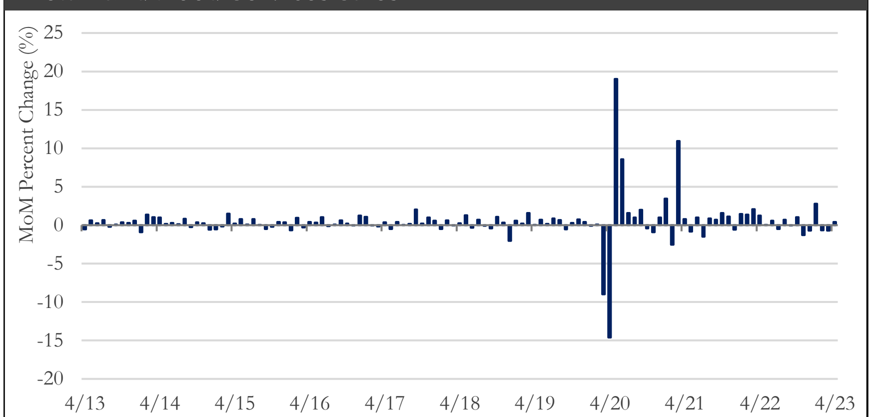
Economic Commentary & Capital Market Update

Recap

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

Recent data has added to a mixed picture of economic activity. U.S. growth cooled in the first quarter, and home prices fell in more parts of the country than in over a decade. But a solid labor market last month kept wage growth elevated while headline inflation cooled to its slowest pace in two years.

Retail and Food Services Sales



Source: U.S. Bureau of the Census

Americans increased retail spending modestly in April as easing inflation returned some purchasing power to shoppers. Seasonally adjusted retail sales rose in April compared with March, the first increase in sales since January. The goods sector has corrected, and equipment spending should remain weak for the year. There have also been increased indications that the labor market is weakening, though from a very high starting point, and consumer price inflation has remained stubbornly high yet showing signs of slowing.

Beyond labor, there have been growing signs of weakness elsewhere in the economy. Both ISM reports demonstrated an economic slowdown last month. The ISM manufacturing index slid to its lowest level since 2020

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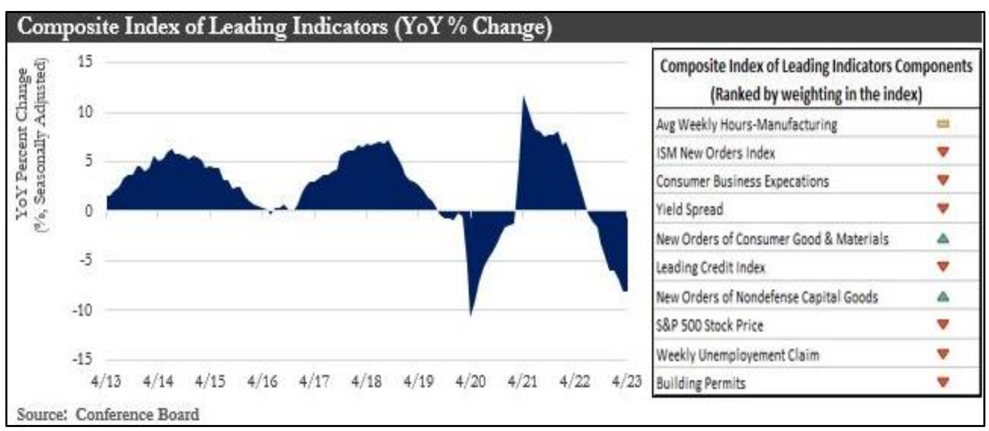
and has been consistent with a sector now in correction for five straight months. At the same time, the services index report called service sector resilience into question.

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 two midsize American banks will also likely slow U.S. economic growth.

The onset of a mild recession in the year's second half remains the most likely outcome. Early signs of labor market softening have been 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 will fall into recession in the year's second half. The LEI dropped 1.2% in March, its sharpest monthly decline since April 2020. The decline was widespread, reflecting a weakening manufacturing sector, a souring consumer sentiment, and a building permits downshift.



Inflation

Inflation has cooled from its recent peak but has remained stubbornly elevated. The Consumer Price Index (CPI) increased 0.4% in April from March. The 12-month change slipped to 4.9% – down from 5.0% in March.

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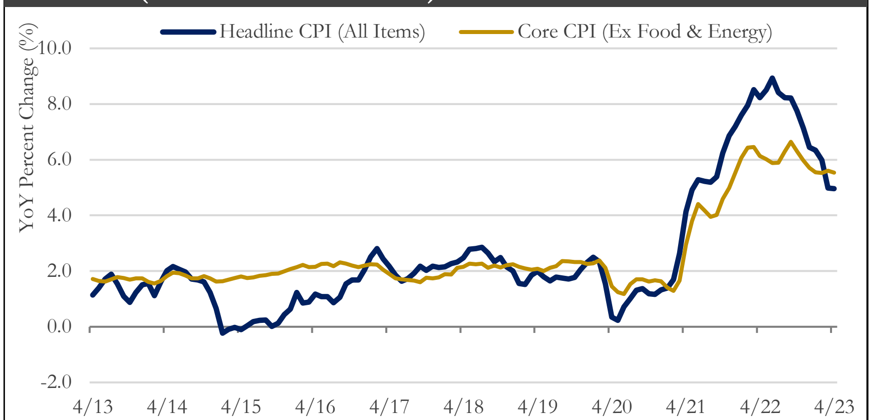
Core inflation (excludes food & energy) was up 0.4% in April from March. Compared to last April, core inflation has remained elevated at 5.5%.



Source: U.S Bureau of Labor Statistics

There were some encouraging signs in last month's CPI numbers. The continued deceleration in shelter costs suggested that some passthrough from last year's pullback in rental rates has occurred, which should continue for the next several months. Meanwhile, price growth across non-housing services decelerated to its slowest month-on-month pace of change in nearly two years. That said, goods prices have accelerated for a second consecutive month and have become a source of inflationary pressure again.

Debt Ceiling

President Joe Biden and Speaker Kevin McCarthy struck an eleventh-hour agreement to suspend the debt ceiling through year-end 2024. The deal has passed Congress. The debt ceiling budget drama should now subside until after the 2024 election.

This debt-ceiling agreement would suspend the two-year borrowing limit and curb government spending during that time. It would cut spending on domestic priorities while boosting military spending. It would also extend limits on food assistance to some beneficiaries to prod them to find jobs and would speed up environmental reviews for energy projects.

Setting aside the specific changes, this bill has marked a critical inflection point in federal fiscal policy. The past several years have been marked by

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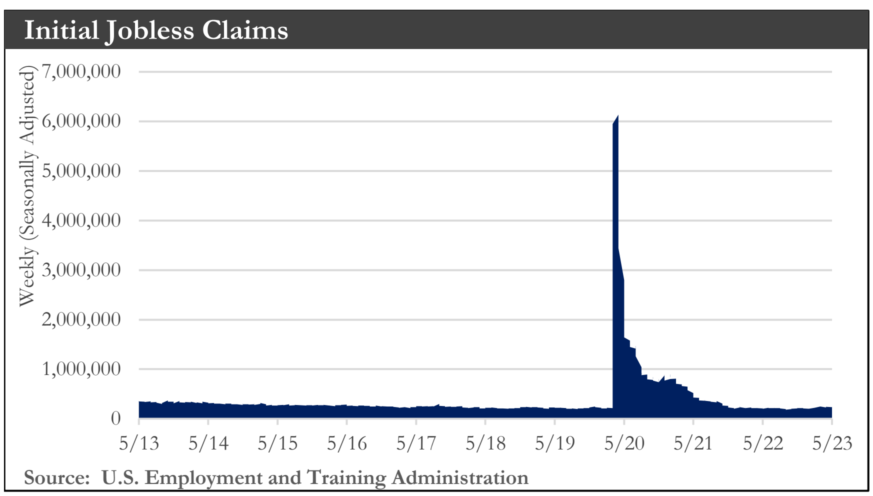
highly accommodative federal fiscal policy. This era may end as the federal fiscal policy shifts to a more neutral stance.

The next president and Congress will face a long list of fiscal policy items to address in 2025. These would include another debt ceiling increase, new discretionary spending levels, the expiration of significant parts of the 2017 Tax Cuts and Jobs Act, and the expiration of more generous subsidies for purchasing health insurance under the Affordable Care Act. Major fiscal policy shifts might follow a potential lull in the federal fiscal policy action over the next 18 months after the 2024 presidential election.

Labor Market

Employers added 253,000 jobs in April as the U.S. economy faced banking turmoil, rising interest rates, and still-high inflation. The unemployment rate fell to 3.4%. The jobs market remained on solid ground, but cracks are emerging. Each month, the tailwinds from efforts to re-staff post-lockdowns have weakened, while the hiring headwinds from tighter monetary policy have strengthened. Jobless claims have ticked higher, job openings have rapidly declined, and temporary help employment fell again in April, with the latter being a valuable indicator of labor demand growth on the margin. Job growth should slow more meaningfully in the second half of the year and into 2024 as the lagged effect of monetary policy tightening bites.



Housing Market

Residential investment remained a growth detractor for the eighth consecutive quarter, but its negative impact moderated noticeably.

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Residential investment should be less of a drag this year, a message echoed by some moderate positive signals out of the housing market. New home sales, a volatile series of data points, have continued to trend up since the end of last year. Tight supply conditions in the existing home market looked to be driving more action toward the new home market.

With housing affordability still exceptionally low, buyers have shown increased sensitivity to mortgage rates. The stress in regional banking has also contributed to the hesitation among buyers to sign housing contracts.

Monetary Policy

The Fed increased rates by another quarter-point and signaled it could be done tightening, as the Fed ended guidance that had pointed to further increases. The decision marked the Fed's tenth consecutive rate increase aimed at battling inflation and will bring its benchmark federal funds rate to a range between 5% and 5.25%, a 16-year high.

With the Fed dropping its language on the need for more hikes, it signaled that it is moving to a meeting-by-meeting approach. This posture would leave its options open in the future. At this point, it would be too early to say if there will be another hike, particularly given the uncertainties surrounding the recent tightening in lending standards and its potential effects on the real economy. The Fed should remain on hold through the summer, and rate cuts could potentially start at the end of 2023 or the beginning of 2024.

The U.S. Dollar

The dollar has fallen about 8.6% from a peak in September and has experienced its worst start to the year since 2018. The U.S. currency has further to fall as the Federal Reserve nears the end of its most aggressive program of interest rate increases since the 1980s. Also weighing on the dollar have been concerns over the banking system, the potential U.S. debt default, and expectations the U.S. could slip into recession in the coming months.

The Fed delivered a quarter-point rate increase in May and could lower borrowing costs by the end of the year by at least a quarter point.

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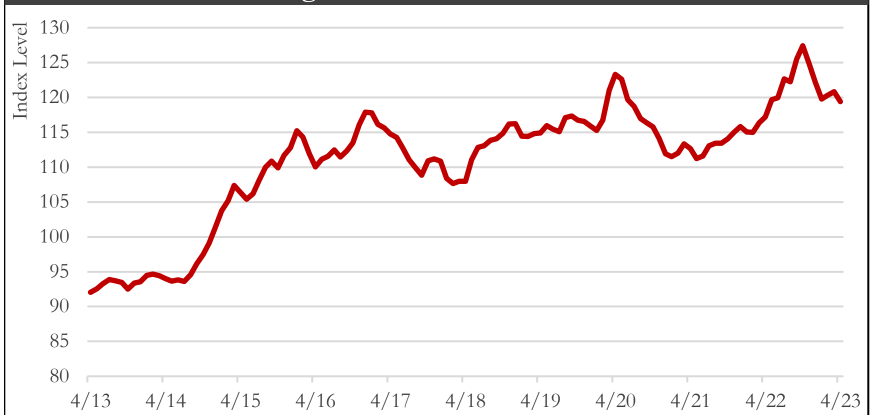

Source: Board of Governors of the Federal Reserve System

Meanwhile, the European Central Bank and the Bank of England could raise their key rates by over half a percentage point by year-end. That divergence should help currencies such as the euro and the British pound to keep gaining against the dollar.

Outlook

The U.S. economy has shown new signs of cooling, with a reading of supplier inflation moderating and applications for unemployment benefits rising. U.S. economic growth slipped in the first quarter, and consumer spending stagnated in March and April. The Fed should remain on course to pause interest rate increases at their next meeting in June. The Fed has aggressively raised rates for over a year to cool inflation by slowing economic activity. The central bank should see signs of inflation declining toward its target.

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. These competing factors are not likely to be sustainable, so real personal consumption expenditures could decelerate in the coming months, lowering headline GDP growth.

Growth should average 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.

Inflation has slowed from its multi-decade highs, though more recent data has shown some stalling in the disinflation process. The Fed funds rate

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reached 5.25% in Q2-2023 and should 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 should cut interest rates back to a level more consistent with its neutral (2.5%) rate.

But the U.S. economy could still fall into a modest recession later this year with a peak-to-trough decline of about 1.2% by Q1-2024 from Q3-2022 GDP print.

Sources: Department of Labor, Department of Commerce, Eurostat, Peoples Bank of China, Bloomberg, Institute for Supply Management, The Conference Board

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Index Performance as of: 5/31/2023

	1 Month	3 Month	YTD	1 Year	3 Year	5 Year	10 Year
Russell							
Russell 3000 Value	-3.76	-3.37	-1.65	-5.00	11.72	6.42	8.26
Russell 3000	0.39	4.17	8.73	2.01	12.23	10.05	11.44
Russell 3000 Growth	4.30	11.77	19.77	9.14	12.32	13.07	14.28
Russell 1000 Value	-3.86	-2.86	-1.45	-4.59	11.60	6.75	8.40
Russell 1000	0.47	4.93	9.29	2.42	12.43	10.59	11.74
Russell 1000 Growth	4.56	12.80	20.75	9.54	12.84	13.83	14.75
Russell Midcap Value	-4.44	-7.44	-3.18	-9.52	12.28	5.21	7.97
Russell Midcap	-2.79	-4.79	0.60	-4.53	10.17	6.86	9.29
Russell Midcap Growth	0.06	-0.03	7.62	5.76	5.81	8.17	10.55
Russell 2000 Value	-1.98	-11.29	-5.07	-11.53	13.55	2.05	6.41
Russell 2000	-0.93	-7.37	-0.06	-4.71	9.20	2.71	7.33
Russell 2000 Growth	0.02	-3.59	4.85	2.65	4.60	2.71	7.88
Standard & Poors							
S&P 500	0.43	5.75	9.64	2.89	12.90	10.99	11.97
Consumer Discretionary	3.21	5.43	18.64	-0.79	6.66	8.23	11.73
Consumer Staples	-6.08	1.42	-1.89	0.68	10.61	11.34	9.23
Energy Sector	-10.04	-7.26	-11.44	-7.55	31.81	5.31	3.47
Financials Sector	-4.32	-10.71	-6.77	-8.60	12.98	5.35	9.18
Health Care Sector	-4.29	0.85	-5.60	-1.71	9.24	11.19	12.21
Industrials Sector	-3.16	-3.68	-0.99	4.11	14.56	7.42	10.23
Information Technology	9.46	21.99	33.95	19.33	20.17	20.17	20.62
Materials Sector	-6.85	-7.94	-2.99	-10.68	12.80	7.54	8.67
Real Estate Sector	-4.51	-4.93	-1.77	-15.53	4.76	6.25	5.73
Communication Services	6.21	21.67	32.81	5.53	6.19	9.23	6.39
Utilities Sector	-5.87	0.61	-7.22	-9.96	6.14	8.47	9.32
Other U.S. Equity							
Dow Jones Industrial Avg.	-3.17	1.39	0.25	1.96	11.27	8.48	10.60
NASDAQ 100 Stock	7.73	18.62	30.79	13.77	15.17	16.42	18.17
International Equity - Broad Market							
MSCI EAFE NR	-4.23	0.91	6.81	3.06	8.53	3.21	4.56
MSCI Emerging Mkts NR	-1.68	0.15	1.05	-8.49	3.47	-0.67	1.90
MSCI Frontier Markets NR	-0.64	1.02	2.96	-9.60	3.59	-0.34	1.86
MSCI ACWI NR	-1.07	3.44	7.68	0.85	10.07	6.77	7.82
MSCI ACWI ex USA NR	-3.64	0.43	4.77	-1.41	7.23	2.22	3.83
MSCI AC Asia ex Japan NR	-1.83	-0.53	0.30	-8.08	2.97	-0.59	3.60
International Equity - Country Region							
MSCI Brazil NR	0.65	3.79	0.77	-9.51	10.56	1.40	-1.04
MSCI BRIC NR	-4.42	-3.31	-5.48	-9.92	-3.16	-3.68	1.17
MSCI China NR	-8.43	-9.23	-9.07	-14.75	-8.84	-7.01	1.90
MSCI Europe NR	-2.52	-0.16	8.51	5.18	12.00	5.97	6.74
MSCI India NR	2.91	8.44	0.39	1.68	20.12	7.55	7.63
MSCI Japan NR	1.86	6.29	8.56	4.53	4.29	1.78	4.99
MSCI EM Latin Amer NR	-0.85	2.67	5.81	-3.80	14.06	1.80	-0.94
Fixed Income							
Bloomberg US Agg TR	-1.09	2.04	2.46	-2.14	-3.65	0.81	1.39
Bloomberg U.S. T-Bills	0.41	1.19	1.89	3.33	1.17	1.48	0.91
Bloomberg US Govt	-1.14	2.24	2.35	-2.21	-4.45	0.62	0.93
Bloomberg US Credit	-1.39	2.11	2.81	-1.56	-2.90	1.50	2.18
Bloomberg US Corp HY	-0.92	1.14	3.64	0.05	2.90	3.09	3.98
Bloomberg Municipal	-0.87	1.10	1.65	0.49	-0.64	1.65	2.28
Bloomberg US TIPS	-1.20	1.77	2.21	-4.20	0.36	2.64	1.75
Bloomberg Global-Agg	-1.95	1.59	1.44	-4.48	-4.68	-1.17	0.08
Bloomberg Gbl Agg ex-USD	-2.69	1.23	0.57	-6.49	-5.64	-2.84	-1.01
Bloomberg EM USD Agg	-0.75	0.88	1.78	-0.68	-2.39	0.59	2.11
Alternative Investments							
Alerian MLP	-0.52	-0.07	5.20	7.54	25.14	4.79	0.72
Bloomberg Commodity	-5.64	-6.54	-11.37	-22.48	17.15	3.17	-1.86
FTSE Nareit Equity REITs	-3.22	-4.89	0.21	-12.07	8.18	4.39	5.67
S&P Global Nat Res	-9.39	-10.54	-9.07	-14.26	16.87	4.34	4.37
S&P N.Amer Nat Res	-8.60	-7.05	-9.59	-12.07	23.45	4.09	2.42