

## May 22, 2023 – Investment Commentary

### Market Performance

Last week, stocks went up and bonds down. The S&P 500 outperformed MSCI EAFE (Non-US Developed) and MSCI Emerging Market indices. The best performing sectors in the S&P 500 were technology, communications, and consumer discretionary. Across U.S. Russell style & market cap indices, large-cap growth did the best, and the quality factor led more broadly. As for fixed income, the 10 yr. treasury yield rose 23 bp on the week to 3.69% and the 2-10 year Treasury yield spread inverted further to -58 bps. The best performing parts of the bond market were high yield. High yield bond spreads were roughly flat on the week at 477 bps but are still below their 20-year average of 500 bps.

Stock prices and US Treasury yields increased (price down / yields up) with help from optimism surrounding the US debt ceiling negotiations and stronger than expected manufacturing data. The risk-on attitude also supported 10-Year German Bunds yield rising to 2.43%.

The recent developments do not change the broader macro picture much nor where we are in the economic cycle, but we see a sentiment shift in the market pricing of economic risk again. It seems the market consensus pricing of little recession risk or “no landing” scenario.

### A Look Back in Time

The Leading Economic Indicators (LEI) peaked in March of 2006. The recession didn't start for another 21 months. This time, the LEI peaked in December of 2021. Applying the 21 months, the next recession wouldn't start until September of 2023.

The yield curve inverted in July 2006. The recession didn't start for another 18 months. This time, the yield curve inverted in November 2022. Applying the 18 months, the next recession wouldn't start until April 2024.

In the three quarters before the recession started in 2008, real GDP increased at quarter on quarter rates of 2.6%, 2.4% and 2.5% in Q2, Q3 and Q4 of 2007, respectively.

In the 1990s, the Fed was tightening, but a number of foreign central banks were easing. During that time, there was a mild recession, although the NASDAQ crashed in 2001. This time central banks around the world have been tightening (excluding China).

### Outlook

A near-term pause in Fed rate hikes may provide temporary support to risk assets. However, we believe expectations of a sustained rate-cutting phase later this year are unlikely to be supported given the persistence of elevated core inflation and the tight labor market. Earnings have held up better than expected but still declined ~3% year over year in Q1 and we believe estimates may be too high given the headwinds of slowing economic growth and higher starting point for profit margins. Further market appreciation for certain market indexes requires further expansion of valuations or a meaningful re-acceleration in earnings. The concentrated performance amongst certain stocks, debt ceiling concerns, regional banking sector stress and slowing economic activity are several headwinds to upside performance.

## *Disclosures*

### *Investment Commentary Sources: Bloomberg*

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