Economic Commentary & Capital Market Update

Recap

U.S. economic growth decelerated to a 1.1% annual rate in the first quarter of 2023 as consumers faced high inflation, rising interest rates, and the onset of banking problems. The rise in U.S. Gross Domestic Product (GDP) in the year's first three months marked a slowdown from the inflation and seasonally adjusted 2.6% growth in the fourth quarter. Solid consumer spending drove the first-quarter increase, while a slowdown in business investment and a decline in housing investment offset growth.

The U.S. economy has been at an inflection point. Financial market conditions have generally stabilized over the last month after an initial tightening. It remains to be seen how recent developments in the banking sector could affect access to credit, although lending should stay tighter in the months ahead.

Data have shown some signs of economic slowdown. The goods sector has already corrected, and equipment spending should remain weak for the year. Consumer price inflation has remained stubbornly high but has shown signs of slowing. There have also been increased indications that the labor market would weaken from a very high starting point.

Beyond labor, there were growing signs of weakness elsewhere in the economy. Both ISM reports demonstrated an economic slowdown last month. The ISM manufacturing index gained some ground in April but is still in contraction territory and was consistent with a sector in correction for six straight months. At the same time, the services report, which fell slightly, called the sector's resilience into question.

The full effects of the Fed's interest rate hikes and tighter credit conditions will likely be realized later this year, setting the stage for weaker economic growth in the months ahead. Stricter bank lending prompted by the recent failure of multiple midsize American banks will also slow U.S. economic growth. U.S. banks' lending capacity will likely decline by 1% this year due to the fall in the value of many bank stocks as investors reassess the health of mid-sized banks. That reduction in lending should shave about 0.5 percentage points off U.S. GDP in 2023.

Because regional and smaller banks in the United States have accounted

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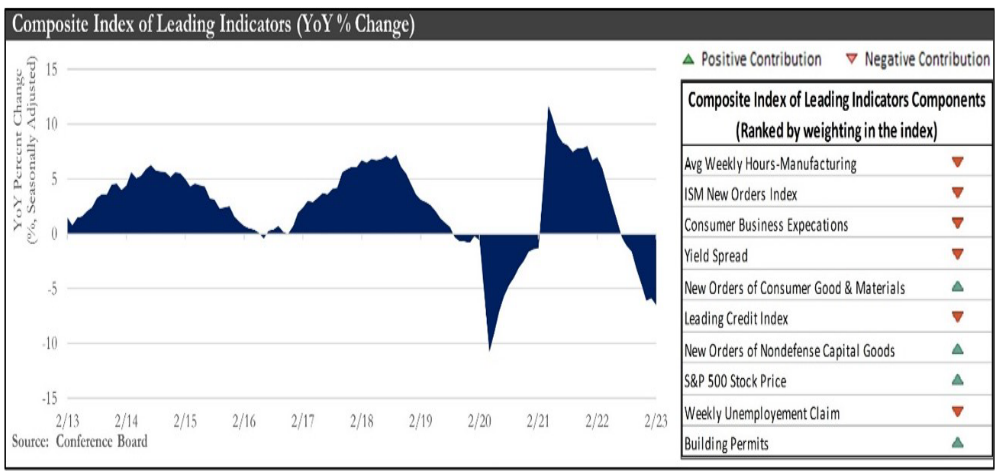
for more than one-third of total bank lending, a reduction in credit availability could have a material impact on economic growth and financial stability.

A mild recession in the year's second half remains likely. Early signs of labor market softening are one reason to believe that May's interest rate hike will be the last. Jobless claims ticked up to 245,000 in April. Although still lower than pre-COVID norms, this upside surprise has shown a clear upward trend in layoffs since the start of the year. A 12-month slide in the Leading Economic Index (LEI) supports the view that the economy could fall into recession in the year's second half. The LEI dropped 1.2% in March, its sharpest monthly decline since April 2020. March's decline was widespread, reflecting a weakening manufacturing sector, souring consumer sentiment, and building permit downshifts.



Real GDP Growth

Real GDP expanded by 1.1% quarter-over-quarter (annualized) in the first quarter of 2023 – a marked deceleration from last quarter's 2.6%. A significant negative inventory swing offset strength in consumer spending in the first quarter.

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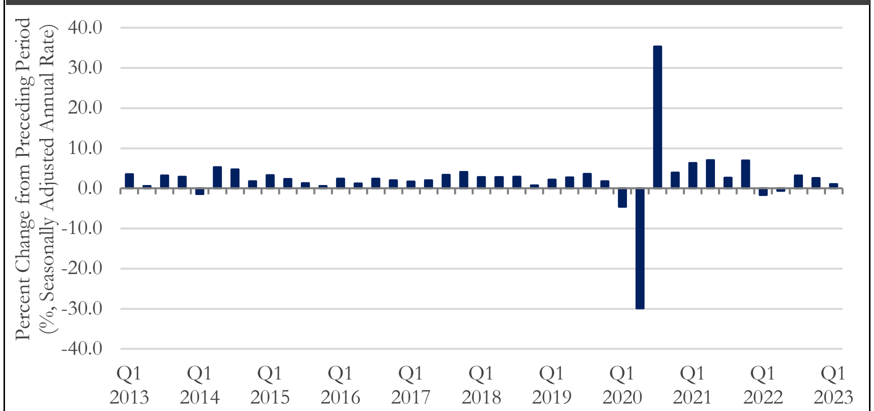
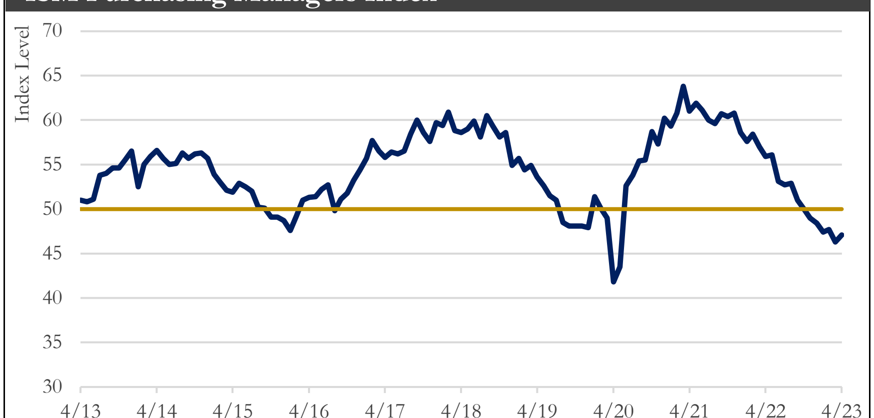
Real GDP Growth: U.S.



Source: U.S. Bureau of Economic Analysis

Much of the strength on the domestic front resulted from a solid reading on consumer spending. A sturdy labor market, alongside some easing in inflationary pressures, has helped to support real household incomes and sustain a robust pace of consumer spending.

ISM Purchasing Managers Index



Source: Institute for Supply Management

But there has been some evidence of cooling in the labor market. At the same time, other higher-frequency data points have indicated a further softening in economic activity heading into the second quarter. These pressures should intensify over the coming months as the cumulative impact of higher interest rates and some tightening in bank lending standards exert a more significant drag on domestic demand, pushing growth to a near-stall speed as early as Q2.

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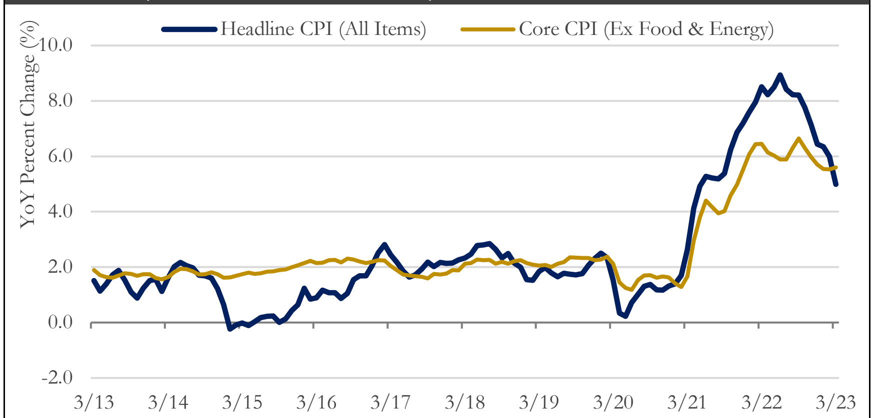
Inflation

Consumer prices in March rose by the smallest amount in nine months thanks to a decline in energy costs and flat food prices. But inflation has continued to run well above the Fed's target, with the core CPI advancing 0.4% and remaining above 5% when measured on a three-month annualized basis.

Inflation (Consumer Price Index)



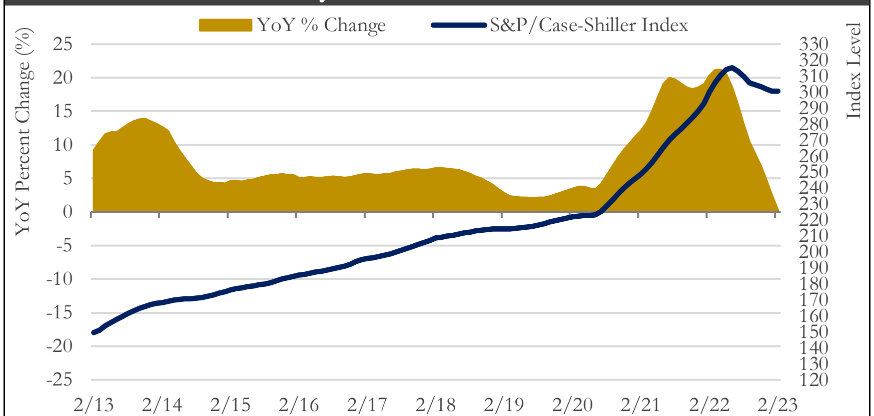
Source: U.S Bureau of Labor Statistics

There have been forward-looking signs suggesting inflation will slow further in the coming months. Lower commodity prices, replenished inventories, and higher financing costs should help goods inflation ease further. Meanwhile, the pullback in the housing market has finally translated into slower shelter price growth. More generally, weaker demand for and greater labor supply has helped to reduce wage pressures. At the same time, deteriorating consumer finances have made it more difficult for businesses to pass on higher prices. However, with inflation —particularly in the service sector — continuing to carry strong momentum, a sustained return to 2% could remain a long way off.

Housing Market

A batch of housing data has confirmed that a full-fledged housing market recovery is still far off. Existing home sales fell by 2.4% month-over-month in March, pulling back from February’s revised 13.8% month-over-month increase. Month-to-month changes have mirrored the volatility in mortgage rates as elevated prices have increased buyers' reliance on financing conditions. While median home prices declined for a third consecutive month relative to year-ago levels, the seasonally adjusted change between March and April would point to low inventory levels. The upturn in mortgage rates has been a factor in keeping resale inventory low, as rising financing costs have discouraged homeowners from putting their houses on the market. However, new home construction has picked up, with single-family housing starts recovering for a second consecutive month in March after eleven straight months of declines.

S&P Case-Shiller 20-City Home Price Index



Source: S&P / Case-Shiller

Labor Market

Over the past month, data has delivered a more consistent message that the jobs market is cooling. Nonfarm payrolls in March rose by the smallest amount in more than two years; job openings lurched lower and annual revisions showed initial jobless claims on a clear upward trend in the past two months. Balance in the jobs market has improved not only through weaker demand but improving supply. The labor force participation rate rose for a fourth consecutive month in March, with the increasing pool of workers helping to soften the recent wage growth trend. The ratio of job openings to the unemployed also eased to 1.7. Both are nowhere near levels to suggest job losses are approaching, but the movement has captured an easing in demand for workers.

In an absolute sense, the labor market has remained strong. Hiring is still well above the last cycle's average, while the unemployment rate dipped to 3.5% last month. However, with the full effect of the Fed's tightening yet to be felt and corporate profits coming under increasing pressure, material weakening could be likely as the year progresses.

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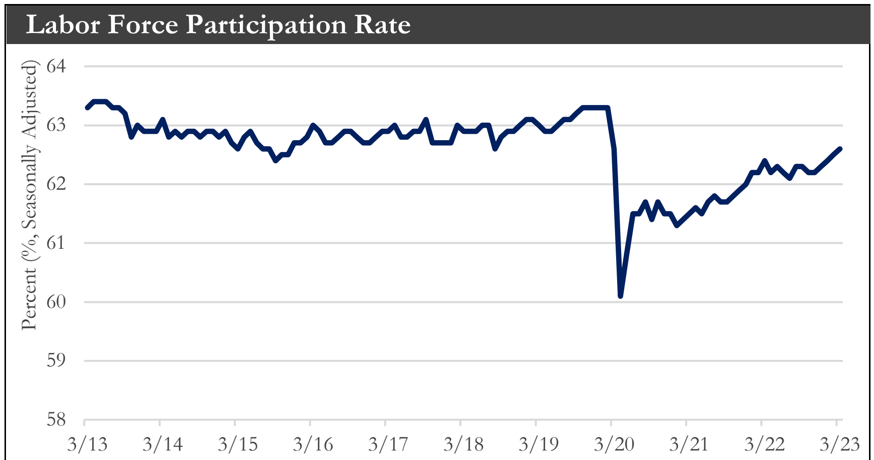
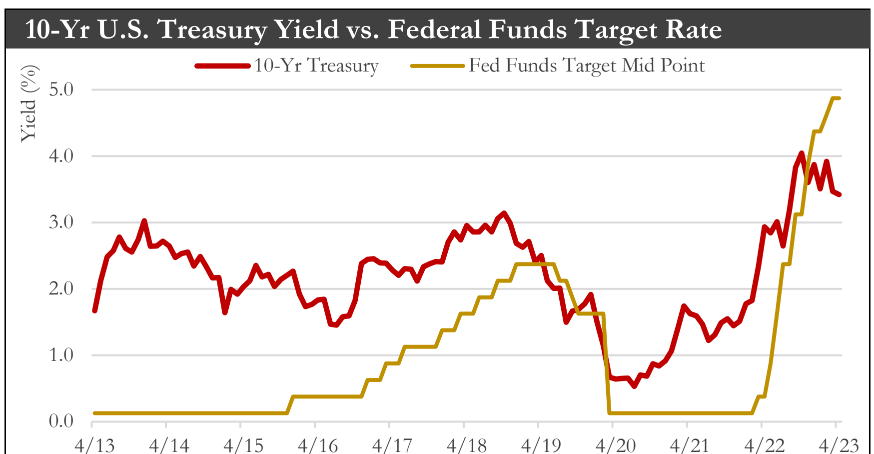


Source: U.S. Bureau of Labor Statistics

Monetary Policy

The Federal Reserve could be in the final stage of its current tightening cycle. Recent data causes the Federal Open Market Committee (FOMC) to elect to hike its federal funds rate one more time by 25 bps at its recent policy meeting on May 3rd. But since growth has already shown signs of slowing, the Fed will likely keep rates at a range of 5.00%-5.25% as it assesses the lagged effects of how tightening has translated to the real economy.



Source: Federal Reserve, Bloomberg

If, as expected, economic growth should start to slow later this year, the FOMC may well begin to ease policy. The Committee would likely bring rates back down to a range of 2.25%-2.50% over the course of 2024 to return to a more neutral policy level, with inflation running slightly higher than an expected 2% by then.

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Outlook

The U.S. economy has continued to expand, albeit relatively sluggishly. Consumer spending, the primary driver of growth, and hiring were surprisingly strong at the start of 2023. Still, they more recently slowed as the Federal Reserve has continued raising interest rates to cool the economy and curb rapid price increases.

Consumers cut retail spending in February and March. Home sales and manufacturing output dropped in March, and robust hiring growth eased.

Fed tightening in May should exert further headwinds on the economy. Additionally, the cash stockpiles consumers have accumulated over the past few years are gradually being eroded. Real personal consumption expenditures will likely decelerate in the coming months, lowering headline GDP growth.

Growth could average about 1.3% in 2023 and just 1.0% in 2024. Weaker economic growth should soon begin to weigh on hiring intentions – putting upward pressure on the unemployment rate. The unemployment rate should rise by more than one percentage point between Q1-2023 and Q4-2024, reaching a peak of 4.5%-5.0%, before gradually moving back to its long-run average of 4%.

Inflation has slowed from its multi-decade highs, though more recent data has shown some stalling in the disinflation process. The fed funds rate could reach 5.25% in Q2-2023 and remain at that level through the fourth quarter of 2023. As higher rates cool demand-side pressures and inflation moves meaningfully back towards 2%, the Fed will be able to cut interest rates back to a level more consistent with its neutral (2.5%) rate.

Sources: Department of Commerce, Department of Labor, Bloomberg, Peoples Bank of China, Eurostat, Institute for Supply Management, National Association of Realtors

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Index Performance as of: 4/30/2023

	1 Month	3 Month	YTD	1 Year	3 Year	5 Year	10 Year
Russell							
Russell 3000 Value	1.28	-3.08	2.19	0.62	14.42	7.45	8.96
Russell 3000	1.07	1.33	8.31	1.47	14.05	10.58	11.65
Russell 3000 Growth	0.86	5.90	14.83	2.24	13.23	13.12	14.03
Russell 1000 Value	1.51	-2.54	2.51	1.17	14.35	7.72	9.11
Russell 1000	1.24	1.95	8.78	1.79	14.20	11.05	11.94
Russell 1000 Growth	0.99	6.61	15.49	2.33	13.61	13.79	14.45
Russell Midcap Value	0.01	-6.26	1.31	-3.51	15.72	6.40	8.66
Russell Midcap	-0.53	-4.44	3.49	-1.71	13.76	7.95	9.84
Russell Midcap Growth	-1.45	-1.08	7.55	1.61	9.21	8.96	10.83
Russell 2000 Value	-2.49	-11.59	-3.15	-8.02	15.40	3.63	6.93
Russell 2000	-1.80	-8.08	0.88	-3.68	11.87	4.12	7.86
Russell 2000 Growth	-1.16	-4.65	4.84	0.69	7.79	3.97	8.41
Standard & Poors							
S&P 500	1.56	2.71	9.16	2.64	14.50	11.42	12.18
Consumer Discretionary	-0.95	-0.06	14.95	-8.54	7.26	7.97	11.68
Consumer Staples	3.60	5.39	4.45	2.24	13.51	12.39	9.67
Energy Sector	3.30	-4.25	-1.56	18.97	37.39	8.21	4.83
Financials Sector	3.18	-8.82	-2.56	-1.86	15.69	6.09	10.31
Health Care Sector	3.07	0.51	-1.37	4.17	12.05	12.22	12.89
Industrials Sector	-1.18	-1.42	2.24	7.00	17.88	8.76	11.11
Information Technology	0.45	11.94	22.37	8.08	19.28	19.71	20.07
Materials Sector	-0.14	-4.44	4.14	-3.03	18.12	9.53	9.65
Real Estate Sector	0.97	-6.40	2.86	-15.98	7.06	7.71	5.53
Communication Services	3.78	9.21	25.05	1.14	6.12	7.43	4.95
Utilities Sector	1.87	0.57	-1.44	-0.21	9.87	9.54	8.94
Other U.S. Equity							
Dow Jones Industrial Avg.	2.57	0.58	3.53	5.64	14.19	9.49	11.20
NASDAQ 100 Stock	0.52	9.70	21.40	3.99	14.66	15.97	17.70
International Equity - Broad Market							
MSCI EAFE NR	2.82	3.17	11.53	8.42	11.68	3.63	4.76
MSCI Emerging Mkts NR	-1.13	-4.74	2.78	-6.51	4.33	-1.04	1.80
MSCI Frontier Markets NR	0.51	-0.84	3.62	-14.82	5.76	-2.13	2.42
MSCI ACWI NR	1.44	1.57	8.85	2.06	12.04	7.03	7.90
MSCI ACWI ex USA NR	1.74	0.57	8.72	3.05	9.74	2.50	3.97
MSCI AC Asia ex Japan NR	-2.08	-5.58	2.17	-5.94	3.21	-0.49	3.65
International Equity - Country Region							
MSCI Brazil NR	3.40	-6.38	0.12	-2.55	13.37	-2.29	-1.83
MSCI BRIC NR	-1.94	-7.74	-1.11	-5.74	-1.53	-3.17	1.28
MSCI China NR	-5.16	-11.16	-0.69	-5.80	-6.27	-5.01	2.71
MSCI Europe NR	2.50	4.24	11.32	7.06	14.05	6.53	7.22
MSCI India NR	4.17	0.56	-2.45	-6.95	17.87	6.15	7.00
MSCI Japan NR	0.37	0.34	6.58	4.30	5.66	1.21	4.18
MSCI EM Latin Amer NR	2.69	-2.87	6.72	4.97	16.79	-1.07	-1.57
Fixed Income							
Bloomberg US Agg TR	0.61	0.49	3.59	-0.43	-3.15	1.18	1.32
Bloomberg U.S. T-Bills	0.38	1.14	1.48	2.97	1.04	1.43	0.87
Bloomberg US Govt	0.53	1.02	3.53	-0.89	-4.16	1.03	0.88
Bloomberg US Credit	0.79	0.43	4.26	0.72	-1.92	1.88	2.08
Bloomberg US Corp HY	1.00	0.77	4.60	1.22	4.71	3.28	4.01
Bloomberg Municipal	-0.23	-0.32	2.54	2.87	0.70	2.06	2.25
Bloomberg US TIPS	0.11	1.59	3.45	-4.00	0.86	2.98	1.41
Bloomberg Global-Agg	0.44	0.17	3.46	-2.31	-3.91	-0.93	-0.03
Bloomberg Gbl Agg ex-USD	0.29	-0.12	3.35	-3.90	-4.68	-2.67	-1.13
Bloomberg EM USD Agg	0.39	-0.63	2.55	0.06	-0.66	0.59	1.91
Alternative Investments							
Alerian MLP	1.65	-0.75	5.74	16.45	28.99	5.94	0.56
Bloomberg Commodity	-0.75	-5.61	-6.07	-16.60	21.14	4.66	-1.51
FTSE Nareit Equity REITs	0.83	-6.44	3.54	-14.80	9.44	5.90	5.37
S&P Global Nat Res	-0.21	-6.68	0.36	-0.89	22.25	6.73	5.22
S&P N.Amer Nat Res	1.78	-5.77	-1.07	5.87	28.28	6.61	3.57