Week in Review

Equity Markets:

With the passage of the debt ceiling increase and the optimistic view of the labor market reports last week, the markets saw broad participation. The S&P 500 ended the week up 1.88% and the NASDAQ finished up 2%. A welcomed rotation to value and small caps also occurred last week. The Dow finished the week up 2% and small caps led the pack with a weekly return of 3.32%.

First quarter earnings are complete. The earnings decline for the quarter was 2.1%, much better than the 6.7% decline that was expected to start the quarter[1]. 78% of companies beat earnings expectations and 75% of companies beat revenue estimates. Now the focus has shifted to the next earnings season which will get into full swing in a couple of weeks. Estimates are calling for earnings to decline 5.4% in the second quarter[2].

Fixed Income Markets:

The debt ceiling saga is complete. The government avoided a US default after passing the bipartisan agreement. The 10-year Treasury yield dropped 10 basis points to finish the week yielding 3.7%.

The labor market reports were met with optimism and Fed Fund's Futures flipped, and now are pricing in a pause at the next FOMC meeting[3]. The futures market has a 75% probability of a pause, compared to the start of last week's 65% probability of another 25-basis point increase.

Economic:

The labor market remains on solid footing, but softness is starting to emerge. The economy added 339,000 jobs in May, nearly doubling economists' estimates[4]. The unemployment rate saw a small move upward to 3.7%. The unemployment rate remains near historic lows, but this is a positive improvement in the eyes of the Fed. The JOLTS report showed that job openings continue to decline, but still remain well above pre-pandemic levels. The labor market has been extremely strong over the last cycle. The tightening cycle the Fed embarked on last year will take time to chip away at the labor market, but so far this year the downward trend shows that policy actions are starting to have an impact.

Looking Ahead

Equity Markets:

Sentiment has made a shift from pessimism to slightly optimistic. With better-than-expected economic data, a debt-ceiling agreement, and market participants moving past the regional bank issues; the reversal is not surprising. We believe investors should remain disciplined and not allow the short-term noise to impact their decision-making. We expect volatility to return as the market works through a slowing economic environment, and what we anticipate to be a higher for longer rate environment. The VIX, which measures anticipated short-term volatility, hit a pre-pandemic low last week. That is likely to reverse and when it does, it will challenge investors.

As long-term investors, we believe when volatility is heightened, it can present opportunities to purchase indiscriminately sold assets at a discount. A systematic rebalancing program assists in taking the emotion out of the decision-making process. A thoughtfully developed long-term investment strategy coupled with a systematic rebalancing approach should allow investors to withstand short-term volatility.

Fixed Income Markets:

There is still some uncertainty in the fixed-income markets. This can be seen in the large swings in the Fed Fund's futures market. There has been some mixed messaging from Federal Reserve officials on the next potential move. But, one thing is clear, the Fed is not willing to commit to ending rate hikes. They still believe that they must keep a tight grip on inflation, which means cuts are unlikely unless we see a dramatic economic slowdown.

The actions from the Fed going forward will likely increase short-term volatility, but the material impact will be negligible in our opinion. There could be more rate hikes this year, likely to be small, but the majority of the work was completed last year. We believe that bond market sell-offs are positive for investors as these are likely to be short-lived and present long-term opportunities.

Economic:

The economic calendar will be light this week. The ISM Services PMI will be released Monday morning. On Wednesday, the Federal Reserve will release its consumer credit report. As credit conditions have become tighter this will be a timely view on the health of the consumer.

**** *See Important Disclosures on following page*

Sources:

1)FactSet
https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_060123.pdf

2) Refinitiv I/B/E/S
https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_060123.pdf

3)CME Group
https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html

4)CNBC
https://www.cnbc.com/2023/06/02/jobs-report-may-2023-.html