THE PRIVATE CLIENT GROUP
BALANCING LIFE & WEALTH

ECONOMIC & MARKET
INSIGHTS

An Executive Summary for May 2023

During the month of May, equity and bond markets generated mixed results after navigating through a federal debt ceiling stand-off, continuing strong employment numbers, moderating inflation, and another Fed rate hike. Growth stocks posted positive returns but were led by a very narrow group of Nasdaq mega cap names. The Bloomberg Aggregate Bond Index was down as longer dated yields rose.

The Federal Reserve continued its rate hiking campaign, completing its 10th consecutive increase. The 25-basis point rate hike brings the target Federal Funds rate to 5.0% - 5.25%. While the hikes began in March 2022, the lagging effects are likely greater this cycle given how far behind the curve the Fed was to start. At that time, inflation was already running near 7% and the Fed was still actively growing its balance sheet via quantitative easing. Arguably, the Fed reached neutral around 3% in September 2022 as the rate exceeded its long run inflation target of 2.5%. The Fed did not really reach restrictive status until January 2023 when the Fed Funds hit 4.5% - a level that was finally in range of current inflationary trends. Historically, the average time lag to slow the economy has been around 12 months with ranges between six to 18 months. Given the Fed path, the effective time lag so far is likely around six months.

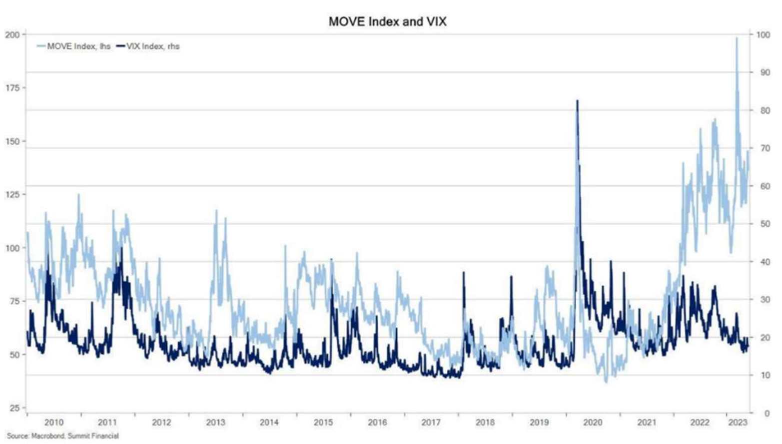
Per the Fed Fund futures market, the Fed is very close to the terminal rate and an end to its rate hiking cycle. Futures predict another 25-basis point rate hike in June or July with a higher probability of a June pause followed by a July hike. The June/July hike is now forecast as the Fed's last with a strong probability of rate cuts beginning in Q1 next year. Rate cuts are sensitive to continuing declines in inflation across all measures, Core PCE in particular, but most importantly towards the Fed's cadence on specific components of inflation.

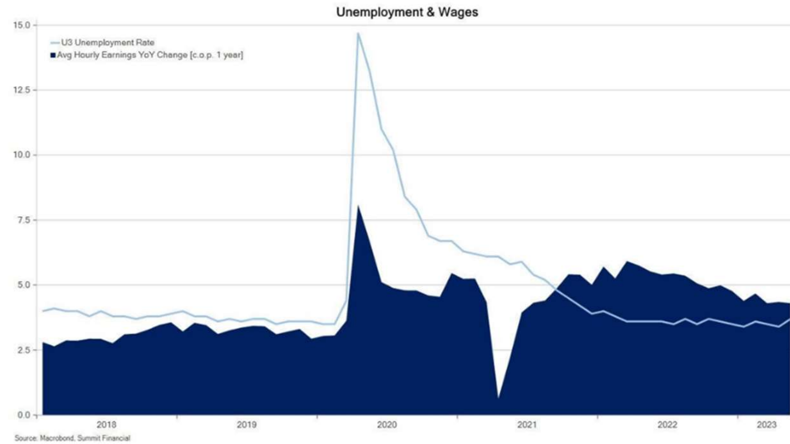
Under the backdrop of the risk of a US debt default, Congress and the President successfully negotiated a budget. The deal is estimated to reduce overall deficits by $1.5 trillion over 10 years. The budget incorporates no tax changes, reduces discretionary spending marginally, maintains spending on mandatory programs, includes some work requirements for welfare programs and adds a sequester provision for cutting spending. Initial forecasts estimate its impact on overall economic growth to be minimal to mildly positive.

Internationally, concerns are mounting around China's near-term growth. While first quarter Chinese GDP growth reached 4.5%, it continues to run below the country's 5% target and the post-COVID bounce has been weaker than many analyst predictions. Germany's economy entered a recession with first quarter economic growth falling -0.3% after fourth quarter 2022 growth shrank -0.5%. This follows the UK narrowly avoiding a similar fate. In contrast, the US continues to experience moderate economic growth. US ISM Services activity remained positive in tandem with retail sales, non-farm payrolls growth and low initial unemployment claims. Of concern is the continuing contraction in commercial bank lending, though some of this may be offset by lending growth in private credit markets.

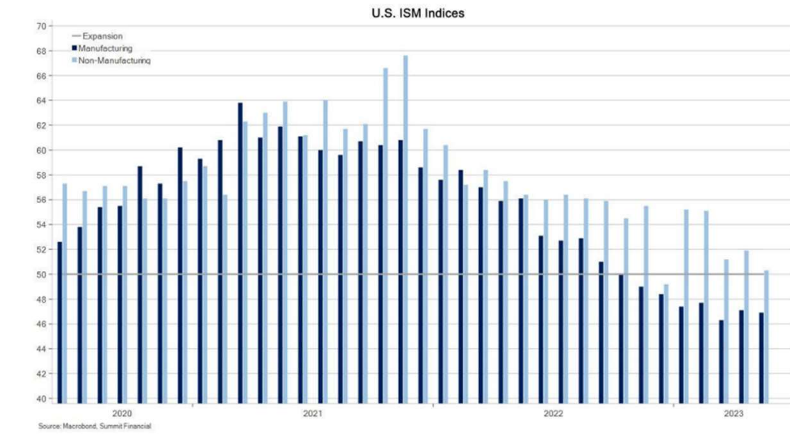
Within equity markets, S&P 500 earnings growth continues to struggle. Per Factset, current Year 2023 consensus earnings growth is projected at 1.2%. With reported Q1 growth at -4.1%, Q2 growth forecasted at -6.4% and Q3 growth forecasted at 0.9%, all the heavy lifting will shift to Q4 with its +8.3% growth projection. With high interest rates, rising labor costs and the Fed in restrictive mode, it is difficult to envision earnings accelerating towards year end even though a falling USD is beneficial. After almost one year of continuous cuts by analysts to EPS forecasts for Current Year 2023 and 2024, consensus estimates have stabilized, and analysts are maintaining their forecast for an economic soft landing.

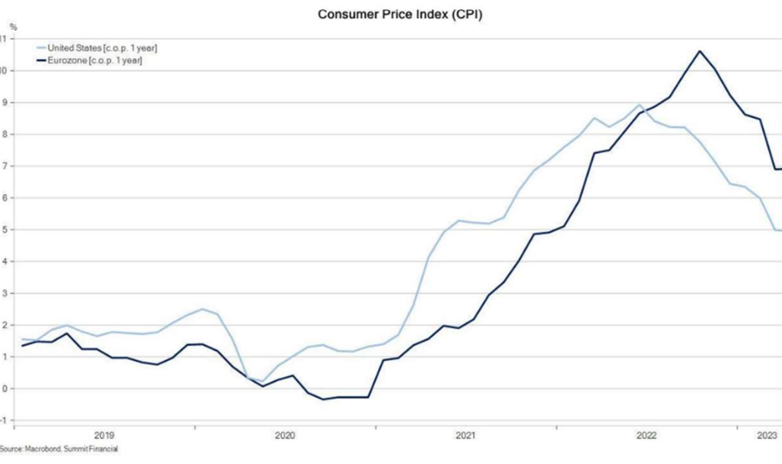
Looking at fixed income markets, short-term treasuries offer the highest returns followed by short duration corporate bonds. Long-dated US treasuries, as measured by the US 10-year treasury, continue to offer yields near 3.7% providing a modest real return versus estimated inflation (five years forward) which is running near 2.1%. Short-term treasuries, as measured by 3-month T-Bills, are yielding near 5.3%, their highest levels in 16 years. With the Fed likely nearing the end of its rate hike cycle, and investment grade bonds yielding over 5%, extending duration is beginning to make more sense.

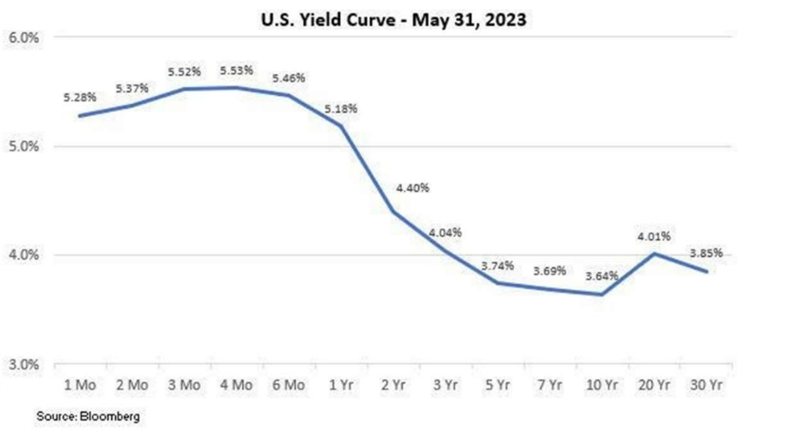

MOVE Index and VIX
MOVE Index, lhs
VIX Index, rhs
200
175
150
125
100
75
50
25
100
90
80
70
60
50
40
30
20
10
0
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
Source: Macrobond, Summit Financial

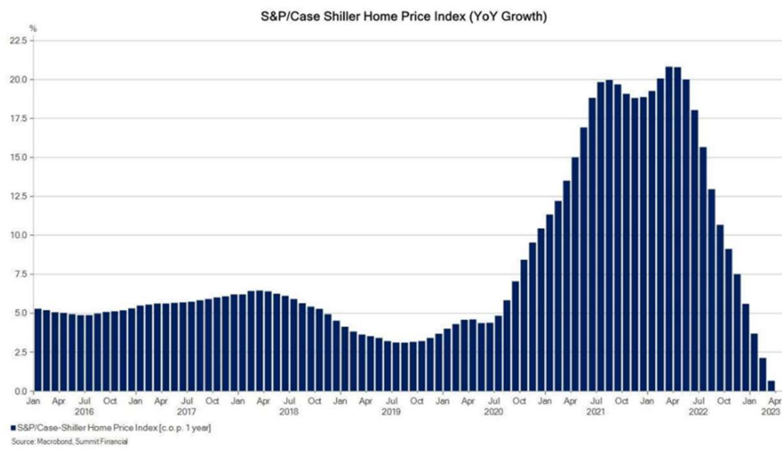

Unemployment & Wages
U3 Unemployment Rate
Avg Hourly Earnings YoY Change [c.o.p. 1 year]
15.0
12.5
10.0
7.5
5.0
2.5
0.0
2018
2019
2020
2021
2022
2023
Source: Macrobond, Summit Financial

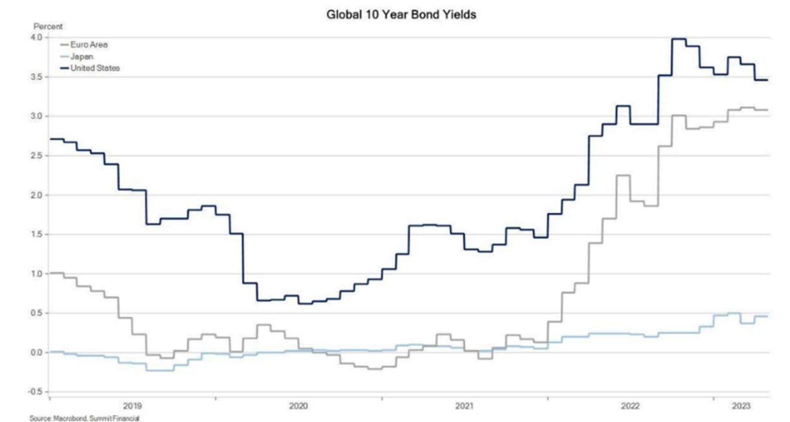
Price to Earnings (Estimated Consensus EPS)
U.S.
EAFE
Emerging Markets
28
26
24
22
20
18
16
14
12
10
2019
2020
2021
2022
2023
Source: S&P and MSCI


U.S. ISM Indices
Expansion
Manufacturing
Non-Manufacturing
70
68
66
64
62
60
58
56
54
52
50
48
46
44
42
40
2020
2021
2022
2023
Source: Macrobond, Summit Financial


Consumer Price Index (CPI)
%
United States [c.o.p. 1 year]
Eurozone [c.o.p. 1 year]
11
10
9
8
7
6
5
4
3
2
1
0
-1
2019
2020
2021
2022
2023
Source: Macrobond, Summit Financial


U.S. Yield Curve - May 31, 2023
6.0%
5.0%
4.0%
3.0%
5.28%
5.37%
5.52%
5.53%
5.46%
5.18%
4.40%
4.04%
3.74%
3.69%
3.64%
4.01%
3.85%
1 Mo
2 Mo
3 Mo
4 Mo
6 Mo
1 Yr
2 Yr
3 Yr
5 Yr
7 Yr
10 Yr
20 Yr
30 Yr
Source: Bloomberg


S&P/Case Shiller Home Price Index (YoY Growth)
%
22.5
20.0
17.5
15.0
12.5
10.0
7.5
5.0
2.5
0.0
Jan
Apr
Jul
Oct
2016
2017
2018
2019
2020
2021
2022
2023
S&P/Case-Shiller Home Price Index [c.o.p. 1 year]
Source: Macrobond, Summit Financial


Global 10 Year Bond Yields
Percent
Euro Area
Japan
United States
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
-0.5
2019
2020
2021
2022
2023
Source: Macrobond, Summit Financial

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