Week in Review

Equity Markets:

The markets recovered from the small pullback that occurred the prior week. The S&P 500 ended the week up 1.36%. Large-cap growth significantly outperformed its value counterpart. The Russell 1000 Growth finished the week up 2.72% compared to the Russell 1000 Value Index ending down 0.82%[1]. Small caps also lagged the broader markets with the Russell 2000 finishing down 2.07%[1]. The lagging performance pulled the index's year-to-date down to 0.56%.

With only a few S&P 500 companies yet to report, this quarter's earnings results have come in much better than expected. 79% of companies have beaten earnings estimates and 61% exceeded revenue expectations[2]. The earnings beat rate exceeds both the 5 and 10-year averages[2]. At the beginning of the quarter, analysts expected to see earnings grow by 3.4%, as of Friday, the expected growth stood at 5.9%.

Fixed Income Markets:

The 10-year Treasury yield finished the week at 4.43%, down from the 4.51% close the week prior. However, the path for the week was not smooth. After closing Thursday at 4.28%, yields jumped 0.15% on Friday following the hot non-farm payroll report. The yield remains inverted as short and long-term rates have moved together. The inversion currently stands at -0.44%.

The 2's/10's inversion is the longest on record, but recently a less closely watched yield inversion, the 3-month Treasury Bill and the 10-Year Treasury has been inverted for 614 days, this marks the longest inversion since the inversion that started in 1928[3].

Economic:

Labor market reports highlighted the week's most important releases. The JOLTS report, which has a two-month lag, was released on Tuesday and showed that job openings fell more than expected in April. There were 8.059 million job openings which was a decrease of 296,000 from March. This equates to 1.24 job openings per unemployed person. This shows that the labor market continues to soften which saw a high of nearly two openings per unemployed worker at the peak. Private payrolls, which is a report released by ADP, also came in weaker than expected. According to the report, payrolls increased by 152,000, well below the 175,000 that was forecast. The headline report for the week, Non-Farm Payrolls, reversed the softening trend from the other reports and showed that the economy created 272,000 jobs last month, nearly 50% higher than the 185,000 that was expected. The unemployment rate hit 4%, the highest level since January 2022. The ISM Manufacturing PMI fell to 48.7 in May, down from 49.2 in April. The services sector remains resilient with the Services PMI recording 53.8, a significant improvement from the 49.4 reading in April.

Looking Ahead

Equity Markets:

Corporations have continued to navigate the higher rate environment and show their ability to keep healthy profit margins. The ability to control costs and expand margins has offset the impact of soft revenue growth. The recent rally has pushed the market multiple to 21.1x forward four-quarter earnings[4]. Our opinion remains that an elevated multiple is difficult to sustain and indicates very robust expectations. We believe key factors to meet these high expectations will be continued margin strength and little to no deterioration in the consumer. While not impossible, a breakdown in either of these will likely lead to market pullbacks to normalize multiples.

The divergence in market participation continues as we continue to see a small number of companies push the market higher. For a brief time, breadth improved but has again reverted to narrow leadership. Investors should continue to monitor their allocations to ensure over-concentration does not expose their portfolios to excess risk.

Fixed Income Market

Policymakers will meet on Tuesday and Wednesday to determine the next move in the fight against inflation. According to the Fed Fund's futures market, there is a 99.4% chance that the Fed will hold rates at the current level[5]. Market expectations have come back to align with the expectations policymakers set at the beginning of the year. At one point, the market had priced in a minimum of five rate cuts this year. We thought these expectations were too high and believe the recalibration of expectations should lead to a more stable interest rate market through the end of the year.

We believe that rates will stand rangebound between 4.3% and 4.75%. The Federal Reserve has made significant improvements in the inflation environment, but inflation has remained above the 2% target as the stickiness of certain data points has been difficult to battle. From a long-term perspective, our outlook on the fixed-income market remains positive as we believe secular deflationary factors persist.

Economic:

The Federal Reserve's Policy Meeting is not the only important event taking place. On the same day as Chairman Powell's press conference, last month's CPI report will be released. The expectations for the release are for an increase of 0.1% month-over-month which would be an improvement on the 0.3% increase in the previous report. PPI will be released on Thursday. The PPI has historically been a good leading indicator for the CPI. To close the week, the University of Michigan will release its preliminary results of the Consumer Sentiment Index.

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

Sources:

1)JP Morgan
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4) LSEG I/B/E/S
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5) CME Group
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