MONTHLY MARKET UPDATE

May 2023

OPAL WEALTH ADVISORS

Global financial markets dealt with shifting expectations for monetary policy, resurfacing of banking sector stress, debt ceiling anxiety, challenging corporate earnings, and mixed economic data during the month of May. Resilient labor markets, decelerating but sticky inflation, and a healthy consumer backdrop enabled the Fed to deliver a 25 bps hike to Fed Funds (5.0%-5.25%) on May 3rd but also served to shift market expectations of Fed rate cuts later this year, instead pricing in the possibilities of rate hikes over the coming months.

May began with a third high profile bank failure with First Republic Bank joining Signature and Silicon Valley on the list of 2023 FDIC seizures but sector stress seemed contained to these outliers as the month wore on based on limited Fed emergency facility utilization and an absence of glaring balance sheet issues. Another dramatic budget negotiation packaged as a debt ceiling debate came and went as we've seen before with a deal materializing at month-end before any U.S. creditworthiness issues surfaced. First quarter earnings season closed with U.S. and European markets in an earnings recession but notably beat heavily reduced forecasts in a highly 'managed' fashion.

U.S. and European economic data remained relatively healthy across service sectors but still in a contractionary state across manufacturing sectors with U.S. GDP registering a 1.3% growth rate following a 2.6% fourth quarter due in large part to a healthy consumer balance sheet backed by a cooling but still robust labor market. Meanwhile, China's Covid reopening momentum clearly slowed in May, disappointing investors who are beginning to see the need for a more pronounced policy response to stimulate growth.

The net result for financial markets was an extraordinarily thin global equity market where only the tech heavy cap weighted S&P 500 managed a slight gain of 0.43% while nearly all other equity indices lost ground including U.S. small caps (-0.92%), developed international (-4.23%) and emerging markets (-1.68%). Narrow breadth was the topic of the month supported by a remarkable 9.11% average rally across the 10 largest S&P 500 stocks contrasted with a 4.11% average decline across the other 490 stocks. Interest rates drifted higher across the curve due to a combination of Fed rate hikes, projected economic growth, and inflation pushing 2yr and 10yr UST yields back up to 4.40% and 3.64%, respectively. The 3m/10yr and 2yr/10yr yield curves remained very inverted while high-yield credit spreads expanded slightly from 4.53% to 4.69% in a slight uptick in credit risk pricing on the month. Rising U.S. interest rates and some marginal risk aversion magnified global interest rate differentials, translating to an abnormally large 2.56% return in the USD.

Market Anecdotes

- Q1 earnings season saw the S&P post blended earnings decline of -2.2% and revenue growth of 4.1%. Forward earnings estimates for Q2 (-6.4%), Q3 (0.7%), and Q4 (8.1%) see recovery eventually but not until year end.
- Much like Wall Street earnings forecasts, consensus economic forecasts too have been well below the mark as evidenced by the surging Bloomberg Economic Surprise Index.
- The Nasdaq is off to its best five-month start in history returning 31% on a total return basis. The next best instance was in 2003 when it returned 22% to start the year.
- Thankfully, the debt ceiling was suspended for a sixth time in a last minute budget negotiation compromise. Not thankfully, we have $30t in outstanding debt and zero political will on either side to address any actual material budget issues.
- Large caps record outperformance over small caps and U.S. outperformance over non-U.S. can be, at least partially, explained through an examination of sector weighting differences with growth stocks (NASDAQ) leading the way and more prevalent in U.S. markets.
- Large market cap growth stock outperformance and narrow breadth has led to index concentration issues and historically significant performance dispersion among cap weight versus Value Line and equal weighted indices.
- The latest IMF Global Financial Stability Report highlighted the stark difference between U.S.

and European bank stresses in terms of bond market-oriented balance sheet losses with exposure nearly 2x higher in the U.S. and losses as percentage of Tier 1 capital nearly 5x higher.

- NY Fed Household Debt and Credit Report showed credit growth slowing from 8.5% to 7.6% in Q1 with a deceleration in mortgages offsetting notable increases in credit card and HELOC debt while credit card delinquencies are beginning to turn higher.
- A Goldman Sachs look at corporate debt shows a move higher in default rates but ample runway when accounting for generationally low coupons, excluding floating rate bank loans.
- The combination of a slowing economy and substantially higher interest rates (debt service) has led to a notable increase in leveraged loan defaults.
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Economic Release Highlights

- The May Employment Report registered 339,000 jobs, well over consensus 190,000, but the unemployment rate rose to 3.7%. Participation Rate stayed at 62.6% while average hourly earnings were in line with consensus for both MoM (+0.3%) and YoY (4.3%).
- The PIO report showed higher than forecasted inflation for both headline and core readings (YoY 4.4%, 4.7%) (MoM 0.4%, 0.4%) and did increase slightly over the prior month. Personal Consumption Expenditures came in at 0.8%, well above the 0.4% forecast, and Personal Income (+0.4%) was in line with consensus.
- The JOLT Survey showed job openings increasing 3.67% to 10.10mm but down 14.05% from one year ago.
- May U.S. PMI readings of 54.5, 48.5, 55.1 (C, M, S) saw the manufacturing index fall short of consensus 50.0 while services exceeded the spot forecast of 52.6.
- May PMIs (C, M, S) for the U.K. (53.9, 46.9, 55.1) and Eurozone (53.3, 44.6, 55.9) were similar to the U.S. with composite and services strong but manufacturing falling short of estimates.
- Retail Sales were mixed versus forecasts with headline (0.4% vs 0.7%), ex-vehicles (0.4% vs 0.4%), and ex- vehicles & gas (0.7% vs 0.4%) but rebounded from prior declines.
- Industrial Production beat expectations (0.5% vs 0.0%) as did the reading on Manufacturing Output (1.0% vs 0.1%).
- The final May UofM Consumer Sentiment Index was revised higher to 59.2, well above the preliminary reading of 57.7 and final consensus estimate of 58.0.
- NFIB Small Business Optimism Index deteriorated slightly to 89.0, just below the 89.7 spot consensus and at the low end of the forecast range (89.0-90.0).
- The Housing Market Index registered 50, ahead of the spot forecast of 45 and the consensus range of 43-46. Starts of 1.401M and Permits of 1.416M were both within consensus range. The Case-Shiller Home Price Index rose 0.42% from the prior month and +0.63% YoY.
- New Home Sales increased 4.12% to 683k and sit 11.78% above prior year levels. Existing Home Sales declined 3.3% MoM to 4.28M. Pending Home Sales came in flat versus an estimate of 1.1% MoM growth.

Outlook

Will labor market slack appear quickly enough to tackle inflation before a recession ensues? Blue chip consensus forecast is for recession to begin on June 30th and persist for the remainder of the year. Our feeling is that while we are clearly late in the cycle, upside economic growth and restrictive monetary policy will persist over the near-term for longer than markets have been discounting. Monetary tightness, tight lending standards, and higher interest rates are just beginning to impact the economy and corporate fundamentals with signals in the labor market, leveraged loan market, commercial real estate, and clearly across small and mid-sized banking institutions.

We continue to see recession risks more prevalent toward the end of 2023 or first half 2024, with healthy consumer balance sheets/consumption, and a healthy service sector paving the way for some incremental economic growth but not necessarily smooth sailing for financial markets. We expect the start-stop conditions to continue favoring periodic tactical (0-6 months) asset allocation shifts anchored at a neutral to slight underweight equity allocation rather than a decided pro-growth or defensive investment posture. In other words, keep risk assets on a short leash.

We remain neutral on the growth/value style dimension, reflecting our view that we are nearing the end of an economic cycle and a general unwillingness to chase the technology/AI price action (acknowledging it may persist a while). From a geography perspective, we remain neutral U.S. to non-U.S. Recommended fixed income positioning is to remain short duration over our forecast horizon with the deeply inverted yield curve posing a tangible cost to extending duration at this time.

Equity	Level	1 Mo	3 Mo	YTD	1 Yr	3 Yr
Dow Jones	32908	(3.17)	1.39	0.25	1.96	11.27
NASDAQ	12935	5.93	13.19	24.06	8.04	11.74
S&P 500	4180	0.43	5.75	9.65	2.92	12.92
Russell 1000 Growth		4.56	12.81	20.76	9.55	12.85
Russell 1000 Value		(3.86)	(2.86)	(1.43)	(4.55)	11.63
Russell 2000		(0.92)	(7.35)	(0.04)	(4.68)	9.23
Russell 3000		0.39	4.17	8.74	2.03	12.25
MSCI EAFE		(4.10)	1.28	7.22	3.61	9.08
MSCI Emg Mkts		(1.65)	0.24	1.16	(8.07)	3.86
Fixed Income	**Δ Yield**	**1 Mo**	**3 Mo**	**YTD**	**1 Yr**	**3 Yr**
US Aggregate	2.49	0.10	0.18	0.09	0.75	0.20
High Yield	5.91	0.19	0.28	(0.15)	1.58	0.67
Municipal	1.91	0.08	0.14	0.04	0.28	0.02

Commodities	5/31/23	3/31/23	12/31/22	9/30/22
Oil (WTI)	72.14	75.68	80.16	79.91
Gold	1964.40	1979.70	1813.80	1671.80

Currencies	5/31/23	3/31/23	12/31/22	9/30/22
USD/Euro ($/€)	1.07	1.09	1.07	0.97
USD/GBP ($/£)	1.24	1.24	1.21	1.11
Yen/USD (¥/$)	139.78	132.75	131.81	144.71

Treasury Rates	5/31/23	3/31/23	12/31/22	9/30/22
3 Month	5.52	4.85	4.42	3.33
2 Year	4.40	4.06	4.41	4.22
5 Year	3.74	3.60	3.99	4.06
10 Year	3.64	3.48	3.88	3.83
30 Year	3.85	3.67	3.97	3.79

Style Returns

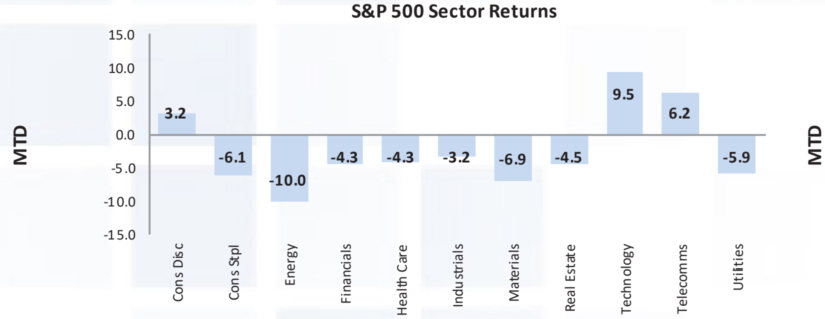
MTD

	V	B	G
L	-3.86	0.47	4.56
M	-4.44	-2.79	0.06
S	-1.97	-0.92	0.02

YTD

	V	B	G
L	-1.43	9.30	20.76
M	-3.17	0.61	7.62
S	-5.04	-0.04	4.86

S&P 500 Sector Returns



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