

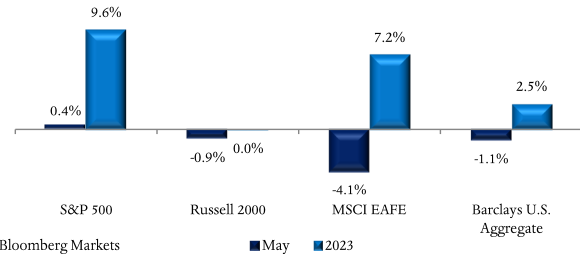


## MARKETS

Equity markets produced mixed results in May amid narrow breadth and wide divergences between sectors (featuring some big advances and some significant declines). Artificial Intelligence and its paradigm shift dominated headlines throughout the month. As a result, the tech-laden Nasdaq 100 Index gained 7.7% (+30.8% ytd), leading the growth factor to outperform value. The Russell 1000 Growth Index gained 4.6% for the month (+20.8% ytd), while the Russell 1000 Value Index lost -3.9% (-1.4% ytd). The bellwether S&P 500 index rose a more modest +0.4% (+9.6% ytd). However, some attention to breadth is appropriate given that seven of the top eight stocks in the S&P 500 by market cap are primarily responsible for the entirety of 2023's gains. Overseas, stocks were biased to the downside as seen by the MSCI EAFE index's decline of -4.1% in May (+7.3% ytd). The sole outlier was Japan's Nikkei 225 index which rose +7.0% during the month (+19.6% ytd) on the back of a resurgent economy and corporate reforms.

Bonds finished May with losses due to increases in yields across the curve. The Barclays US Aggregate index declined -1.1% during the month (+2.5% ytd). The US 10-year Treasury ended the period with a yield of 3.64% compared to 3.43% previously. This compares with the 2-year Treasury yield of 4.40% which highlights the inversion in the curve, typically a precursor to economic recession. After the Federal Reserve's interest rate hike, the market is pricing in roughly a 25% chance of an increase in June, tapering off thereafter.

Commodity markets also experienced weakness. The GSCI index dropped -6.5% in May, with all components of the index ending the month in negative territory (-13.4% ytd). Energy was the worst performing sub-sector with sharp falls in the price of natural gas and crude oil (the WTI benchmark declined -11.3% in May



Source: Bloomberg Markets

to \$68.09 per barrel, a figure that is approximately 40% below year ago levels). This performance is likely a reflection of lackluster global demand for goods and a weakening of commodity intensive activity in China.

## GEOPOLITICS

Politicians in Washington came together to defuse America's debt ceiling issue before the June 5 deadline. The legislation marked a moment of bipartisanship in a significantly divided political environment. House of Representative members produced a 314 vote supermajority, while the Senate voted 63-36 in favor of a deal that satisfied almost no one. Good faith negotiations allowed the Democrats to protect their priority programs from deeper cuts and the Republicans to garner concessions on spending. Both President Biden and House Speaker McCarthy (R-Calif.), and their followers, demonstrated their ability to overcome seemingly irreconcilable political differences to produce a bipartisan victory. It is, however, important to note that the debt ceiling has nothing to do with future spending, only with what previous Congresses have already spent or authorized to spend. The Congressional Budget Office projects a \$1.5 trillion annual federal budget deficit this year, a figure that is expected to steadily rise, reaching \$2.7 trillion in 2033. Measured in relation to the size of the economy, deficits are forecast to persist within a growing range of 6.0% to 6.9% of GDP over the next decade, well above the 50-year average of 3.6%.

## UNITED STATES

US inflation temporarily bounced in April, with headline and core CPI (consumer price index) both rising 5.0% and 5.5%, respectively, year-over-year. However, underlying data suggests this uptick is only a temporary pause on the road to lower inflation levels. Recent data highlighted stronger-than expected auto sales (+19.6%), housing starts (+2.2%) and employment numbers (+339,000 jobs added in May, with wages 4.3% higher), suggesting continued economic growth.

From a monetary policy perspective, the Federal Reserve has telegraphed that the central bank is at or near the end of its interest rate hiking policy. The Fed is now in a data dependent stance due to the short-term economic uncertainty. Assuming that the Fed Funds rate (circa 5%) is at or near its terminus, what will matter more going forward is the duration which it will rest at this elevated level. The significance of this is seen in the latest bank lending surveys which indicate a tightening of credit standards and a decline in borrowing demand.

## EUROPE

The German economy was not, after all, able to avoid a mild recession over the winter. The final reading for the country's Q4 2022 GDP fell -0.5% sequentially, followed by another decline of -0.3% in Q1 2023. General eurozone data also points to ongoing slowing momentum in the current quarter. The overall purchasing managers' index fell to 53.3% in May from 54.1% in April, indicating expansion, but the third month of deceleration, amid weakness in the manufacturing sector. Consumer confidence slightly improved versus the previous month but back-to-back monthly declines in car registrations pointed to continued weakness in goods demand, and a tepid economic outlook.

It was, thus, not surprising to see eurozone inflation ease in May, with the annual rate dropping to 6.1% from the prior month's 7.0%, representing the lowest level since February 2022. Prior to this deceleration,

## May 2023 Economic Statistics

	May-23	Dec-21	Dec-20
Federal Funds Target Rate	5.00 - 5.25%	0 - 0.25%	0 - 0.25%
Consumer Confidence Index	102.3	115.8	88.6
Manufacturing PMI Index	46.9%	58.7%	60.7%
Unemployment Rate	3.7%	3.9%	6.7%
JPY/USD	139.34	115.08	103.24
USD/EUR	1.0688	1.1368	1.2213
Gold/oz.	\$1,962.30	\$1,828.39	\$1,896.49
Oil (WTI)/bbl	\$68.09	\$75.21	\$48.52

Sources: see disclosure \*

the European Central Bank had delivered an expected 25 basis point interest increase, raising the deposit rate to 3.25%, and indicating that the transmission of past hikes into tighter monetary and financing conditions was having the desired effect. Futures markets now expect two further interest rate raises from the ECB, to a terminal deposit rate of 3.75%.

The UK's April inflation tumbled from 10.1% to 8.7%, showing solid progress towards moderation, but remains very high. More concerning was the acceleration of the core CPI component from 6.2% to 6.8%, the highest rate since March 1992. The Bank of England (BoE) voted to increase interest rates by 25 basis points to 4.5%, highlighting that "if there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required." In the aftermath, markets priced short-term rates peaking at 5.5%. The BoE also upwardly revised its forecasts for the economy after the UK's GDP grew by 0.1% in Q1 2023.

## ASIA

Post the end of zero-Covid policies and a strong first quarter, current Chinese macro data indicate a slowdown in economic activity. Most recently, imports dropped 7.9% and industrial production grew a less than expected 5.8% year-over-year. Notably, the figures are boosted by last year's depressed data, recorded during the Shanghai lockdown. Further, declines in the property market have accelerated, with real estate investments falling -6.2% from the prior year versus -5.8% in the previous month. Recent PBoC efforts to

improve liquidity have focused on increasing the quantity of money rather than the cost of funds, with the central bank cutting the Reserve Requirement Ratio, thereby increasing banks' ability to lend. The overall picture is indicative of an economy where domestic demand has yet to fully recover.

In Japan, first quarter GDP rose by 1.3% year-over-year, driven by strong private consumption and nonresidential investment. April CPI also accelerated further with the BoJ's key inflation measure, which excludes fresh food and energy, rising 4.1%, the most since 1981. Recent data points have given investors enthusiasm that Japan is on the way out of the deflationary stagnation of the past.

## OUTLOOK

Global job markets remain robust, as seen by recent unemployment data in the US (3.7%), eurozone (6.5%) and UK (3.9%), coupled with rising wages. In addition, global service-oriented business surveys stand at annual highs, indicating strong consumer demand. In contrast, manufacturing conditions are probing multi-year lows, signaling an industrial recession. Concurrently, central banks are in the midst of draining the financial system of liquidity.

This combination of factors leads us to characterize the economic outlook as opaque, worthy of keeping an open mind as to the path forward. Data points indicate the possibility of a soft economic landing, buoyed by a resilient labor market and strong wage growth, bolstering consumer sentiment. However, there is also the risk of a recession under the weight of stubbornly high inflation which the Federal Reserve is intent on snuffing out via high interest rates and tightening of monetary policy. The longer that short term interest rates stay high, the higher the probability of a recession.

US equity markets have been bifurcated in 2023, with growth stocks significantly outperforming their value oriented counterparties (featuring a 10% spread between the Russell's growth and value indexes). This is partly a reversal of last year's relative performance, as well as lower long-term interest rates benefitting growth stocks, and the

greater economic sensitivity of industrial and consumer related businesses. We have also witnessed an extreme degree of concentration of index returns, whereby the top 10 stocks in the S&P 500 index are responsible for 104.1% of the +9.6% ytd return (a significant outlier compared to the historical median of 23.6%). To illustrate, without the recent appreciation in these ten (mostly technology) constituents the S&P 500 would still be mired in a bear market, alongside the Russell 2000 index and most other stocks in the market. We therefore continue to recommend a cautious approach towards equity investing, with a focus on quality and an attention to valuation.

Fixed income markets, spanning risk-free sovereigns to bonds of various qualities, have transitioned to offering plentiful relative yields, a welcome relief for income oriented investors. This resulted from one of the fastest-ever string of central bank rate increases, coupled with a significant widening of credit spreads. We believe there is good value in short-term US Treasuries (offering 4-5% yields), for the following reasons. First, the debt ceiling issue has been resolved, with some modest spending reductions agreed upon. Second, the Fed has telegraphed that it will soon cease raising interest rates. Third, inflation has been trending down, with more deceleration to come. Fourth, banking deposit runs and failures appear to have subsided. Further, from a technical perspective, post lifting of the debt limit the US Treasury will need to issue an additional \$1.1 trillion of bonds in the near-term. Also the Fed continues with its \$95 billion per month of bond sales. All these data points reinforce why investors should continue to focus on short-dated maturities.

We have identified opportunities for investors to capitalize should a credit dislocation occur. Energy and agricultural related commodities stand to benefit from cyclical tailwinds stemming from underinvestment. Over the longer-term, we are seeking to benefit from disruptive trends in the defense, edu-tech and cybersecurity sectors. We would also point to the compelling characteristics of the growth companies in our Nordic Technology and Innovation Fund.

Important Disclosure and Terms of Use: Property of Papamarkou Wellner Asset Management, Inc. For targeted distribution only and not a solicitation. This report may not be displayed, reproduced, distributed, transmitted, or used to create derivative works in any form, in whole or portion, by any means without express written consent by Papamarkou Wellner Asset Management, Inc. or its broker dealer affiliate, Papamarkou Wellner & Co., Inc. MEMBER: FINRA/SIPC. All opinions expressed within unless otherwise stated are those of Papamarkou Wellner Asset Management, Inc. based on the most recent market, security, and economic data available.

\*Sources: Reuters, Bloomberg, Bureau of Labor Statistics, Conference Board, Federal Reserve, Institute for Supply Management, MSCI, Russell, Standard & Poor's, Financial Times and the Wall Street Journal.