## *Summary*

Economic data for the week included a revision higher for Q1 GDP, as well as reported gains in personal income, personal spending, and durable goods. New home sales also saw an increase, while jobless claims reset from recent unusual filing activity.

Global equity markets featured gains in the U.S., offset by declines in developed foreign markets. Bonds fell back as persistent inflation raised odds of another Fed rate hike. Commodities were mixed, with demand and supply conditions in energy seemingly in balance.

## *Economic Notes*

(0/+) The second edition of **U.S. GDP** for Q1-2023 was revised upward by a few tenths from 1.1% to 1.3%, a positive surprise compared to an expected no change. A small update higher in personal consumption, a lesser decline in inventories, and stronger state/local government spending all helped the final figure; offsetting was a deterioration in residential investment by a percent to a deeper decline of over -5%. PCE inflation for Q1 was revised higher by a non-meaningful few basis points.

The Atlanta Fed's GDPNow estimate for Q2 continues to show strength, although it fell back last week from 2.9% to 1.9%. This level of growth is certainly fighting back against ongoing 50/50 calls for a recession this year. It also remains well above the Blue Chip consensus median, which calls for a growth pace of just under 0.5% in the quarter (within a wide range of roughly -1.0% to +1.5%). It appears that residential investment has ceased being negative, which removes a headwind on growth, while net exports have deteriorated. Consumer spending remains strong, complemented by positive non-residential fixed investment, and inventories.

(0) **Personal income** for April rose 0.4%, about on par with the level expected, reflecting mixed underlying inputs but a half-percent drop in transfer receipts. **Personal spending** rose a stronger 0.8%, about double median expectations, with goods outperforming services, in contrast to recent trend toward the latter. For the trailing 12 months, income was up 5%, while spending rose 7% (with services twice that of goods)—keeping in mind that inflation has driven much of that growth. This pulled the savings rate back by a revised -0.4% to 4.1%. For inflation, the PCE price index rose 0.4% on both a headline and core level, a little higher than expected for the month. This brought the year-over-year changes to 4.4% and 4.7% on a headline and core level, respectively. These are slightly higher than the prior month, and another indication of inflation remaining sticky for now. These served to sustain higher Fed probabilities of another possible hike in June.

(+/0) **Durable goods** orders for April rose 1.1%, exceeding expectations that called for a decline of -1.0%. Removing the strong transports segment (from defense aircraft) pulled this down to a -0.2% decline, led by weakness in computers/electronics. On a core level, capital goods orders rose 1.4%, well above expectations for a slight decline. Core capital goods shipments rose 0.5%, above assumptions for little change. Overall durable goods orders are up 4% over the past year, while removing transportation orders takes the change down to flat, showing general lackluster results for this indicator.

(+) **New home sales** for April rose by 4.1% to a seasonally-adjusted annualized rate of 683k units, a tenth above the prior month, and exceeding expectations calling for a -2.6% drop. However, March sales were revised down by nearly -30k. For April, gains in the South exceeded declines in the Northeast and West. The April report included annual revisions to seasonal factors, which played a role in altering these results for the past several months. Nevertheless, sales are up 12% on a year-over-year basis, which happens to be the first gain for that timeframe in over a year. At the same time, median prices are down -8% year-over-year to $420,800. Inventory remains high at 7.6 months' sales, with that potential impact being muted by far lower inventory for existing homes.

(0) **Initial jobless claims** for the May 20 ending week rose by 4k to 229k, well below the median forecast of 245k. Continuing claims for the May 13 week fell by -5k to 1.794 mil., below consensus expectations of 1.800 mil. In a unique and dramatic twist in recent weeks, the very large batch of fraudulent claims in MA were removed from prior weeks' data, resulting in an adjustment for national statistics. This may play a role in relative comparisons over the next few weeks to months, potentially tempering their usefulness in the near-term.

(0) The **FOMC minutes** from the May meeting showed little new information, but did show a shift from prior meetings in that members had become less certain about ongoing policy tightening. This is far from language that would be seen as 'dovish,' but indicated a higher bar and rising chances for a pause in June. This reflects the committee's mixed opinions, with inflation still 'unacceptably high,' and slow to decelerate at a core level, in keeping with estimates for improvement pushed out. At the same time, growth is running at low enough levels to raise risks of a 'mild recession.' While confusing to market onlookers, this 'balance' of 'two-sided' risks is actually a reasonable place for the Fed to be, and would be appropriate for a pause, if upside and downside risks become balanced in their own right. A pause doesn't mean a hiking phase is over, as there are no rules against pausing for a meeting or series of meetings, and restarting one or more hikes later if needed. Markets generally want certainty about Fed movements, ideally with simple-to-interpret trends, but the persistence of inflation may not accommodate this simplicity.

***Market Notes***

| **Period ending 5/26/2023** | **1 Week %** | **YTD %** |
|---|---|---|
| DJIA | -0.97 | 0.70 |
| S&P 500 | 0.35 | 10.29 |
| NASDAQ | 2.52 | 24.43 |
| Russell 2000 | -0.02 | 1.26 |
| MSCI-EAFE | -2.29 | 8.80 |
| MSCI-EM | -0.42 | 2.52 |
| Bloomberg U.S. Aggregate | -0.67 | 1.20 |

| **U.S. Treasury Yields** | **3 Mo.** | **2 Yr.** | **5 Yr.** | **10 Yr.** | **30 Yr.** |
|---|---|---|---|---|---|
| 12/31/2022 | 4.42 | 4.41 | 3.99 | 3.88 | 3.97 |
| 5/19/2023 | 5.29 | 4.28 | 3.76 | 3.70 | 3.95 |
| 5/26/2023 | 5.34 | 4.54 | 3.92 | 3.80 | 3.96 |

U.S. stocks were mixed last week, led by technology (up nearly 5%, on the heels of a 25% rise in Nvidia), and a smaller gain in communications. All other sectors were down for the week, led by -3% drops in materials, staples, and health care. Real estate also fell back a percent.

During the weekend, a debt ceiling deal (lifting it into 2025) was reached, but is hinged on enough Congressional votes being gathered. The debate over the ceiling had continued through last week, with Treasury Secretary Yellen's warning of an early June deadline clearly in the minds of investors. (By Friday, Yellen had extended the original 'X-date' of June 1 to June 5.) The negotiation between the Democratic White House/Senate and Republican House began to ramp up to dominate market sentiment throughout the week, in contrast with fewer apparent concerns in preceding weeks. Despite several starts and stops, leaders have appeared to remain confident of a deal getting done, as technocrat staffers increasingly took charge of the details. In fact, President Biden's change in stance from 'no negotiation' to ultimately being open on including spending limits was the most dramatic example of how conditions had evolved. The final wild card is focused on the most conservative and progressive Congressional members, who remain steadfast to more stringent budget-reducing requirements and no negotiated changes, respectively. Debt ceiling aside, the two parties remain far apart on a host of other issues related to policy and spending, which points to few areas of common

ground until at least the 2024 election. It’s only the risk of financial catastrophe from a potential default that’s bringing them together now.

The strong earnings results and future expectations from Nvidia on Thurs. coincided with a mini-frenzy about the potential for artificial intelligence (AI), for which they’re a leader in hardware and software applications. This has helped push market sentiment for growth stocks higher. However, this could be more of a ‘fear of missing out’ than on tangible revenue-generating products, at least at this early stage, with some naysayers comparing this to the euphoria of the late 1990s when anything to do with the new concept of the internet saw rising interest. These pockets of strong sentiment have been a sporadic tendency for growth stock investors over the past decade, as strong fundamentals and still-attractive revenue growth potential have kept major stocks on the radar consistently. Expectations for a peak in yields this year along with atrocious performance for growth stocks in 2022 have also stoked interest. The drawback in several cases, though, is the higher valuations, at least relative to ‘value’ stocks, which remain discounted by a variety of metrics compared to long-term average comparatives.

Foreign stocks underperformed U.S. stocks on the week, although emerging markets outperformed developed with a flattish reading. European equities in particular lagged as economic indicators there have taken a negative turn. In fact, Germany was deemed to have fallen into at least a minor recession, with -0.3% Q1 growth following a Q4 -0.5% figure. At the same time, strong inflation continues to keep central bank policy hawkish in Europe and the UK for the foreseeable future, creating a dilemma. In EM, gains in India, South Korea, and Taiwan offset a sharp drop in China—which continues to experience concerns over weaker-than-expected economic reopening growth. The Chinese also placed a ban on the purchase of Micron Technology’s chip products, which continues the geopolitical tensions surrounding technology.

Bonds lost ground last week as interest rates ticked higher in keeping with sticky inflation results. Sentiment also soured a bit as investors digested mixed messages about a potential Fed rate hike in June. (Odds favored a pause after the May meeting, but have been drifting higher recently, now to about a 2/3 chance of another 0.25% move.) All bond groups were negative, with high yield and bank loans mildly outperforming longer duration treasuries, due to lower duration and higher coupons. Coinciding with debt ceiling stress were yields on T-Bills maturing in early June rising to over 7% briefly last week. Treasury yields have drifted higher generally over the past month, which appears largely due to lower recession risks and higher growth expectations, although the non-zero default probability related to the debt ceiling negotiations may also be playing a role. Developed market foreign debt fell over a percent along with a sharp rise in the dollar for the week.

Commodities were mixed, with gains in agriculture and energy offset by declines in metals. Crude oil rose over a percent on the week to just under $73/barrel (with Saudi Arabia hinting at production cuts), offset by a -10% drop in natural gas (due to a combination of weaker weather-related demand, and high inventories). Energy remains challenged year-to-date, with crude oil down -10% and natural gas down -45%, as concerns over weaker-than-expected economic growth have held down demand expectations. Storage levels in Europe remain high, which inspires confidence in the event of a potentially warmer summer and needs for next winter, albeit far off.

Have a good week.

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Sources: FocusPoint Solutions, American Association for Individual Investors (AAII), Associated Press, Barclays Capital, Bloomberg, Citigroup, Deutsche Bank, FactSet, Financial Times, First Trust, Goldman Sachs, Invesco, JPMorgan Asset Management, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, The Conference Board, Thomson Reuters, T. Rowe Price, Univ. of Michigan, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal, The Washington Post. Index performance is shown as total return, which includes dividends. Performance for the MSCI-EAFE and MSCI-EM indexes is quoted in U.S. Dollar investor terms.

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Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.