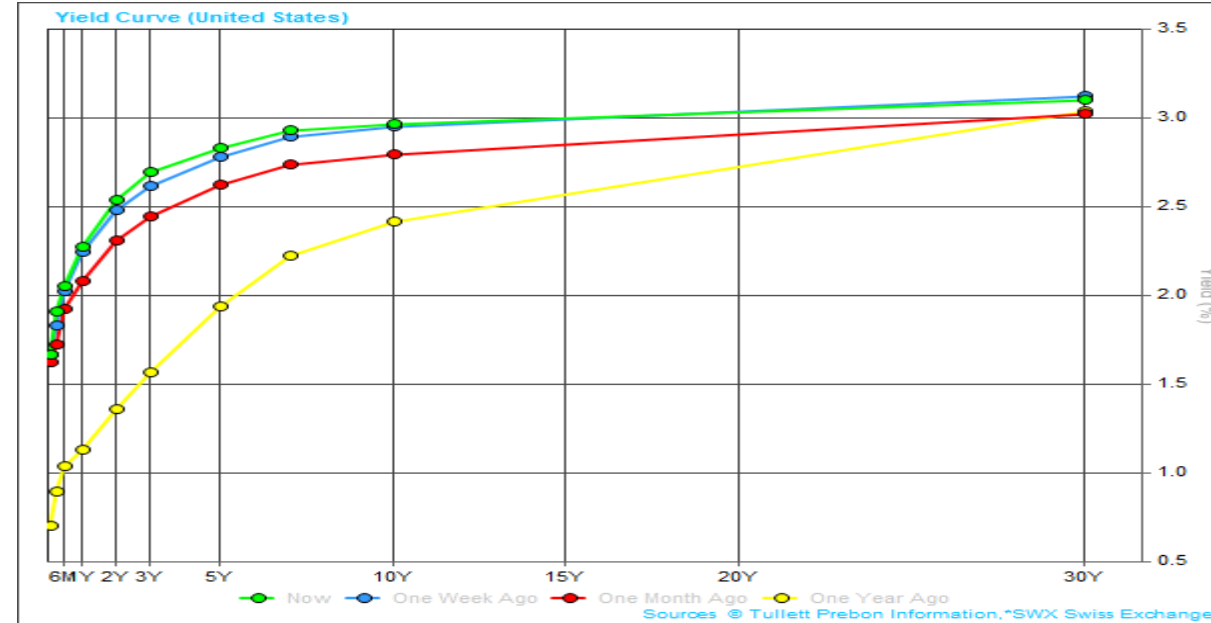
**FIXED INCOME**

The fate of the flattening U.S. yield curve now rests squarely in the words of Federal Reserve officials. Bond traders have already reached their verdict. The yield spread between five- and thirty-year Treasuries narrowed last week to as little as 26 basis points, the lowest since August 2007. The prospect of an inverted curve, which has predicted past recessions, is as strong as ever. And it's not just Wall Street scrutinizing the development -- St. Louis Fed President James Bullard on Friday said it's "crunch time" for inversion, predicting it could happen this year or in 2019 if the Fed keeps up its pace of rate hikes. Several more central bankers will have a chance to opine on the phenomenon this week, including incoming New York Fed President John Williams, while the nominee for Fed vice chairman, Richard Clarida, will face Congress. What they signal may prove pivotal in a period otherwise lacking in debt auctions and top-tier data. Any hints that the looming inversion has them contemplating a slower pace of rate increases could spur another bout of bull steepening, like after policymakers' May meeting. If they ignore the curve, there's little to stop the grind flatter. "The Fed is supposed to adjust rates when the economy is doing well and inflation may pick up, but at some point they would have to stop," Krishna Memani, Chief Investment Officer at Oppenheimer Funds Inc., said in a Bloomberg TV interview. But if they let the curve invert, "all they will do is take the U.S. economy down the drain." It's hard to overstate the flattening move in the U.S. yield curve. Select just about any two maturities, and the gap between them has shriveled over the past year. At one point last week, investors picked up a mere two basis points for owning ten-year Treasuries instead of seven-year debt. Strategists at BMO Capital Markets said in a report Friday that if that portion of the curve inverts, others are likely to follow, possibly before July. Traders, for their part, are betting on persistent rate hikes. In fact, fed funds futures are pricing in between two and three additional increases this year, which is above the central bank's forecast of two more in 2018.

**CURRENT GENERIC BONDS YIELDS**

TREASURIES		AGENCIES		CORPORATES		MUNICIPALS	
3 mo	1.90%	3 mo	1.87%	3 mo	2.30%	3 mo	1.58%
6 mo	2.04%	6 mo	1.94%	6 mo	2.40%	6 mo	1.64%
1 yr	2.25%	1 yr	2.09%	1 yr	2.51%	1 yr	1.70%
2 yr	2.54%	2 yr	2.43%	2 yr	2.81%	2 yr	1.83%
5 yr	2.84%	5 yr	2.76%	5 yr	3.28%	5 yr	2.15%
10 yr	2.97%	10 yr	3.29%	10 yr	3.77%	10 yr	2.63%
30 yr	3.10%	30 yr		30 yr	4.15%	30 yr	3.56%

**CHANGE IN TREASURY YIELD CURVE**



**EQUITY**

INDEX RETURNS	LAST WEEK	YTD
Dow Jones Industrials	2.51%	1.26%
S&P 500 (Large Cap)	2.49%	2.72%
S&P 400 (Mid Cap)	2.23%	2.54%
Russell 2000 (Small Cap)	2.65%	5.07%
NASDAQ Composite	2.73%	7.64%
MSCI EAFE (International)	1.18%	2.08%
iShares Real Estate	1.17%	-3.36%

Stocks experienced a broad-based rally last week with small cap, mid cap, and large cap indexes all rallying over 2%. Nine of the 11 major sector groups rose – with four gaining at least 3%. Consumer Staples and Utilities were the two sectors that declined – continuing their lagging performance so far this year. As a group, Consumer Staples is down over -12% this year compared to Technology stocks which are up over +9%.

Oil prices fell slightly last week, but still remain over \$70 a barrel and near three year highs. On Tuesday President Trump announced the U.S. would withdraw from the Iran nuclear agreement and begin imposing a wide range of sanctions. The announcement did little to materially slow down the bull market in crude over the past 18 months. Prices were helped by Saudi Arabia's pledge to support the market.

The latest unemployment reading made lots of headlines after it showed the latest unemployment rate at 3.9%. While on the surface the news suggests the economy is strong, Bespoke wrote in a report that low unemployment readings are a bad sign for future stock returns. The group noted that one year forward returns from a starting unemployment rate of 3.9% have led to -4.6% S&P 500 price returns on average since 1948. However, it is worth noting the range of those returns is quite large with gains as big as +15.3% and losses as large as -27.5%.

Shares of Sears Holding rallied sharply to end the week after the company announced it will begin working with Amazon to provide full-service tire installation and balancing for customers who purchase any brand of tires on Amazon. With the collaboration, Sears Auto will become the first nationwide auto service center to offer Amazon.com customers the Ship-to-Store tire solution integration into the Amazon.com checkout process.

Wal-Mart traded lower on Thursday after the company's announcement it had reached a deal to acquire Flipkart, the largest Indian e-commerce retailer. Walmart is acquiring a 77% stake in Flipkart for \$16 billion – the deal is expected to close later this year, subject to regulatory approval.

Earnings releases continue to slow down this week as volume drops off, notable reports include: Home Depot, Macy's, Campbell's Soup, and John Deere. Brokerage conferences begin to pick up so expect to see lots of upgrades and downgrades announced throughout the week. The U.S. economic calendar is fairly light – of note is Wednesday's release of U.S. housing data.

The rally last week moved the S&P 500 through the 2680 and 2705 resistance levels we noted in these comments last week. That changes the technical picture slightly. Moving forward we are now watching 2675, 2640, and 2580 as levels of support and 2800 as the next notable resistance level. The index closed last week at 2727.

**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 summary 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 overweighted 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.

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