ZCM Market Insights

Monthly Market Commentary: May 2023

The banking crisis continued to dominate headlines in April as capital markets focused on how regulators and the Federal Reserve would respond and attempt to keep it contained. Also weighing on minds, the improving but still high inflation rates, likeliness of a recession, ongoing Ukraine/Russia war, and continued interest rate increases.

The S&P 500 returned 1.56% in April, following a 3.67% return in March. On a year-to-date basis as of April 30th, the S&P 500 has returned 9.18% following a 7.50% return in 2022. As measured by the Russell 2000, Small Cap stocks returned -1.80% in April after returning -4.78% in March. On a year-to-date basis as of April 28th, the Russell 2000 has returned 0.89%. Large Cap Value outperformed Large Cap Growth in April, with the Russell 1000 Value returning 1.51% and the Russell 1000 Growth returning 0.99%. On a year-to-date basis as of April 28th, Large Cap Growth has outperformed Large Cap Value with returns of 15.49% and 2.53%, respectively. In April, the Russell 2000 Growth returned -1.16%, and the Russell 2000 Value returned -2.49%. On a year-to-date basis as of April 28th, Small Cap Growth outperformed Small Cap Value with returns of 4.84% and -3.13%, respectively.

Returns by Sector (as of April 28, 2022)

	S&P 500		Russell 2000	
Sector	April 2023	YTD	April 2023	YTD
Communication Services	25.05	3.77	5.83	-0.83
Consumer Discretionary	15.03	-0.95	11.07	-0.77
Consumer Staples	4.45	3.59	7.30	1.29
Energy	-1.52	3.30	-5.75	-2.05
Financials	-2.56	3.18	-11.39	-3.08
Health Care	-1.37	3.07	3.58	5.70
Industrials	2.24	-1.18	4.88	-2.14
Information Technology	22.37	0.45	2.78	-9.89
Materials	4.14	-0.14	4.33	-4.09
Real Estate	2.94	0.97	-2.36	-2.94
Utilities	-1.44	1.87	-0.33	-1.66
TOTAL RETURN	9.17%	1.56%	0.88%	-1.80%

Source: Bloomberg

Real gross domestic product (GDP) increased at an annual rate of 1.1% in the first quarter of 2023, according to the “advance” estimate released by the Bureau of Economic Analysis. In the fourth quarter, real GDP increased 2.6%.

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A series that provides a glimpse of our internal thought process through current topics affecting our clients and colleagues.

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The increase in consumer spending reflected increases in both goods and services. Within goods, the leading contributor was motor vehicles and parts. Within services, the increase was led by health care and food services and accommodations. Within exports, an increase in goods (led by consumer goods, except food and automotive) was partly offset by a decrease in services (led by transport). Within federal government spending, the increase was led by nondefense spending. The increase in state and local government spending primarily reflected an increase in compensation of state and local government employees. Within nonresidential fixed investment, increases in structures and intellectual property products were partly offset by a decrease in equipment.

The decrease in private inventory investment was led by wholesale trade (notably, machinery, equipment, and supplies) and manufacturing (led by other transportation equipment as well as petroleum and coal products). Within residential fixed investment, the leading contributor to the decrease was new single-family construction. Within imports, the increase reflected an increase in goods (mainly durable consumer goods and automotive vehicles, engines, and parts).

Compared to the fourth quarter, the deceleration in real GDP in the first quarter primarily reflected a downturn in private inventory investment and a slowdown in nonresidential fixed investment. These movements were partly offset by an acceleration in consumer spending, an upturn in exports, and a smaller decrease in residential fixed investment. Imports turned upward.

The April Institute for Supply Management's (ISM) Purchasing Managers' Index PMI® registered 47.1%, 0.8 percentage point higher than the 46.3% recorded in March. Regarding the overall economy, this figure indicates a fifth month of contraction after a 30-month period of expansion. The New Orders Index remained in contraction territory at 45.7%, 1.4 percentage points higher than the figure of 44.3% recorded in March. The Production Index reading of 48.9% is a 1.1-percentage point increase compared to March’s figure of 47.8%. The Prices Index registered 53.2%, up 4 percentage points compared to the March figure of 49.2%. The Backlog of Orders Index registered 43.1%, 0.8 percentage point lower than the March reading of 43.9%. The Employment Index elevated into expansion territory, registering 50.2%, up 3.3 percentage points from March’s reading of 46.9%. The Supplier Deliveries Index figure of 44.6% is 0.2 percentage point lower than the 44.8% recorded in March; this is the index’s lowest reading since March 2009 (43.2%). The Inventories Index dropped 1.2 percentage points to 46.3%, lower than the March reading of 47.5%. The New Export Orders Index reading of 49.8% is 2.2 percentage points higher than March’s figure of 47.6%. The Imports Index remained in contraction territory, though just barely, at 49.9%, 2 percentage points above the 47.9% reported in March.

According to the U.S. Bureau of Labor Statistics (BLS), In April, the economy added 253k jobs ahead of the consensus estimate of 185k, although March’s report was revised lower from 236k to 165k. April’s gain continues to reflect a robust labor market. Private payrolls grew by 230k, also an improvement from last month’s downwardly revised gain of 123k. The unemployment rate decreased from 3.5% to 3.4%. The household survey used in the unemployment rate showed a gain of 139k jobs for April. The unemployment rate declined because in an unusual statistical outcome, the civilian labor force declined slightly in April. While the headline job gains look impressive relative to the consensus, employment has been trending down over the last six months, likely as a result of the Fed's efforts to slow the economy and tame inflation. Job gains continued in professional services at +43k, healthcare +40k, and leisure & hospitality, a beneficiary of the pandemic reopening, +31k.

April was another month of good news for workers, although not for the Fed, as average hourly earnings rose 0.5% for the month and 4.4% over the past year. While wages continue to lag inflation, employees have seen ongoing increases and have experienced declining prices over the last few months. The Fed raised rates on May 3 and indicated they would monitor incoming data, including employment and wages. April's wage numbers will not give them comfort, although the trend lower in employment will likely lessen the upward pressure on wages.

Overall, the April Jobs Report continues the complicated narrative for the U.S. economy with weakening activity but a robust labor market. Despite the strong headline and solid wage growth in this report, we believe there is enough evidence of a slowdown to permit the Fed to pause its rate hikes. Worries related to the banking industry and other rate-sensitive sectors should give the Fed reason to discount the strength in April's report as it prepares for its next meeting in June.

The U.S. personal savings rate was 5.1% in March, up from the February reading of 4.8%. Personal income increased $67.9 billion (0.3 percent) in March, according to estimates released today by the Bureau of Economic Analysis. Disposable personal income (DPI) increased $71.7 billion (0.4%) and personal consumption expenditures (PCE) increased $8.2 billion (less than 0.1%).

The $8.2 billion increase in current-dollar PCE in March reflected a $44.9 billion increase in spending for services that was partly offset by a $36.7 billion decrease in spending for goods. Within goods, the decrease was led by motor vehicles and parts and gasoline and other energy goods. Within services, the largest contributors to the increase were spending for housing and utilities and health care services.

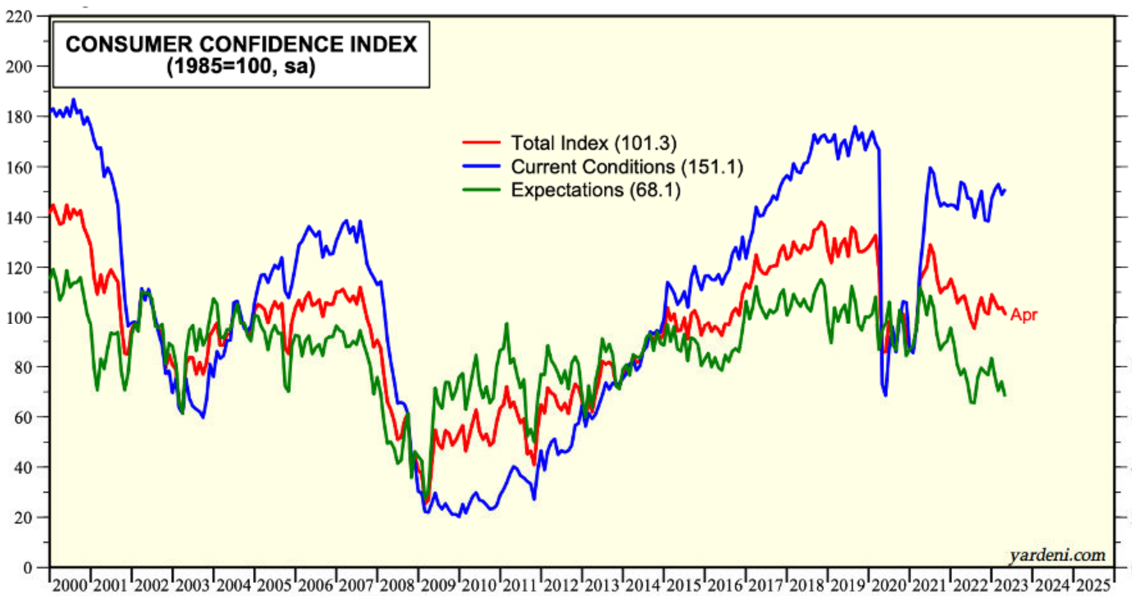
After a volatile March, the markets tiptoed through April hoping for some clarity about the impact of the banking crisis on the economy. The Fed raised rates by 25bps to 5.0%-5.25% at their May meeting. The statement was tweaked from "The Committee anticipates that some additional policy firming may be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2% over time." to "In determining the extent to which additional policy firming may be appropriate to return inflation to 2% over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial conditions." This softening language seemed to indicate a pause, but Chair Powell insisted that, "A decision on a pause was not made today" and suggested it could be made at the June meeting. The question now hanging over the Fed is the extent to which the banking crisis tightens financial conditions. While the current CPI and PCE have been trending lower, they remain well above the Fed's target of 2% and the job market continues to be strong. It would seem if the banking crisis is truly resolved and wages remain above the targeted inflation rate, then the Fed might be compelled to raise rates further and keep them elevated through the end of the year. Bond markets do not believe this is the most likely path for the Central Bank. On the contrary, bond markets believe the

Fed will be forced to cut rates by the fourth quarter of 2023, an expectation we feel is premature. The Fed's next meeting is on June 14. After their hike and statement yesterday, it is likely the Fed will monitor data on employment, wages, inflation, and the banking sector for a period of time. We believe the Fed will indeed end the rate hikes, although they will likely continue to pursue a restrictive policy by continuing their Quantitative Tightening (QT.)

Consumer Confidence fell in April to 101.3 down from 104.0 in March. Consumer Confidence most recently reached a peak of 128.9 in June 2021. According to a statement from the Conference Board, "While consumers' relatively favorable assessment of the current business environment improved somewhat in April, their expectations fell and remain below the level which often signals a recession looming in the short-term Consumers became more pessimistic about the outlook for both business conditions and labor markets. Compared to last month, fewer households expect business conditions to improve and more expect worsening of conditions in the next six months. They also expect fewer jobs to be available over the short term. April's decline in consumer confidence reflects particular deterioration in expectations for consumers under 55 years of age and for households earning $50,000 and over."

The Present Situation Index (based on consumers' assessment of current business and labor market conditions) increased to 151.1 from 148.9 in March. The Expectations Index (based on consumers' short-term outlook for income, business, and labor market conditions) fell to 68.1 from 74.0 in March. In 13 of the last 14 months, the Expectations Index has been below 80, the level which often signals a recession within the next year. According to information from the BEA, the consumer is responsible for approximately 70% of the U.S. economy.

Consumer Confidence (as of April 28, 2023)



Source: The Conference Board.

The Bloomberg U.S. Aggregate Bond Index had a total return of 0.61% for April building on impressive March performance. Year-to-date, the Index has a total return of 3.59%. The 10-year Treasury was relatively unchanged, ending the month at 3.42% lower by 5bps. On a duration adjusted basis, the 3-year and 5-year Treasuries were the best performing with the yields falling 7bps and 9bps respectively. The 2s10s yield curve was flatter by only 2bps during April, ending the month at -59bps. This contrasted with March where we saw a violent swing as a result of the Silicon Valley Bank (SVB) collapse. The corporate market outperformed during the month with the Index producing 18bps of excess return bringing year-to-date to a positive 40bps. Mortgage pass-thru securities (MBS) were not as lucky, earning -10bps for April building on already difficult year. Year-to-date, the MBS Index has a negative 60bps of excess return hampered by high volatility and now the systematic liquidation of Silicon Valley Bank MBS portfolio.

West Texas Intermediate (WTI) finished April at $74.87 (76.78) per barrel, decreasing 1.1% since ending March at $75.67per barrel. WTI has decreased 5.8% since the 2022 year-end price of $80.26 per barrel. WTI increased 6.7% in 2022 following a 58.9% increase in 2021. WTI peaked at over $129 per barrel in March 2022, retreated, and spiked to over $123 per barrel in July 2022. Turmoil from the invasion of Ukraine by Russia, the related sanctions, and increasing demand have been a significant factor in market volatility in 2022 and so far in 2023.

The Volatility Index (VIX) ended April at 15.78, decreasing 15.6% since the March month-end reading of 18.70. The VIX has decreased 27.18% since beginning 2023 at 21.67. The VIX's 2022 peak was 35.15 on March 7th. Movement in the VIX has been driven by market turbulence over inflation, increasing interest rates, recessionary fears and the war between Russia and Ukraine. The long-term average of the VIX is approximately 20.

We actively monitor the capital markets and are prepared to respond accordingly. As we have stated in the past, we continue to advise our clients to adhere to their long-term plans and objectives.

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S&P 500: is an unmanaged index of 500 common stocks primarily traded on the New York Stock Exchange, weighted by market capitalization. Index performance includes the reinvestment of dividends and capital gains.
Russell 2000: The Russell 2000 Index is a small-cap stock market index that makes up the smallest 2,000 stocks in the Russell 3000 Index.
Russell 1000: The Russell 1000 Index is a stock market index that tracks the highest-ranking 1,000 stocks in the Russell 3000 Index.
VIX: The VIX Index is a popular measure of the stock market's expectation of volatility based on S&P 500 index options.
Bloomberg US Aggregate Bond Index: The Bloomberg US Aggregate Bond Index, or the Agg, is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States.