ROBERTSON STEPHENS®

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Market Moves

Last week, stocks experienced their worst weekly decline since March, breaking a 5-week gain streak ,while the tech heavy NASDAQ broke an 8-week streak of gains. The S&P 500 outperformed the MSCI EAFE and MSCI Emerging Markets indices. The declines were primarily driven by concerns over the Federal Reserve's potential need to raise interest rates one to two more times this year before maintaining elevated rates until inflation significantly decreases. Throughout the week, multiple Fed officials addressed last week's decision to keep rates unchanged, emphasizing their data-dependent approach in determining future rate hikes. On Friday, U.S. Treasuries yields fell, with some dropping as much as 10 basis points. The spread between the 2- and 10-Year bond yields inverted even further, surpassing 1%. Market participants widely interpret such inversions as a signal of an impending recession. Reflecting apprehension about the economic outlook, investors shifted their focus from stocks to bonds, as seen in the weekly flow data. A significant $5 billion was withdrawn from global equity funds, while $5.4 billion was added to bond funds. The equity rally until last week, included AI optimism, hope that the Fed will pause and evidence of a resilient economy.

Near Term Considerations

In the upcoming week, markets will closely analyze key data points such as the Core Personal Consumption Expenditures (PCE) Index (excluding food and energy), which is the Fed's preferred measure of inflation and has demonstrated month on month "sticky inflation" at around 5%. The PCE and GDP indicators this week will offer insights into the likelihood of a rate hike in July and assist investors in determining their positions for the holiday-shortened week ahead.

- *Housing starts* rose a material 22% in May, the highest since April 2022, indicating continued economic resilience. The strength in housing (or as defined in the CPI as shelter) is not helping the Fed's ability to bring down core inflation.
- With profits under some pressure, the *labor market* remains key to economic activity.
- *Dividend stocks* have had their worst relative performance since 1999 so far in 2023.
- S&P500 index is trading at a *premium valuation* of 19x estimated earnings vs. 15x for its 20-year average while the 10 largest stocks are trading at 29x vs. 20x earnings for its long-term average.
- *Yield curve* conventional wisdom holds that an inverted yield curve is a harbinger of an economic contraction. The data indicates that curve inversions typically predate recession by 11 months. The 3M-10Y spread turned negative on 10/25/22, signaling a recession (magnitude and severity TBD) this coming September. However, some Wall Street analysts indicate that recessions begin when the curve un-inverts. This makes intuitive sense as the yield curve steepens when the Fed cuts rates in anticipation of a downturn. Treasury futures currently imply that the curve will first un-invert in June 2026. This compares to expectations of an un-inversion in April 2024 on 4/30/23, and January 2025 on 5/31/23. The recent shift in economic outlook helps to justify strong YTD returns. However, we believe it's another mixed-signal data indicator supporting bulls and bears.
- The bond market as measured by *Fed Fund Futures* is pricing in a rate hike in July and then holding for the rest of 2023 before a first cut in January 2024. This is a dramatic shift from earlier in the year where multiple rate cuts were anticipated in 2023.

Portfolio Implications

Investors face a variety of shifting scenarios regarding potential macro-economic outcomes. Depending upon an investor's time horizon, there is a volatile path higher for risk assets such as equities where peak to trough intra calendar year index drawdowns are typically ~15%. As a result, we are focused on balancing quality growth with quality dividend paying stocks and identifying less expensive parts of the global equity markets that have lagged in the rally. Finally, we believe more resilient diversified portfolios include quality fixed income and complementary alternative strategies.

Disclosures
Investment Commentary Sources: Bloomberg