# Market Notes

*(As of May 31, 2023)*

## *Equity Market Summary*

- The stock market right now is being driven by a handful of mega cap tech names. The underlying technicals suggest a much weaker market. We've seen this sort of market behavior during speculative markets preceding massive drawdowns. AAPL & MSFT make up 15% of the index. In our opinion, it's short-sided *(and actually an incredibly bearish economic proposition)* to suggest that a handful of mega cap tech names will be the only companies to grow over the next 10 years. An extraordinary level of revenue growth would be required to justify current valuation levels.

- The current rally off October's lows is very different to the previous 5 new bull markets off the bear market lows. New bull markets are typically led by small caps, with broad market breadth, and a steepening yield curve, which is not the case today.

- Each of the companies that is driving Equity market performance is trading at or meaningfully above where it was trading at the end of 2021, despite significantly higher interest rates, an inverted yield curve, slower economic growth, negative money supply growth, and a contracting manufacturing sector.

- Furthermore, looking at 6 quarters of EPS & Revenue growth, each of these companies was experiencing significant revenue growth *(at least 40%)* and earnings growth *(at least 35%)* at the end of 2021. Since 2021 *(6 quarters)*, each of these companies has seen EPS fall *(AMZN by as much as 78%)*, while revenue growth has been flat or negative.

- In our opinion, the last 5 months have sent many warning signals which have been ignored by the Equity Market *(Banking Crisis, Sticky Inflation, CRE Vacancies, Deeper Yield Curve Inversion, Narrow Market Breadth)*

## *Federal Reserve & Yield Curve Summary*

- Since October, the Treasury has been spending down their General Account which effectively offset the Fed's tightening measures. Now that the debt deal has been reached, they will need to refill their coffers, which will reduce the amount that banks can lend as well as pressure short-term rates.

- Markets expected May's rate hike to end the Fed's hiking cycle, and priced in rate cuts later this year, however, Fed officials have indicated that more hikes may will be necessary. Historically, when the Fed does lowers rates, it's because something has broken in the financial system, which is not good for stocks. From the 1st cut to the last cut, the NASDAQ fell -40% during the GFC & -29% during the Tech bubble.

- Equity markets are pricing in that the Fed will lower rates, without a recession. Given the Fed's hawkish rhetoric and historical precedent, this would truly be a "goldilocks scenario".

- In our view, there are 2 paths for the Federal Reserve to cut interest rates: 1) The Federal Reserve's goal of a "soft landing" is achieved through a protracted period of tighter monetary policy and the Fed cuts rates in a few years. 2) Tighter policy creates a recession cratering inflation and resulting in immediate rate cuts to stimulate economic growth.

- Inflation is down from peak levels but is still quite sticky. MOM CPI has averaged +0.5% over the last 5 months. Should this continue, inflation will continue to fall initially, before picking back up again to the 5-6% range in 2024. Several months of sub +0.2% CPI will be necessary to curb inflation down to target.

- While most market participants believed the May rate hike would end the Fed's hiking cycle, economic data has proven resilient, and the labor market continues to be tight. At the latest meeting, Chairman Powell indicated that more rate hikes are likely needed and did not forecast any rate cuts until after 2024. 2023 rate cuts are starting to get priced out of the Fed Funds futures market.

- The Fed has been adamant that they will not lower rates until inflation reaches their target and remains there, as they are trying to drain liquidity from the financial system that has built up over 12 years. It is our opinion that a recession will be necessary to achieve this goal *(earnings on average fall -30% during recessions)*.

- While yields have most likely peaked this cycle, there are still several factors that can continue to pressure yields higher *(Quantitative Tightening, Shrinking Bank Reserves, Tighter Credit Conditions)* and it is unlikely that we return to ultra-low interest rates any time soon.

# *Historical Bear Market Lows & New Bull Markets*

| Bear Market Low | + 231 Days | S&P 500 | Average S&P Stock | Russell 2000 | Gold Price | % Stocks > 200D Moving Average | Treasury Curve Steepness *(2 - 10)* |
|---|---|---|---|---|---|---|---|
| 8/12/1982 | 3/31/1983 | 54% | -- | 72% | 24% | -- | 70 |
| 10/11/1990 | 5/30/1991 | 34% | 42% | 47% | -7% | 86% | 144 |
| 10/9/2002 | 5/28/2003 | 24% | 37% | 33% | 14% | 83% | 211 |
| 3/9/2009 | 10/26/2009 | 60% | 84% | 75% | 13% | 94% | 249 |
| 3/23/2020 | 11/9/2020 | 60% | 67% | 71% | 20% | 72% | 66 |
| **10/12/2022** | **5/31/2023** | **18%** | **10%** | **5%** | **17%** | **44%** | **-79** |

- The above chart shows asset class performance 231 days after the bear market low which ultimately led to a new bull market. In each instance, the rally was led by small caps and broad market breadth *(average S&P 500 stock > index)*, with Gold lagging meaningfully.

- Each of the previous 5 new bull markets also had a positive sloping yield curve, and at least 72% of S&P 500 stocks trading above their 200-day moving average.

- The current rally off the lows stands in stark contrast to these historical periods, as small caps are lagging large caps, the average S&P 500 stock is materially underperforming the index, and Gold has kept pace with the S&P 500. Additionally, the yield curve is still inverted by almost -80bps *(largest since 1980)*, and a mere 44% of S&P 500 stocks are trading above their 200-day moving average.

Source: Bloomberg data as of 5/31/2023 *(SPX Index; SPW Index; RTY Index; XAU Curncy; USYC2Y10 Index)*; the S&P 500 is widely regarded as the best single gauge of large-cap U.S. equities and serves as a foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. the Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing about 8% of the total market capitalization; the 200-Day Moving Average refers to the average closing price of a stock or index over the previous 200 days and is a metric used in technical analysis to analyze price trends; the spread between the 10-Year & 2-Year Treasury Yields is an indicator of economic growth expectations and market liquidity. A negative spread is widely regarded as a recessionary signal.

# *Strategas: Market & Macro Environment Remain Very Split*

**Annual S&P 500 Contribution of 10 Largest Weights During Positive Performance Years**

| Year | Top 10 as % of Total | S&P 500 % Perf. |
|---|---|---|
| **2023 YTD** | **104.1%** | **9.5%** |
| 2007 | 78.7% | 3.5% |
| 2020 | 58.9% | 16.3% |
| 1999 | 54.5% | 19.5% |
| 2021 | 45.0% | 26.9% |
| 1998 | 36.8% | 26.7% |
| 1996 | 33.9% | 20.3% |
| 2017 | 33.3% | 19.4% |
| 2019 | 32.8% | 28.9% |
| 1991 | 28.6% | 26.3% |
| 2006 | 27.6% | 13.6% |
| 2016 | 26.6% | 9.5% |
| 2003 | 23.6% | 26.4% |
| 1995 | 22.3% | 34.1% |
| 2014 | 22.2% | 11.4% |
| 2004 | 21.1% | 9.0% |
| 2005 | 20.5% | 3.0% |
| 2010 | 19.6% | 12.8% |
| 2012 | 19.2% | 13.4% |
| 1997 | 19.1% | 31.0% |
| 2013 | 17.6% | 29.6% |
| 2009 | 15.5% | 23.5% |
| 1992 | 14.9% | 4.5% |
| 1993 | 12.2% | 7.1% |

"As the month draws to a close and the S&P pushes to fresh YTD highs, we remain struck by the many contradictions in our work. The obvious conflict is the market's headline strength vs. its indifference under the surface – even after last week's NVDA-fueled move, just 44% of S&P 500 issues are above the 200-day (remarkably light for a market nearly 8 months off the October low). Additionally, more than 100% of the year's gain has come from the top 10 weights… it's not unusual for the large names to contribute a significant share of the performance in an up-year, but the current magnitude is a clear historical outlier. "

– Strategas Technical & Macro Research *(5/30/2023)*

Source: Strategas Research *(5/30/2023)*

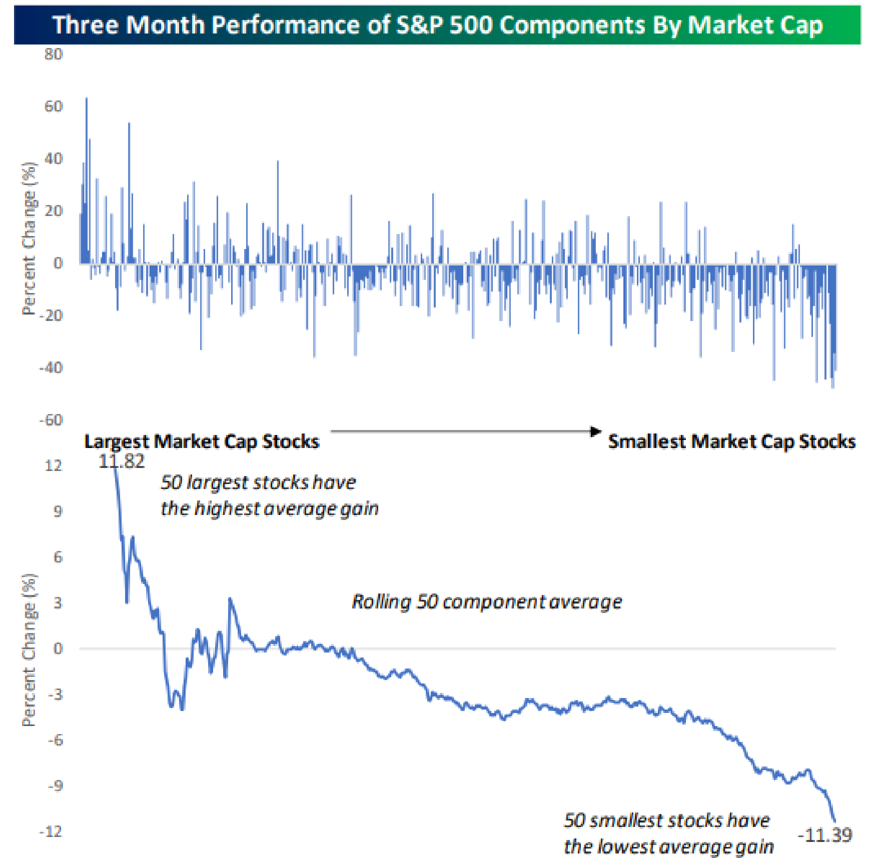
## *The Bespoke Report*

"The performance disparity that we've seen this year between the mega caps and everyone else can't be overstated. Look at the charts to the right. The top one shows the 3-month performance of every stock in the S&P 500 arranged by market cap with the largest stocks on the left and the smallest on the right. In the chart, there is a clear trend in performance sloping down from the left to right.

For just two examples, the seven largest stocks in the S&P 500 are all up over the last three months with an average gain of 32.8%. At the other end of the chart, the seven smallest stocks in the S&P 500 are all lower and down by an average of 35.0%. It goes even further than that as the twenty smallest stocks in the S&P 500 are all down YTD with an average decline of 20.3%.

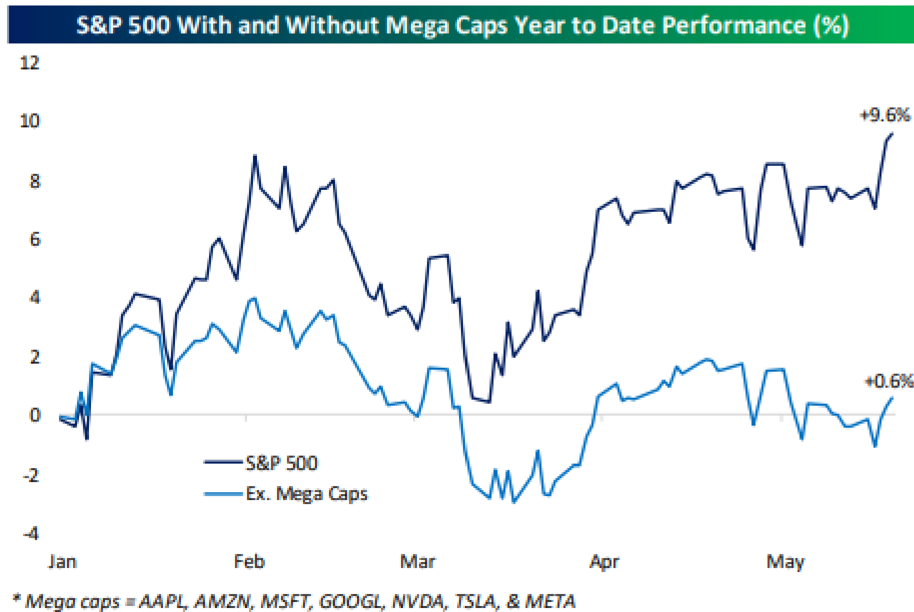
The lower chart shows the trailing three-month performance of S&P 500 components on a rolling 50-component basis starting with the 50 largest and moving all the way down to the smallest 50 stocks in the index. While the 50 companies with the largest market caps are up an average of 11.82%, the 50 companies with the smallest market caps are down an average of 11.39%.

- Bespoke Investment Group *(5/26/2023)*




Source: Bespoke Investment Group *(5/26/2023)*.

# *The Bespoke Report*




"While the narrative that it's "just the mega-caps" rallying this year isn't quite accurate since there are plenty of non-mega-caps making new highs right now too, the mega-caps have basically accounted for all the gain in the major indices like the S&P 500 this year.

As shown *[to the left]*, the S&P 500 is up +9.6% YTD heading into the weekend, but if we remove AAPL, AMZN, MSFT, GOOGL, NVDA, TSLA, and META, the index would only be up +0.6%on the year.

Apple *(AAPL)* has accounted for 20% of the S&P's move this year, while Microsoft *(MSFT)* accounts for 17.7%, and NVDA accounts for 12.25%. These three alone account for half of the S&P's move in 2023."

- Bespoke Investment Group *(5/19/2023)*

Source: Bespoke Investment Group *(5/19/2023)*

| | 12/31/2021 | | 5/31/2023 | | Difference | |
|---|---|---|---|---|---|---|
| | Fed Funds Rate | 0.25% | Fed Funds Rate | 5.25% | **Fed Funds Rate** | **5.00%** |
| | 10-Year Treasury Yield | 1.51% | 10-Year Treasury Yield | 3.64% | **10-Year Treasury Yield** | **2.13%** |
| | Yield Curve *(10yr - 2yr)* | 77 bps | Yield Curve *(10yr - 2yr)* | -76 bps | **Yield Curve** *(10yr - 2yr)* | **-153 bps** |
| | GDP Growth *(YOY%)* | 5.70% | GDP Growth *(YOY%)* | 1.60% | **GDP Growth *(YOY%)*** | **-4.10%** |
| **M2 Money Supply* | Money Supply Growth *(YOY%)* | 12.70% | Money Supply Growth *(YOY%)* | -4.63% | **Money Supply Growth *(YOY%)*** | **-17.33%** |
| ***ISM PMI < 50 considered contracting* | ISM Manufacturing PMI | 58.6 | ISM Manufacturing PMI | 46.9 | **ISM Manufacturing PMI** | **-19.97%** |

| | AAPL | | AMZN | | MSFT | | GOOGL | | NVDA | | META | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 12/31/2021 | 5/31/2023 | 12/31/2021 | 5/31/2023 | 12/31/2021 | 5/31/2023 | 12/31/2021 | 5/31/2023 | 12/31/2021 | 5/31/2023 | 12/31/2021 | 5/31/2023 |
| **P/E Ratio** | 29.4 | 30.1 | 71.4 | 130.0 | 38.5 | 35.0 | 29.0 | 25.4 | 85.9 | 183.7 | 24.4 | 23.9 |
| **EPS Growth *(6 Quarters)*** | 223% | -27% | 123% | -78% | 36% | -2% | 88% | -24% | 296% | -16% | 35% | -41% |
| **Revenue Growth *(6 Quarters)*** | 119% | -21% | 41% | -8% | 40% | 3% | 67% | -4% | 81% | 2% | 62% | -9% |

- The top boxes illustrate how the current macroeconomic environment is vastly different today compared to December 2021. During 2021, the US economy enjoyed rapid expansion, fueled by ultra-low interest rates and unprecedented monetary stimulus *(money supply growth)*.
  - In their effort to quell inflation, the Federal Reserve has aggressively tightened monetary policy to drain the excess liquidity from the financial system that built up over the previous 11 years.
  - As a result, the current environment is one with significantly higher interest rates, an inverted yield curve, slower economic growth, negative money supply growth, and a contracting manufacturing sector.
- Despite a significantly weaker macroeconomic environment, each of the 6 companies responsible for YTD Equity market performance are trading at a valuation equal to *(or meaningfully higher)* than their valuation in December 2021.
  - Furthermore, looking at the previous 6 quarters ending December 2021, each of these companies was experiencing significant revenue growth *(at least 40%)* and earnings growth *(at least 35%)*.
  - Since the end of 2021 *(6 quarters)*, each of these companies has experienced negative EPS growth *(as much as -78%)*, with flat or negative revenue growth.

Source: Bloomberg data as of 5/31/2023 *(FDTR Index; USGG10YR Index; USYC2Y10 Index; GDP CYOY Index; M2% YOY Index; NAPMPMI Index)*; see slide 25 for definitions and disclosures

## Average Performance of S&P 500 Constituents

| Dividend Yield | | # Stocks |
|---|---|---|
| Non-Dividend Payers | 10.9% | 108 |
| Dividend Payers *(0 - 2%)* | 2.4% | 177 |
| Dividend Payers *(> 2%)* | -6.3% | 218 |

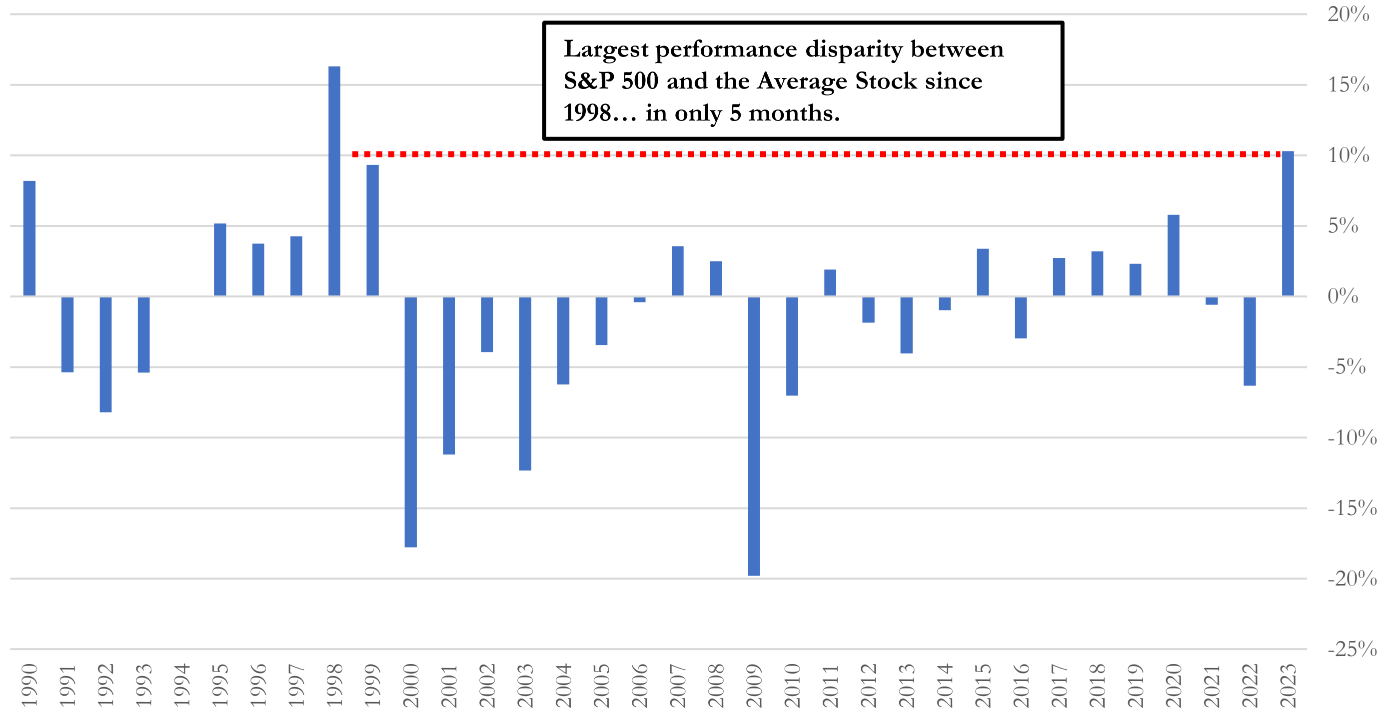
| Market Capitalization | | # Stocks |
|---|---|---|
| 15 Largest Stocks | 27.3% | 15 |
| 16 - 50 Largest Stocks | 3.3% | 35 |
| Remaining 453 Stocks | -0.7% | 452 |

| P/E Ratio | | # Stocks |
|---|---|---|
| P/E Ratio > 50x** | 13.1% | 49 |
| P/E Ratio 25x - 50x | 4.8% | 138 |
| P/E Ratio < 25x | -3.4% | 316 |

**Includes non-earners *(no P/E ratio)*

- The chart to the left shows S&P 500 constituent performance as broken down by fundamental factors.
- On average, non-dividend paying stocks are outperforming high-dividend paying stocks by +18.5% YTD.
- On average, the 15 largest stocks are outperforming the 452 smallest stocks by outperforming high-dividend paying stocks by +27%.
- There are 49 stocks in the S&P 500 that at the start of the year were either non-earners *(no P/E Ratio)* or are trading at > 50x earnings. These stocks are up on average almost +15% YTD.
- 138 stocks had a P/E ratio between 25x – 50x to start the year, those stocks are up +5.2% YTD on average.
- The 317 stocks in the S&P 500 that traded below 25x their earnings at the start of the year are down on average -1.4% YTD.

Source: Bloomberg data as of 5/31/2023 *(SPY Constituents used as a proxy).* P/E Ratio refers to the ratio of a stock's price relative to its Earnings Per Share indicates the price investors are willing to pay for a company's earnings. It is the most common metric used for determining the valuation of a company's stock.

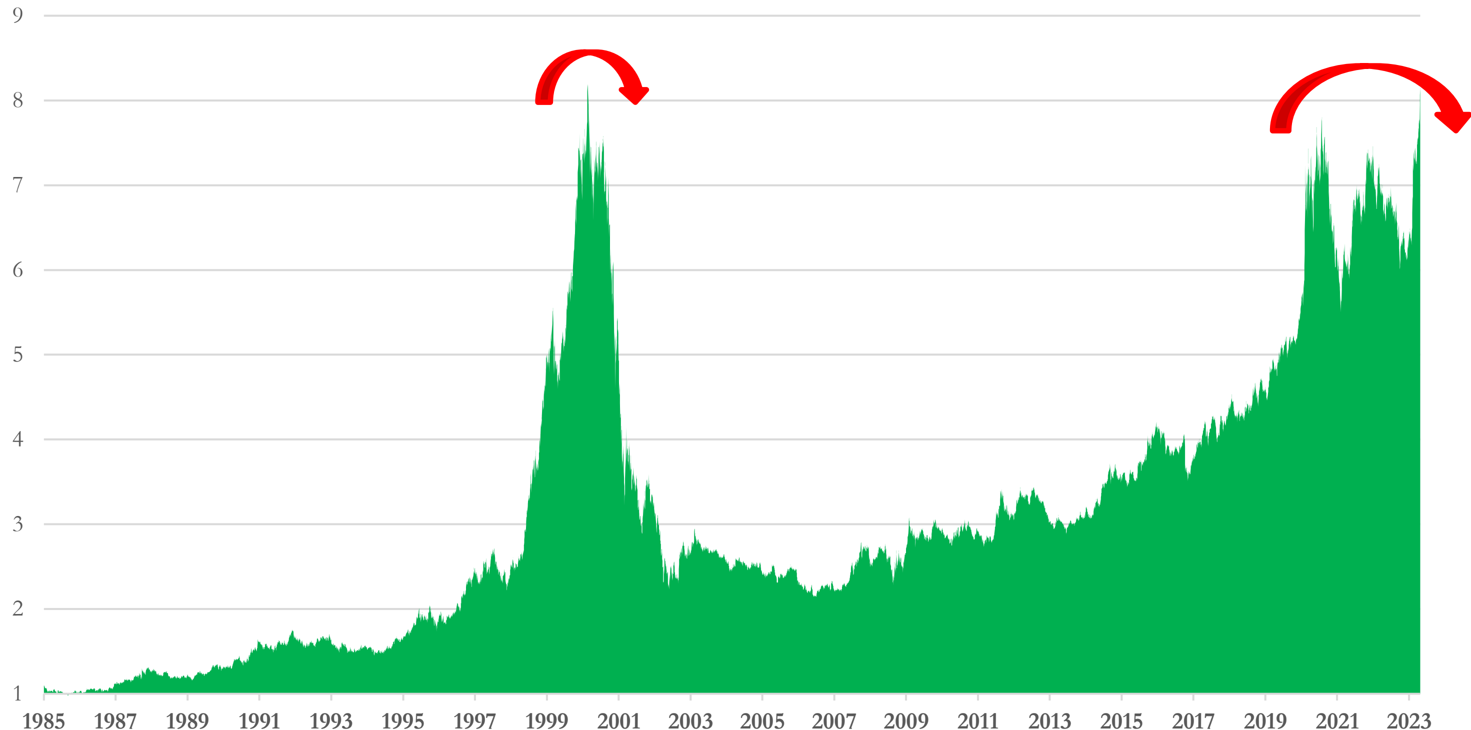



- YTD in 2023, the average stock in the S&P 500 has lagged the index by more than 10%. In only 5 months, this underperformance is the largest disparity since 1998.

Source: Bloomberg data as of 5/31/2023 *(SPX Index; SPW Index)*; the S&P 500 constituents are weighted according to their market capitalization and will be more heavily influenced by the largest stocks; in the S&P Equal-Weighted Index, each constituent is weighted equally, and it is a better indication of the performance of the average stock in the index.

- Similarly, since February 2023, the NADAQ Index's price has decoupled from the performance of its constituents, as the number of declining stocks is far exceeding the number of advancing stocks.

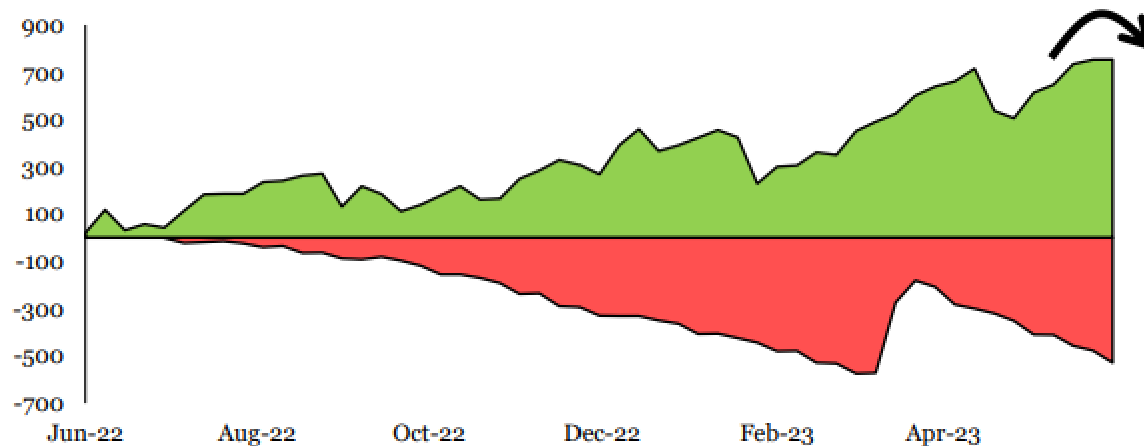
Source: Bloomberg data as of 5/31/2023 *(CCMP Index; TRADCAND Index)*; the NASDAQ Composite Index is a market capitalization-weighted index of more than 3,700 stocks and is broadly considered to be a benchmark for Technology stocks; the Bloomberg Cumulative Advance-Decline Line for the NASDAQ aggregates the total number of stocks advancing and declining stocks on a daily basis.




- The above chart compares the performance of the largest US Technology stocks *(NASDAQ 100)* to small cap stocks.
- The current performance disparity between these indices is currently mimicking the most extreme points of the Tech Bubble *(Richard Bernstein Advisors)*.

Source: Bloomberg data as of 5/31/2023 *(NDX Index; RTY Index);* the NASDAQ-100 Index is a modified capitalization-weighted index of the 100 largest companies in the NASDAQ Composite Index

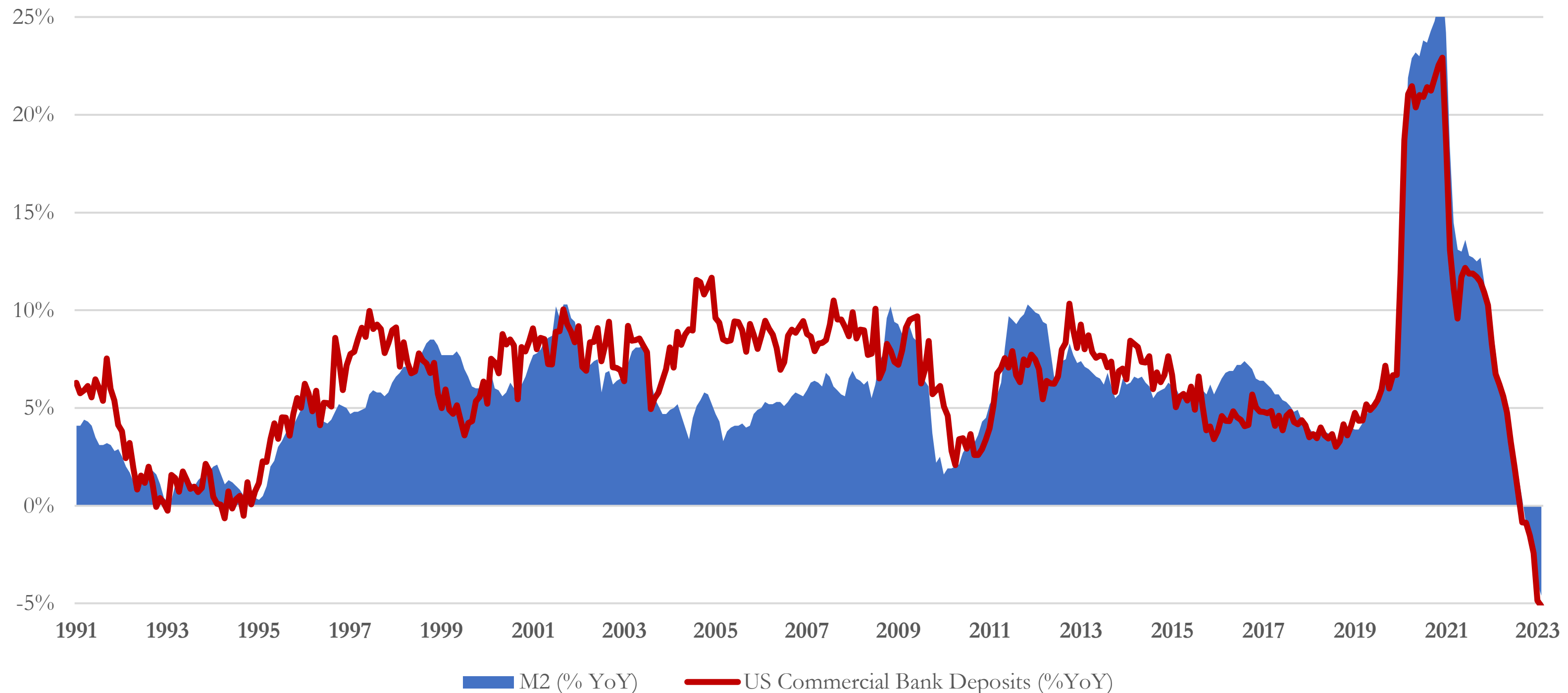
# *Strategas: Liquidity Drain Could Alter Market Leadership*




"The liquidity cycle is shifting now that the debt ceiling was lifted on Saturday. Since January, when the US hit the debt ceiling, the US was in a period of net liquidity with Treasury spending down its Treasury General Account by a net $400B. The affect of this spending was to overwhelm the Fed's QT effort, boosting liquidity into the banking sector, leading to temporary relief from the Fed's tightening campaign. That relief has ended. Hundreds of billions of dollars of TGA liquidity injections that benefited risk assets in February, March, and May are no longer taking place. QT is now standing on its own, and that means every other week we will likely see $40Bof liquidity rolling off the Fed's balance sheet. At the same time, Treasury is expected to reload the TGA by $450-600B over an eight-week period. Our sense is that at least half of this will come from bank reserves, draining liquidity further. To avoid raising this cash entirely from bank reserves, Treasury is about to flood the market with $1T of T-Bills to drive up short-term yield to entice money market funds to rotate funds out of Reverse Repos into Treasuries. The Fed may be on pause, but Treasury is raising rates. Ultimately this may force the Fed to end QT, but for the time being we expect a tightening cycle."

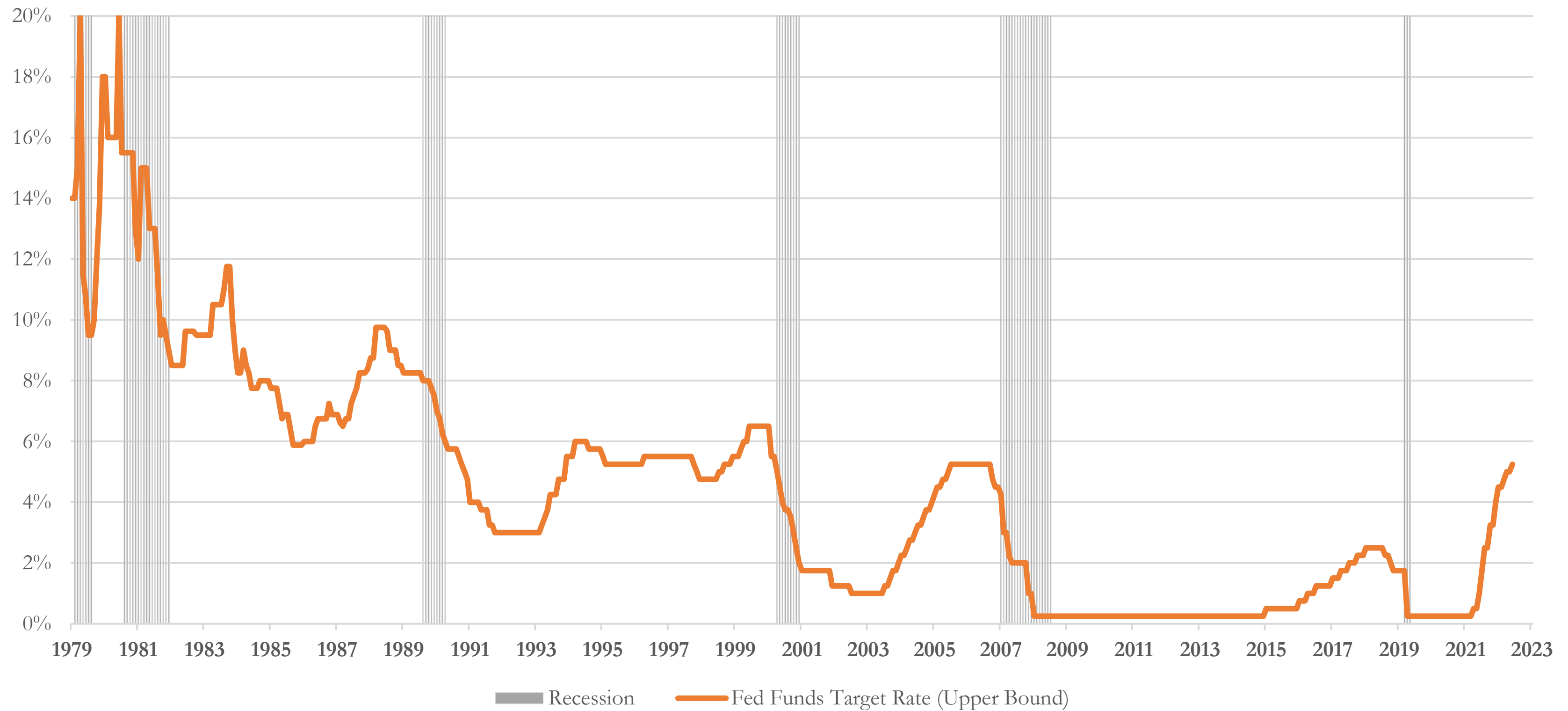
- Strategas Technical & Macro Research *(6/7/2023)*

Source: Strategas Research as of 5/31/2023



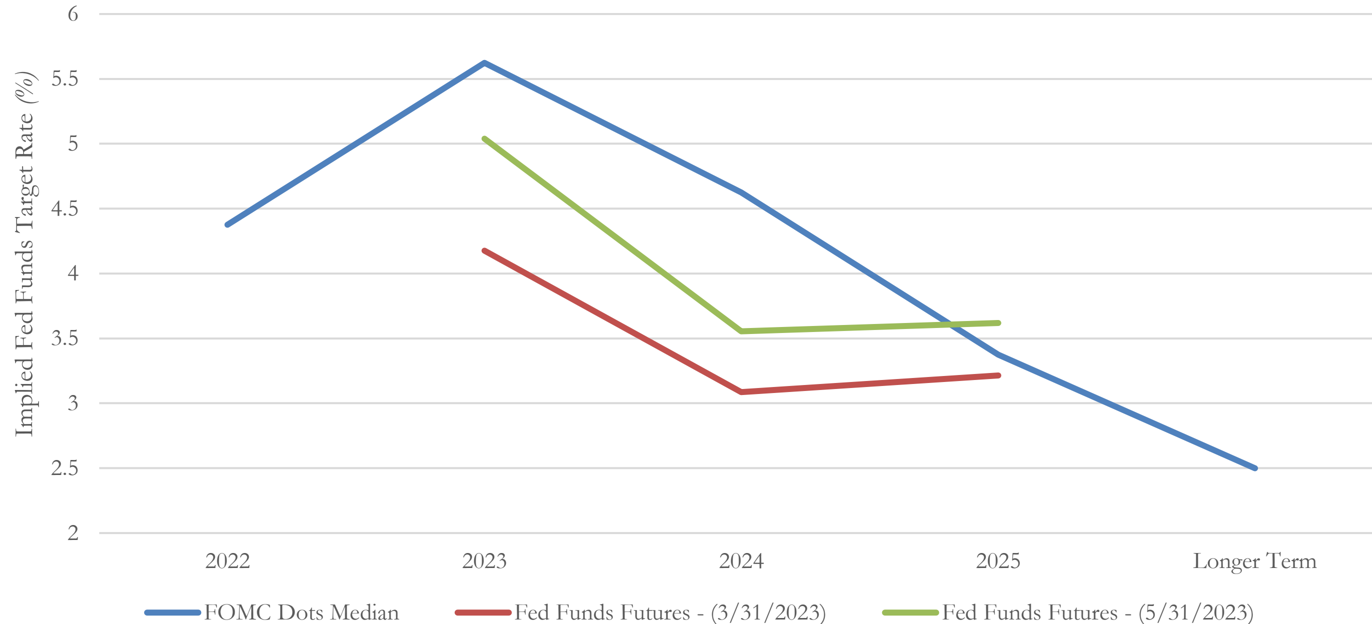

- The Federal Reserve's primary tool in fighting inflation has been raising interest rates, but they also have been reducing the money supply *(M2),* which closely tracks US Commercial Bank Deposits.
- A significant decline in Commercial Bank Deposits will reduce credit availability *(amount banks can lend)*, leading to tighter credit standards that limit Commercial Real Estate, Business, & Consumer loans, resulting in weaker economic growth.
- As of April 2023, both M2 Money Supply & Commercial Bank Deposits experienced negative growth for the first time in over 30 years and may continue to fall after March's bank failures.

Source: Bloomberg data as of 05/31/2023 *(M2% YOY Index, ALCLDEPO Index - % change YoY);* M2 is the Federal Reserve's estimate of the total money supply including all cash people have on hand plus all of the money deposited in checking, savings, and other short-term vehicles; US Commercial Bank Deposit information tracked and published by Federal Reserve



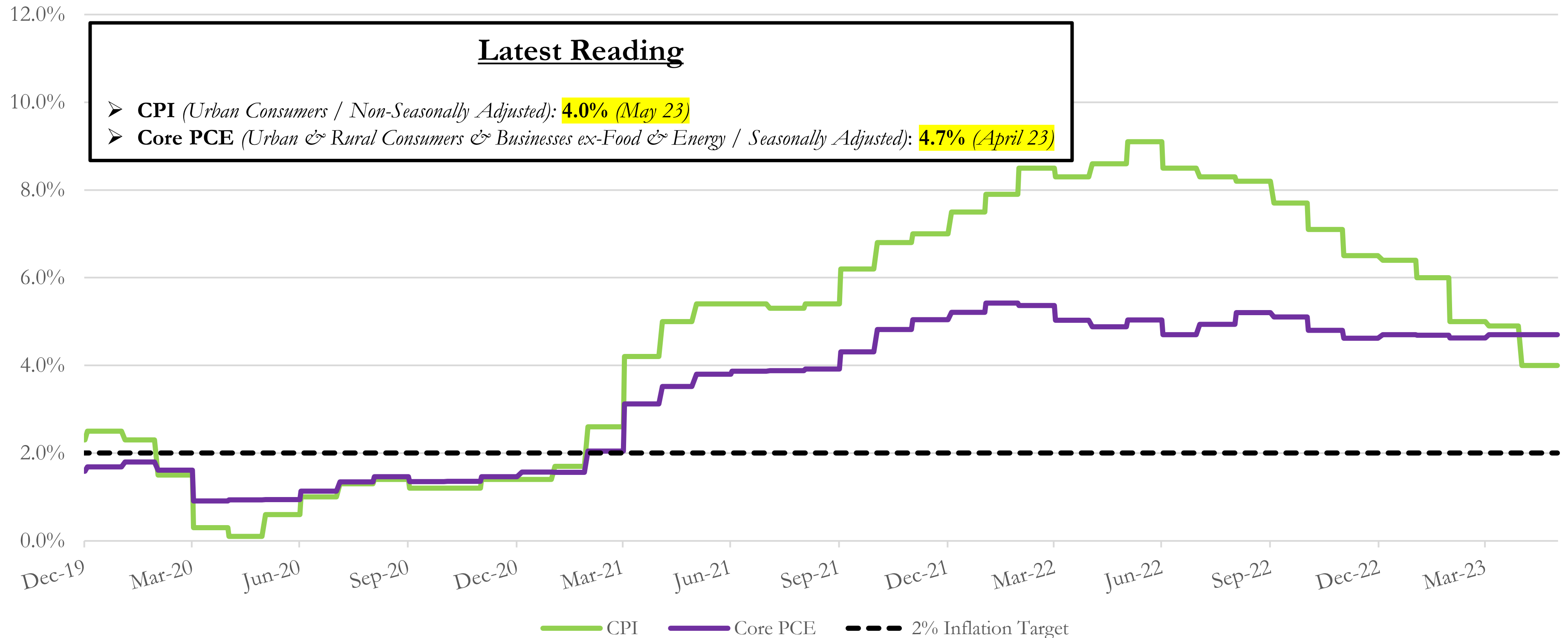

- The Federal Reserve typically cuts interest rates in response to a recession, which is currently not being priced into Equity markets.

Source: Bloomberg data as of 5/31/2023 *(FDTR Index)* ; Recessions identified by National Bureau for Economic Research *(NBER);* Fed Funds Target Rate *(Upper Bound)* reflects the upper bound of the 25-basis point range for the Federal Funds Rate *(overnight bank lending rate)*, which is the Federal Reserve's primary monetary policy tool.




- In response to the bank failures in March, the market priced in rate cuts into the second half of 2023.
- The dot plots from March's FOMC meeting suggest that the Federal Reserve still intends to keep policy "tighter for longer" in their effort to quell inflation.
- The bond market has since priced out rate cuts for 2023 on the heels of continued resilient economic data and comments from Fed officials indicating that more rate hikes may be necessary.

Source: Bloomberg data as of 5/31/2023 *(FOMC Dot Plot)*; the Federal Open Market Committee *(FOMC)* refers to the 12-member board that determines monetary policy decisions in the United States which influence interest rates and money supply; Fed Funds Futures are futures contracts that reflect market participant expectations for the Federal Funds Rate *(overnight bank lending rate)*, which is the Federal Reserves primary policy making tool.




- Non-Seasonally Adjusted CPI is the inflation metric most often quoted in headlines, however, Core PCE is the Federal Reserves preferred inflation metric. It includes both urban and rural consumers and businesses, removing the volatility of food and energy prices.

- The Fed's tightening efforts and falling energy prices have quelled headline CPI from its 9.2% peak in June 2022, however, less progress has been made on Core PCE. During the latest Fed meeting, Chairman Powell indicated that

Source: Bloomberg data as of 5/31/2023 *(CPURNSA Index – Year-Over-Year; PCE CYOY Index)*; Consumer Price Index *(CPI)* is the most common measure of inflation, published monthly by the US Bureau of Labor Statistics and is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services; PCE Deflators *(PCE)* track overall price changes for good and services purchased by businesses and consumers, excluding food and energy prices.

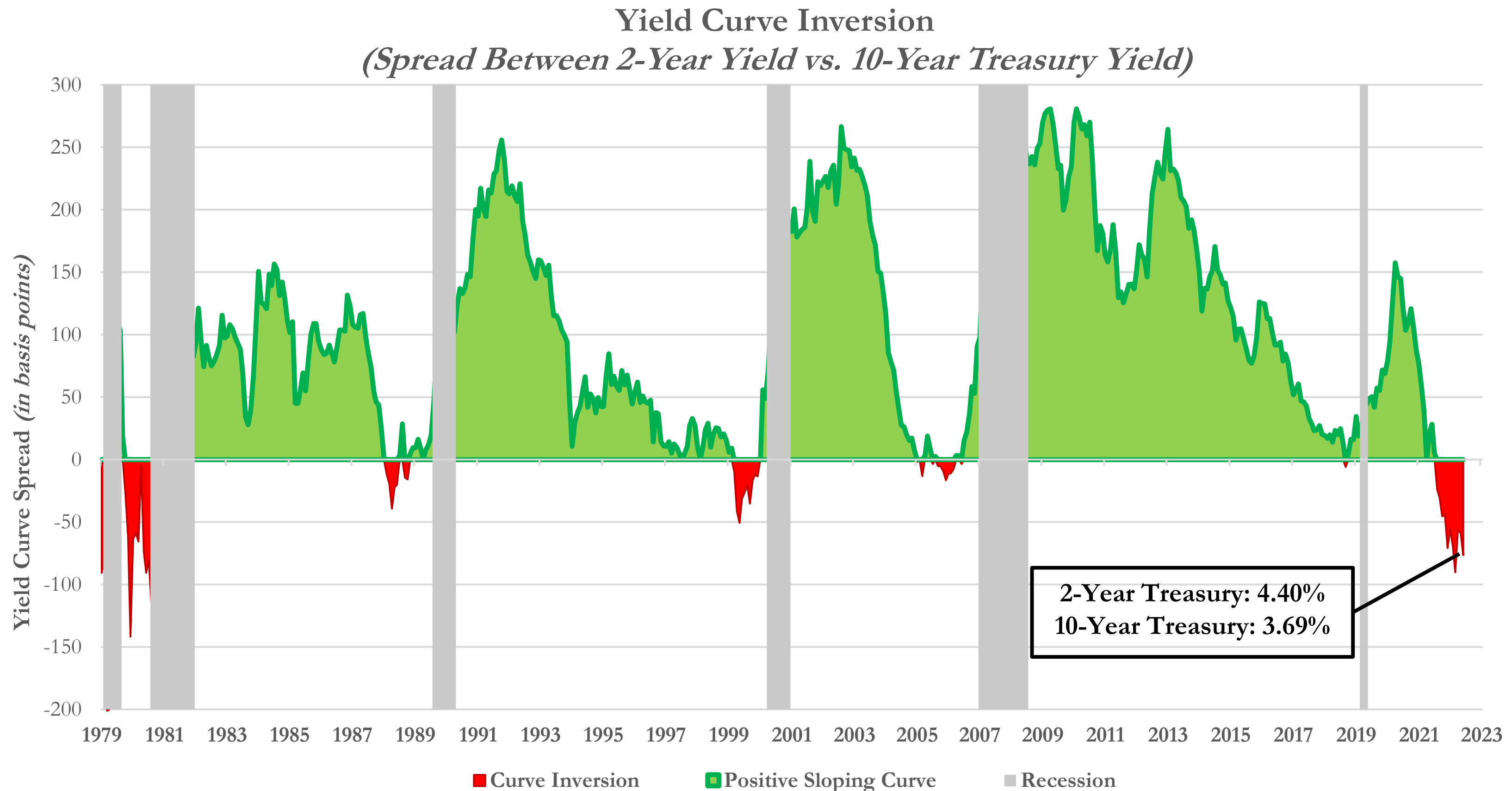
| Months | | Actual CPI YOY *(%)* | Fed Funds Rate *(%)* |
|---|---|---|---|
| Jun-22 | **Peak CPI:** | **9.1%** | 1.6% |
| Jul-22 | | 8.5% | 2.3% |
| Aug-22 | | 8.3% | 2.3% |
| Sep-22 | | 8.2% | 3.1% |
| Oct-22 | | 7.7% | 3.1% |
| Nov-22 | | 7.1% | 3.8% |
| Dec-22 | | 6.5% | 4.3% |
| Jan-23 | | 6.4% | 4.3% |
| Feb-23 | | 6.0% | 4.6% |
| Mar-23 | | 5.0% | 4.8% |
| Apr-23 | | 4.9% | 4.8% |
| May-23 | | 4.0% | 5.1% |

**Constant Month-over-Month Changes to CPI *(Non-Seasonally Adjusted)***

| Future YOY CPI | -0.10% | 0.00% | 0.10% | 0.20% | 0.30% | 0.40% | 0.50% | 0.60% | 0.70% | Fed Funds Futures |
|---|---|---|---|---|---|---|---|---|---|---|
| Jun-23 | 2.1% | 2.4% | 2.7% | 3.0% | 3.3% | 3.6% | 3.9% | 4.2% | 4.5% | 5.1% |
| Jul-23 | 2.0% | 2.4% | 2.8% | 3.2% | 3.6% | 4.0% | 4.5% | 4.9% | 5.3% | 5.1% |
| Aug-23 | 1.9% | 2.4% | 2.9% | 3.5% | 4.0% | 4.5% | 5.0% | 5.5% | 6.1% | 5.3% |
| Sep-23 | 1.6% | 2.2% | 2.8% | 3.4% | 4.1% | 4.7% | 5.3% | 5.9% | 6.6% | 5.3% |
| Oct-23 | 1.1% | 1.8% | 2.5% | 3.2% | 4.0% | 4.7% | 5.4% | 6.1% | 6.9% | 5.3% |
| Nov-23 | 1.1% | 1.9% | 2.7% | 3.5% | 4.4% | 5.2% | 6.0% | 6.9% | 7.7% | 5.3% |
| Dec-23 | 1.3% | 2.2% | 3.1% | 4.1% | 5.0% | 6.0% | 6.9% | 7.9% | 8.8% | 5.3% |
| Jan-24 | 0.4% | 1.4% | 2.4% | 3.4% | 4.5% | 5.5% | 6.6% | 7.7% | 8.7% | 5.2% |
| Feb-24 | -0.3% | 0.8% | 2.0% | 3.1% | 4.2% | 5.4% | 6.5% | 7.7% | 8.9% | 5.1% |
| Mar-24 | -0.7% | 0.5% | 1.7% | 2.9% | 4.2% | 5.4% | 6.7% | 8.0% | 9.3% | 5.1% |
| Apr-24 | -1.3% | 0.0% | 1.3% | 2.6% | 4.0% | 5.3% | 6.7% | 8.1% | 9.5% | 5.0% |

- For reference, the average MOM increase in CPI through May this year has been 0.5%. Should this continue, inflation would accelerate from current levels into next year.
- The above estimates are meant to be illustrative and are not market forecasts, however, the above chart shows that several months of sub +0.2% CPI growth *(or even negative CPI)* are necessary for inflation to approach the Federal Reserve's 2% inflation target.

Source: Bloomberg data as of 5/31/2023 *(CPURNSA Index – Year-Over-Year, Month-Over-Month)*; Consumer Price Index *(CPI)* is the most common measure of inflation, published monthly by the US Bureau of Labor Statistics and is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services

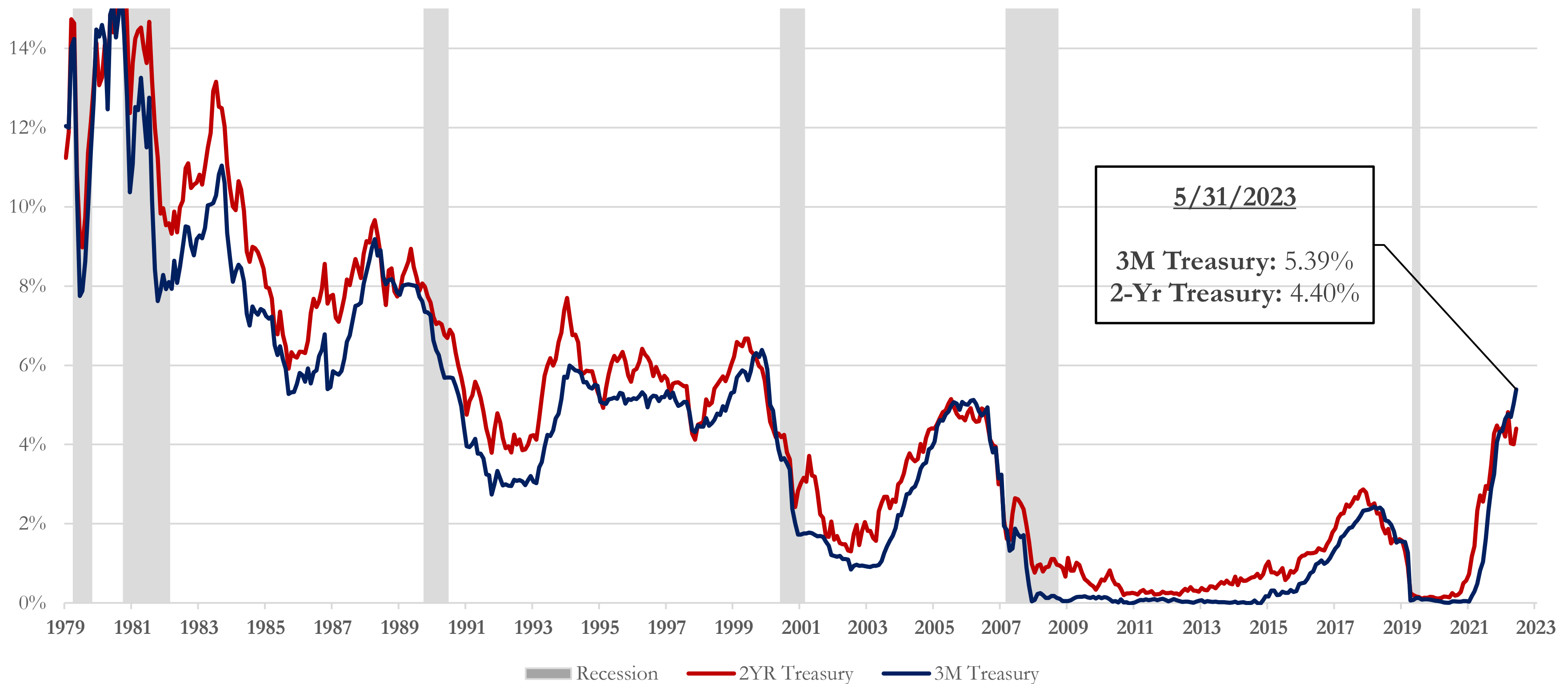



- The current inversion of the 2-Year & 10 Year Treasury Yields has persisted for more than 11 months, and is the deepest inversion since the early 1980's.

- A protracted inversion between the 2-Year & 10-Year Treasury Yields indicates weaker economic growth as a result of tightening lending standards and widely considered a recessionary indicator *(preceded the past 6 recessions)* with an average lead time of 12 months *(has taken up to 22 months to materialize)*.

Source: Bloomberg data as of 5/31/2023 *(USGG2YR Index / USGG10YR Index)* ; Recessions identified by National Bureau for Economic Research *(NBER)*

## 3M Treasury Yield vs. 2-Year Treasury Yield




- The 3M Treasury Bill Yield reflects the current Fed Funds rate, while the 2-Year Treasury Yield generally indicates future expectations for the Fed Funds rate.

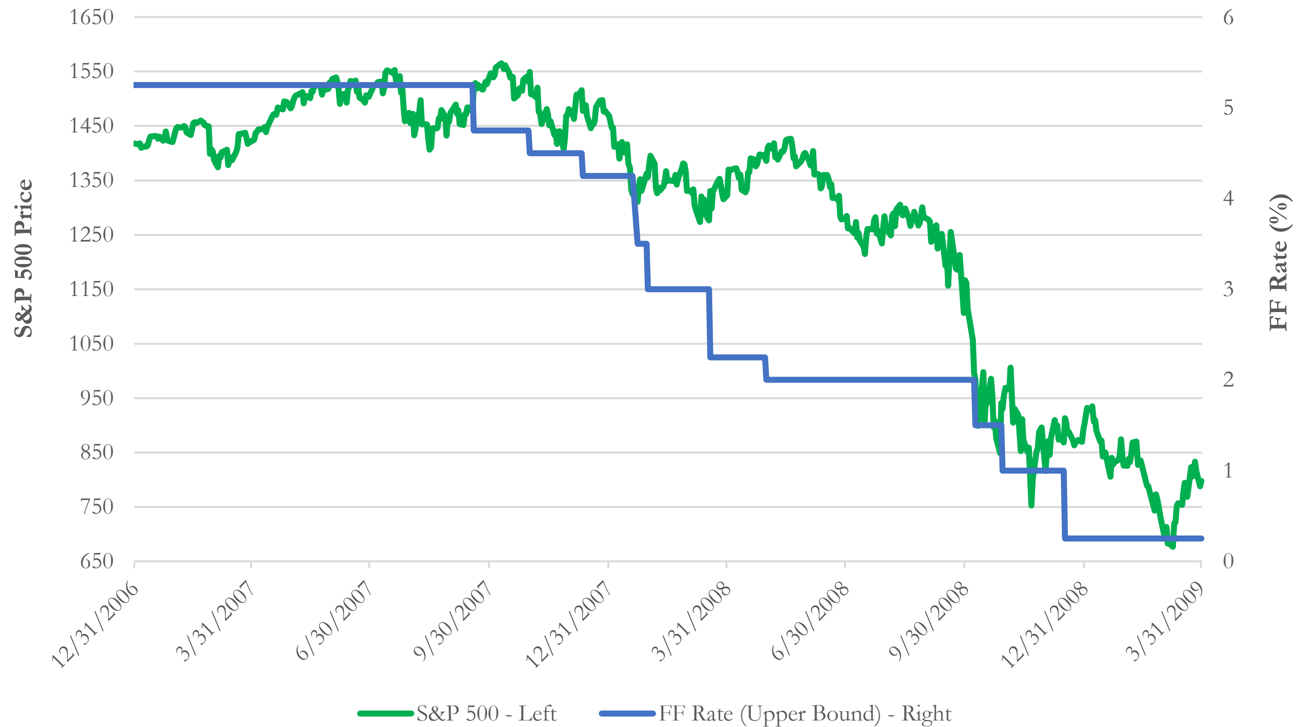
- An inversion between the 3M Yield and the 2-Year Yield generally portends rate cuts in response to a recession.

Source: Bloomberg data as of 5/31/2023 *(USGG3M Index / USGG10YR Index)* ; Recessions identified by National Bureau for Economic Research *(NBER)*

- Equity markets have responded favorably towards the prospect of the Federal Reserve lowering the Federal Funds Rate; however, the Fed historically has cut rates in response to an economic shock which has negatively impacted the stock market.

- During the GFC, from the date of the first cut *(1/2/2001)* to the date of the last cut *(6/25/2003)* the S&P 500 lost -21.1%. During the same period, the NASDAQ fell -29.4%.

Source: Bloomberg data as of 5/31/2023 *(SPX Index; FDTR Index; CCMP Index);* the NASDAQ Composite Index is a market capitalization-weighted index of more than 3,700 stocks and is broadly considered to be a benchmark for Technology stocks.



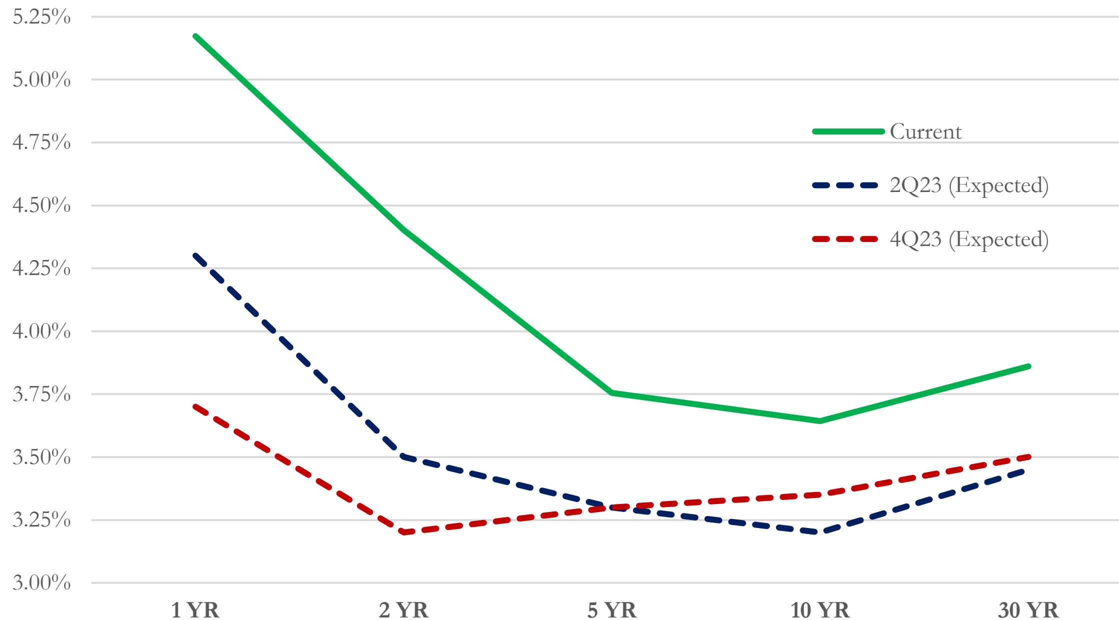

- Equity markets have responded favorably towards the prospect of the Federal Reserve lowering the Federal Funds Rate; however, the Fed historically has cut rates in response to an economic shock which has negatively impacted the stock market.

- During the GFC, from the date of the first cut *(9/17/2007)* to the date of the last cut *(12/15/2008)*, the S&P 500 lost -39.5%. During the same period, the NASDAQ lost -40.9%.

Source: Bloomberg data as of 5/31/2023 *(SPX Index; FDTR Index; CCMP Index);* the NASDAQ Composite Index is a market capitalization-weighted index of more than 3,700 stocks and is broadly considered to be a benchmark for Technology stocks.

## *Strategas: Economic Slowdown Should Nudge Yields Lower*

### 2023 US Yield Curve Forecast




| | 2023 | | | |
|---|---|---|---|---|
| **Maturity** | **1Q** | **2QE** | **3QE** | **4QE** |
| **1 Year** | 4.59% | 4.30% | 3.80% | 3.70% |
| **2 Year** | 4.03% | 3.50% | 3.20% | 3.20% |
| **5 Year** | 3.57% | 3.30% | 3.30% | 3.30% |
| **10 Year** | 3.47% | 3.20% | 3.30% | 3.35% |
| **30 Year** | 3.65% | 3.45% | 3.50% | 3.50% |

E = End of Period Expected Value

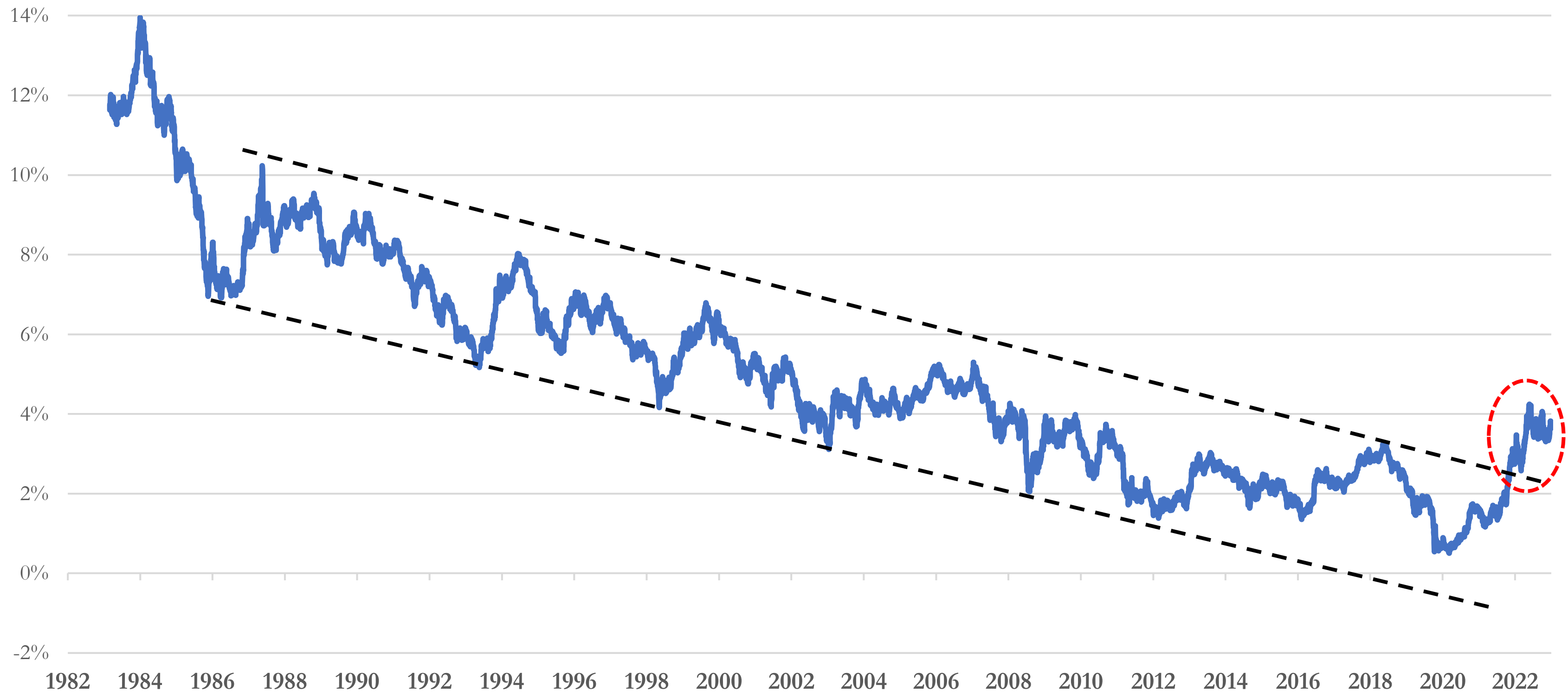
"Looking ahead, we maintain our base case view that 10-year Treasury yields should reverse back towards their YTD lows *(of around 3.25%)* by early Q3, and then hover around those levels as 1) recession becomes evident 2) inflation remains sticky and 3) the Fed cuts rates in the 4th quarter. Along the way, liquidity drain from the Fed, and now the Treasury, should keep the floor under 2, 3, 5, 7, and 10-year Treasury yields relatively high, and above 3.00%.

We feel less certain about the timing of an economic contraction than the event itself; consumers are a wildcard that could keep the economy out of a recession until fiscal drag from the debt ceiling deal hits late this year. But as each month passes, the consumer loses more runway, while monetary and fiscal drag close in on the broader economy, suggesting to us that a recession later this year is still inevitable."

- Strategas Technical & Macro Research *(5/31/2023)*

Source: Strategas Research as of 5/31/2023

# The 35-Year Bull Market in Bonds is Over




*Source: Bloomberg (5/31/2023) – USGG10YR Index*

- At the end of 2022, the 10-year Treasury Yield broke through key resistance levels, signaling the end of a 35-year bull market for bonds.

- The prospect of a weaker macro-economic environment would suggest that yields have peaked this cycle, however, there are enough secular tailwinds *(QT, sticky inflation, reduction in bank reserves)* to indicate that the ceiling and floor for yields is likely higher for the foreseeable future.

# Slide 8 Definitions & Disclosures

- Fed Funds Target Rate *(Upper Bound)* reflects the upper bound of the 25-basis point range for the Federal Funds Rate *(overnight bank lending rate)*, which is the Federal Reserve's primary monetary policy tool.

- The spread between the 10-Year & 2-Year Treasury Yields is an indicator of economic growth expectations and market liquidity. A negative spread is widely regarded as a recessionary signal.

- Gross Domestic Product *(GDP)* is the total monetary or market value of all finished goods and services produced within a country's borders. It is typically calculated on an annual or quarterly basis and serves as a broad measure of a country's economic health.

- M2 Money Supply is the US Federal Reserve's estimate of the total money supply including all the cash people have on hand plus all of the money deposited in checking accounts, savings accounts, and other short-term savings vehicles. M2 is used as a measure of liquidity and capital availability in financial markets.

- ISM Manufacturing PMI is based on monthly data acquired from over 400 industrial companies and is generally considered a leading economic indicator

- P/E Ratio refers to the ratio of a stock's price relative to its Earnings Per Share indicates the price investors are willing to pay for a company's earnings. It is the most common metric used for determining the valuation of a company's stock.

# Disclosures

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