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ASSET MANAGEMENT GROUP, LLC

Economic Indicators | June 2023| By Kim W. Suchy

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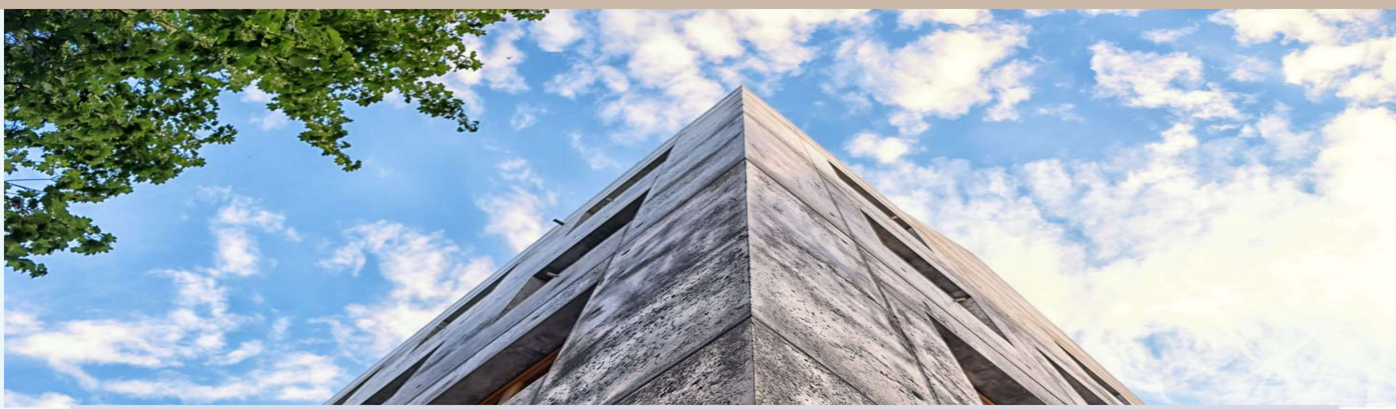

With the debt ceiling issue basically behind us, you must wonder what is next on the Wall Street pundit worry list. Certainly, a recession is the next culprit as the inverted yield curve wants to suggest. Recall that a yield curve inverts when long-term interest rates drop below short-term rates, indicating that investors are moving money away from short-term bonds and into long-term ones. This suggests that the market is becoming more pessimistic about the economic prospects for the near future.

The curve inverted late in 2022 and caused problems in the banking industry. A couple of months ago several big banks that catered to wealthy customers tried to capture better savings rates for their depositors. So, they bought longer term bonds which had better yields. Thus, when short and intermediate term bond yields started climbing, these banks were forced to sell their bonds at losses. Depositors were not made whole, they failed, and regulators took over the banks.

The Fed is aware of what harm an extended inversion can do. If bank depositors are paid more to buy their own Treasuries, banks lose their deposits and this shrinks the credit pool used to make loans; thus, credit tightens, and the economy slows. As, Neel Kashkari, President of the Fed Reserve Bank of Minneapolis emphasized, “an inverted yield curve naturally stresses the banking system”. So, we are on the lookout for the Treasury yield curve getting flatter and eventually un-inverting in the upcoming months.

The Fed meets June 13th to announce its latest tactic on rates. Many are calling for a pause in the recent series of hikes, but inflation remains stubborn, and the job market is robust so the jury is out on whether they will hike one more time or pause. A hike will do little to resolve the inversion issue and give the credit markets additional angst. A pause, on the other hand, gives the Fed time to assess vital economic reports to see if the lag in rate policy is taking effect. Our hunch is a hike would be disruptive for the financial markets. A pause could energize the markets as rates would stabilize and given the recent dip in energy and commodity prices, we may see a notable decline in inflation rates in the months to come.

It is important to remember that the Fed is an agile player, adapting its strategies based on the Treasury’s actions while contending with policy decisions and actions taken by OPEC. Consequently, the Fed’s actions during this pivotal period will impact the financial markets.

Here is your look at developments in the global marketplace.

POSITIVE DEVELOPMENTS

- The Q1 earnings season is complete and 74% have reported a positive revenues surprise, while 77% have reported an earnings beat. These are improvements over their Q4-2022 readings of 68% for both revenues and earnings.
  - Fact Set reports that of the 11 SP500 sectors, consumer discretionary stocks reported a 55% growth in earnings…the highest of all sectors.
- Industrial production came in better than expected in April as it increased 0.5%. The biggest contributor to the gain was auto output, climbing 9.3%, and the rest of the manufacturing sector gaining 0.3%. *Consumers are not giving us an indication that a recession is imminent*.
- New single-family home sales increased 4.1% in April, which exceeded expectations and sales are up 11.8% y/o/y. While sales have been on an upward trend recently and are now up 25.8% from the low in July of last year, they remain well below the pandemic highs of 2020. The median sales price of new homes has fallen by 15.3% from the peak late last year, which has helped sales activity begin to recover. Note, much of this may be the result of people fleeing high-cost rentals and purchasing smaller homes.

NEUTRAL DEVELOPMENTS

- Recently, Fed Chair Powell stated that monetary policy is “restrictive.” He also stated that the banking crisis is bound to tighten credit conditions, reducing the need for the Fed to get more restrictive in its policy stance. These comments suggest that the Fed may be close to pausing or ending its rate hike progression.
- Nick Timiraos noted in a 3/6 WSJ article that the next economic downturn has become the most awaited recession in recent U.S. history. It also keeps getting delayed. Recent robust hiring and consumer spending are the latest proof that the pandemic and the unprecedented policy actions that followed are disrupting the Feds efforts to curb inflation.
  - In short, Govt. stimulus measures left household and businesses in unusually strong shape which extends the lagged effect of Fed initiatives.
- Income and spending rose in April. Incomes rose 0.4% and are up 5.4% in the last year, led by gains in private-sector wages & salaries (+0.5% for the month and up 5.6% year-to-year). Those would be good numbers in a normal low-inflation environment, but inflation is eating up the wage increases.
- Durable goods rose 1.1% in April. However, most of the increase in orders was due to the typically volatile defense aircraft category, which jumped 5.5% in April after declines over the past two months.

NEGATIVE DEVELOPMENTS

- Existing home sales fell 3.4% in April as the housing market faces a host of crosswinds. First, mortgage rates that are now hovering near 7% is the primary. Second, assuming a 20% down payment, the rise in mortgage rates since the Fed began its tightening cycle in March 2022 amounts to a 27% increase in monthly payments on a new 30-year fixed mortgage for the median existing home.
- Retail sales rose 0.4% in April and are up 1.6% versus a year ago. On an inflation adjusted 'Real" retail sales, are down slightly from where they were two years ago and the expansionary monetary policy of 2020-21 has translated into higher inflation, which is why "real" retail sales are down over the past year.
- The People's Bank of China (PBOC) stands out among central banks as it is the only one that is injecting monetary policy stimulus. This tells us that China's economy is not performing well…couple this with a new Covid strain and issues could worsen. The PBOC's required reserve ratio for commercial banks has been lowered 3 times since the start of 2022.Over the past 12 mos. through April, bank loans have increased by a record $3.4T
- The S&P 500 reached a new high in 2023, driven by a surge in the value of its top five constituents: Apple, Microsoft, Amazon, Google and Facebook. These five companies accounted for more than 24% of the total market capitalization of the index, a level of concentration that has never been seen before. However, this impressive growth was not based on strong earnings or revenue growth, but rather on a massive expansion in valuation multiples. The average price-to-earnings ratio of the top five stocks was 49% higher than at the start of the year, and much higher than the average ratio of the rest of the index. This suggests that these stocks are very expensive relative to their fundamentals and may be vulnerable to a correction if investor expectations change.

THE MARKETS

The SP500 concluded the month of May with a modest 1.5% increase. As noted earlier, a concentration of 8 stocks carried the index higher, while overall market breadth was limited. Additionally, the positive sentiment surrounding a potential resolution in the debt ceiling issue prevented the market from experiencing significant downward pressure.

The Nasdaq recorded a significant gain of 7.1%, primarily attributed to the strong performance of AI related stocks. This propelled the tech-heavy index to a broad-based increase. Small cap stocks, as measured by the Russell 2000, also saw a modest uptick of 0.7%.

Sector-wise, technology, communication services, and consumer discretionary sectors emerged as the leaders last month. On the other hand, energy, utilities, and consumer staples sectors struggled to keep up, lagging their counterparts.

Across the pond, European markets experienced weakness in May, although they have still maintained positive YTD performance. Asian markets exhibited mixed results. China and Hong Kong reported negative returns, while Japan was broadly higher.

Overall, May showcased a mixed bag of market performance across different regions, sectors, and indices.

U.S Index	Last Month (% return)	YTD (%)
S&P 500	1.5	8.9
Dow Jones	-2.5	-0.7
NASDAQ Comp	7.1	23.6
Russell 2000	0 .7	-1.0

Source: https://tradingeconomics.com/stocks

Source: https://finviz.com/map.ashx

Map of the Month: May 2023 Market Breadth

The above map illustrates the May 2023 performance of all the components within the S&P 500. Each box's size corresponds to its market capitalization within the index. This visualization clearly indicates that mega-caps took the lead this month.

Throughout this year, the infamous eight mega-caps stocks (Apple, Microsoft, Amazon, Alphabet, Netflix, Nvidia, Tesla, and Meta) have been the most significant contributors to S&P 500 gains. As of May 26th, the S&P 500 has risen by 9.5% year-to-date. However, if you exclude these eight stocks from the S&P 500, the index will show a decline of -1.4%. This indicates that the breadth of the market is weak, with only a handful of stocks driving the index's outperformance.

Earlier this year as the banking crisis unfolded, investors turned their attention to the largest technology stocks due to their robust balance sheets, strong cash flow generation, and minimal reliance on borrowing from banks or capital markets. Additionally, Artificial Intelligence has stirred up quite a frenzy lately, inflating related stock prices as companies start guiding on further development of AI, sub-components, and earnings potential. The eight mega-cap stocks have become a preferred way to play the AI investment theme.

On May 24th, Nvidia reported Q1 earnings and provided guidance that surpassed analysts' estimates by a significant margin. As one of the leading and diversified players in AI, Nvidia guided for $11 billion in revenue for Q2, compared to the $7 billion expected by analysts. The strong quarter and guidance were viewed as an encouraging indicator of the robust demand for AI. In reaction to the earnings print, Nvidia's market cap soared over $200 billion overnight, and surpassed a $1 trillion market cap in the following days.

The collective market capitalization of the eight mega-cap stocks hit a low of $6.8 trillion earlier this year and has now risen 54.3% to $10.5 trillion on May 26th (just 15% below their 2021 record high). Currently, these stocks account for 26.4% of the S&P 500 Index and 47.5% of the S&P 500 Growth Index.

Of course, the recent rise in AI and subsequent stock performance has sparked contrasting views on the Street. Bears argue that stock prices have stretched too far ahead of earnings and are predicting an impending AI bubble. They point to elevated valuations, as the collective forward p/e ratio of the eight mega-caps has risen from 21.1 at the beginning of the year to 29.4 on May 26th. In comparison, excluding these eight stocks, the S&P 500 results in a forward p/e ratio of just 16.0. On the other hand, bulls are fully embracing the potential of AI and believe that stock prices will continue to rise, with valuations further expanding based on future earnings potential.

NEWS YOU CAN USE

The Eastern NBA finals witnessed an impressive turnaround as the Boston Celtics forced a Game 7 against the Miami Heat, despite falling 3 games to 0 to start the series. Throughout NBA playoff history, no team has ever overcome a 3-0 deficit to win a series (total record 0-151), and this year was no exception. In a dominant performance, the Heat trumped the Celtics in Game 7, securing their place in the finals. It's also worth noting that there have been just four teams in the NHL and one team in the MLB to defy the odds and overcome a 3-0 playoff series deficit throughout the history of both leagues.

https://en.wikipedia.org/wiki/List_of_teams_to_overcome_3%E2%80%930_series_deficits

Scientists made an intriguing discovery regarding a rare genetic mutation that may have protected a man from an inherited form of Alzheimer's. Typically, individuals with familial Alzheimer's begin experiencing signs of disease in their 40's. Remarkably, the male subject, who is now 67 years old, remains mentally healthy. He is only the second person to be found with such protection. In 2019, there was a report of a woman who was found with a different mutation, but that worked on the brain similarly, and had resisted the disease well into her 70's. Although only two mutation findings have been made thus far, scientists are enthusiastic about the potential insights both cases could offer in developing new treatments for all forms of Alzheimer's.

https://www.sciencenews.org/article/rare-mutation-alzheimers-gene

Legendary singer Tina Turner passed away this month, aged 83, leaving behind a remarkable legacy. Among numerous accolades throughout her music career, Tina recorded her solo hit "What's Love Got to Do With It" at age 44, making her the oldest female artist to have a No. 1 hit. In total, her solo works amassed more than 100 million record sales and she was the first female artist to be featured on the cover of Rolling Stone magazine. Tina is one of few to be inducted into the Rock and Roll Hall of Fame twice. Her first induction occurred in 1991 alongside her ex-husband and musical partner Ike Turner, and her second induction followed in 2021 as a solo artist.

https://www.reuters.com/world/singer-tina-turner-dies-aged-83-2023-05-24/

As always, if I can be of additional guidance, please feel free to call me at 312.485.6847.

Best regards,

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