MAY 2023

MARKET UPDATE

Large cap equities were largely positive in April, where the S&P 500 gained 1.56%, outperformed by international developed equities, which gained 2.82%. Emerging markets lost 1.13%, despite the dollar slightly declining over the month. However, mid and small cap US equities also suffered losses, with the Russell 2000 being the laggard and losing 1.80%. Across fixed income, the Bloomberg US Aggregate index gained 0.61% as the market digested a mixed inflation report and is waiting to see what the Fed will do and say in their early May meeting.

The first quarter earnings season is just over halfway through, and thus far, more companies in the S&P 500 are beating analysts' estimates than at any point since Q4 20211. This is despite aggregate quarterly earnings declining. Companies outperforming relatively bearish expectations has been an underlying story in the market for the last couple of quarters as economic weakness continues to be a risk, but the economy has held up better than investors have feared.

Over the first quarter, the economy grew at a 1.1% annualized rate2, ahead of the consensus view, based on a Bloomberg survey of economists, of a 1.9% growth rate. However, the economy slowed from the fourth quarter's 2.6% growth rate. Personal consumption grew at a 3.7% rate but was held back by falling private investment.

ADVISORS' PERSPECTIVE

As of the end of April, slightly over half of the S&P 500 companies had reported their first-quarter earnings, revealing positive growth in their top line, but a slight decrease in net earnings. Despite this decline, equity market valuations remain in the middle range of recent history. While the economy still presents a mixed outlook, positive developments in areas such as financial system stress, economic conditions, consumer sentiment, and global output have contributed to the improvement. However, the categories of orders and service conditions experienced a decline.

The market's perception of risk continues to be heavily influenced by evolving economic and inflation outlooks, particularly in terms of how they affect pricing in credit markets. As a result, these ongoing changes continue to shape the market's overall risk sentiment. The latest reports show inflation, as well as economic activity, is slowing down. While slowing economic activity typically doesn't improve investors' mood, the first quarter GDP report showed the US economy is gradually slowing, which may give the Fed some confidence that their rate hikes are having their intended impact. As a result, the markets have largely overlooked these concerns and continue to maintain a positive trend.

The National Bureau of Economic Research (NBER) evaluates several components when assessing for a recession, such as nonfarm payrolls, employment survey, real personal income, and others. Overall data remains mixed, with the labor market slowing but remaining tight. Meanwhile, the consumer slowed, and industrial production picked back up over the last three months following December's decline. In March, retail sales fell 0.6%, its fourth decline in the last five months, and the consumer pulled back on spending, which was also seen in March's flat personal consumption expenditures (PCE) data. Personal income increased in March,

following two consecutive flat months as the consumer's income, after adjusting for inflation, had increased, or remained flat for the last nine months.

Expectations on Fed policy quickly shifted downwards. Based on the futures market, investors are expecting a 25-basis point increase from the Fed following their early May meeting. Through the summer, the markets are betting that the Fed holds rates steady after their May meeting before pivoting to cutting rates in the latter part of 2023.

The next CPI report will be released on May 10th, with the latest Bloomberg survey of economists suggesting a 0.4% monthly and 5.0% yearly price increase. Depending on the CPI report, The Fed may raise rates one more time after May if inflation remains persistent and does not show signs of slowing down.

We remain cautiously optimistic. Considering that we are in or approaching a recessionary period, it would not be a surprise if we recovered quicker than previous ones. In times like these, investors tend to trade based on emotions. We disagree, it is more important now than ever to follow the data. Hilltops partnership with Helios relies on facts and data, which we use during our recalculations on a bi-weekly basis. Our models adjust appropriately to market conditions.

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