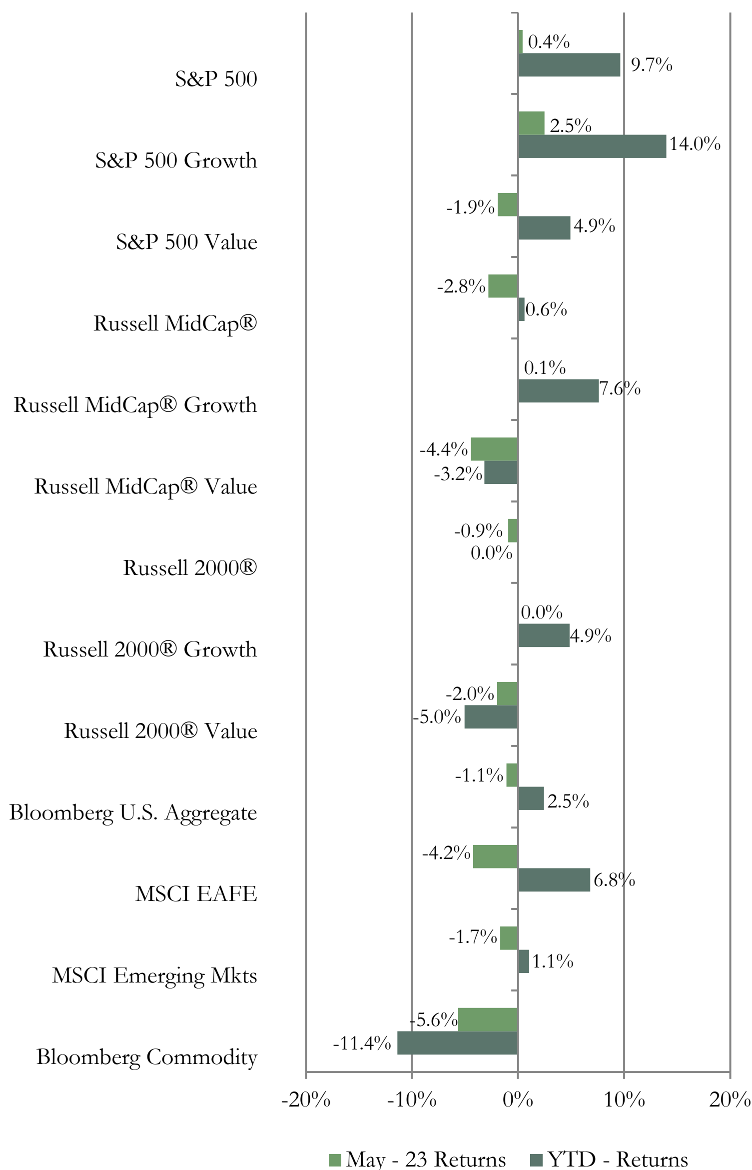
Monthly Market Summary – May 2023

Financial markets started the month out on a weak note and despite a few short rally periods, most major asset class indices ended the month with a negative return. The month started with another one quarter of a percentage point rate hike by both the Federal Reserve Open Market Committee (Fed) and the European Central Bank. The hawkish tone of post-hike comments sent markets lower on fears that tighter monetary policy will lead to recession. The price of gold briefly hit an all-time high on recession worries but dropped later in the month. Some economic data reported during the month suggested the economy has been more resilient than expected in weathering the higher interest rate environment. These reports eased recession fears and sent stock prices higher for brief periods. A key report was the April jobs report that showed the unemployment rate fell to 3.4% and 253,000 new jobs were created which was well above the 180,000 that was expected. The consumer spending report was also positive with a 3.7% gain over the prior quarter with spending on both goods and services increasing. Housing starts also came in higher than expected. Treasury bond yields moved up since the stronger economic data suggested the Fed may not be done raising rates and it is looking less like there will be a rate cut in 2023 as some had expected earlier in the year. The 10-year Treasury bond yield hit a 3-month high of 3.8% before Memorial Day. Uncertainty about the debt ceiling negotiations in the U.S. pressured financial markets most of the month. The 3-month Treasury bill yield hit a multi-decade high (with a corresonding price decline) mid-month due to worries about a possible default by the U.S. government. However, equity and bond markets rallied into the end of the month after news that a deal had been reached and a default would likely be avoided.

Market Indices – May 2023



Key news outside the U.S. included the announcement that Germany is officially in recession since it reported a second quarter of negative gross domestic product (GDP) growth. China's reopening appears to be losing momentum since manufacturing, industrial production, retail sales, and investment spending are all down and youth unemployment has risen to over 20%. In better news, Japan reported stronger than expected GDP growth of 1.6%. In addition, corporate earnings reports have been better than expected in Japan and in Europe.

Major U.S. equity market index returns were mixed for May. The S&P 500 index of larger capitalization (cap) stocks had a positive return but the Russell Midcap and Russell 2000 indices of smaller companies both posted a negative return. The growth index outperformed the value index in all three market cap categories. There was a wide dispersion of returns for the various industry sectors in each market cap category. Information technology and communications were the top performing sectors in all three market cap indices with positive returns. The information technology sector had a return of almost 10% in the S&P 500 and did have a double-digit return in the mid and small-cap indices. Most other sectors posted a negative return for the period with materials and energy posting the worst returns in all three market cap indices. Optimism about potential earnings growth for companies involved in the artificial intelligence (AI) wave has been the main driver of the gains for the information technology and communications sectors especially after the much stronger than expected earnings outlook reported by NVIDIA, a maker of semiconductors used in AI processing. A weaker than expected rebound in China's economy and worries about possible recession in developed markets has been a drag on energy and materials stocks.

Both the MSCI EAFE index of developed international equities and the MSCI Emerging Markets index (EM) had a negative return for May on a U.S. dollar basis. Both indices had a better return on a local currency basis since the dollar advanced during the period. Growth stocks outperformed value stocks in both the EAFE and EM indices. Just as in the U.S. indices, information technology was the top performing sector in both the EAFE and EM. Energy was the worst performing sector in the EAFE index while real estate was the laggard in the EM index. On a geographical basis, the Far East was the best performing region among developed markets with a small positive return. Latin America was the top performing region among emerging markets. China was the poorest performing EM country reflecting the weakening momentum of the post-Covid recovery.

All sectors of the U.S. bond market posted a negative return for May except for the shortest Treasury bond index. Yields moved up during the period reflecting stronger than expected economic data and concerns about a possible default by the U.S. government if a debt ceiling agreement is not reached by the early June deadline set by the Secretary of the Treasury. The yield curve continues to be very steeply inverted. The 3-month Treasury bill yield was 5.5% at month-end compared to the 2-year Treasury bond yield of 4.4% and the 10-year Treasury bond yield of 3.6%.

The Bloomberg Commodity index had a negative return for the month. Each of the sub-indices we track had a negative return. The precious metals sub-index had the smallest negative return. The energy and industrial metals sub-indices had the largest negative returns of over -8%. Both indices were hurt by the weaker than expected rebound in demand from China.

Vogel Consulting, LLC (Vogel) Tactical Recommendations

Inflationary pressures continue to persist as shown by the latest release of the Fed's preferred measure of inflation, the personal consumption expenditures price index, which moved higher to 4.4%. Therefore, the possibility of further rate hikes remains - especially since the Fed and other central banks seem intent on continuing their hawkish positioning. Bank lending standards have been tightening for a few months and the recent banking crisis may result in even tighter access to credit for consumers and business, particularly small businesses that depend on regional and community banks, as banks seek to retain liquidity and reduce risk. This could be a drag on economic growth in an environment of already mixed economic conditions. Therefore, it is likely financial markets will continue to be volatile while there is heightened uncertainty about the impact of tighter monetary conditions on corporate profits. We continue to recommend an overweight to cash reserves. Our neutral view on growth relative to value remains in place as we prefer to have exposure to sectors benefiting from longer-term secular growth trends along with some exposure to cyclicality.

We retain our neutral weight position recommendation for developed market and emerging market equities. Since bond yields are more attractive than they have been in many years, we encourage investors to revisit fixed income allocations. Our fixed income recommendation is for an equal weight position relative to long-term targets. We favor shorter

maturity bonds due to the steeply inverted yield curve. We recommend an underweight allocation to hedge funds. Within the hedge fund sector our view is that the opportunity set for distressed investing strategies may be improving as interest rates are at multi-year highs and credit conditions are tightening.

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