OBSERVATIONS: *Jobless claims higher, mixed inflation data, PacWest back in the news*

- A relatively quiet news cycle left broad domestic markets relatively unchanged for the week with the S&P 500 declining -0.2%. Small cap stocks (Russell 2000 index) dropped -1.0% and emerging markets (iShares Emerging Market ETF) lost -2.1% led by a -3.5% decline in China (iShares MSCI China ETF).[1]
- Core inflation (CPI, ex. food and energy) for April registered +0.4% on a month-over-month (MoM) basis, while on a year-over-year (YoY) basis core CPI was 5.5%—both in line with expectations.[1]
- Wholesale prices, as measured by the core Producer Price Index (PPI ex. food and energy) rose +0.2% MoM, in line with expectations. On a YoY basis core PPI reached +3.2%, below expectations of +3.3%, and now sits at a two-year low.[1]
- The FDIC issued a proposed rule that will see 113 banks foot a special assessment fee of about $16bn—roughly equal to current expected losses associated with Silicon Valley Bank and Signature Bank—over a two-year period.[2]
- Troubled PacWest Bancorp reported that it had seen nearly 10% of its deposits leave the bank, mostly on 5/4 and 5/5 following a 5/3 news report that the bank was "exploring all of its options." The bank noted that, as of 5/10, it had available liquidity of $15bn—exceeding its uninsured deposits by almost $10bn.[3]
- The Bank of England (BOE) lifted interest rates by +25bps, as expected, to a new target of 4.5%. Interestingly, the resiliency of the UK economy prompted the central bank to raise its GDP estimates for 2023 and 2024, where the BOE had previously forecast recession over part of that same period.[4]
- Jobless claims rose to 264k, the highest level since October 2021. The 4-week moving average, which smooths the otherwise variable weekly data, rose to 245k, the highest since November 2021.[1]

EXPECTATIONS: *Lending conditions tighten and markets still looking for a rate cut in September*

- Last week's release of the Federal Reserve's Senior Loan Officer Survey for Q1 2023 showed loan demand declined for both large/mid & small firms, while the net percent of banks reporting tighter lending conditions was 46% for large/mid firms and 47% for small firms. The percentage of banks increasing lending rates, relative to their own cost of funds, jumped to 62% for large/mid firms and 58% for small firms.[5]
- Traders continue to price in an interest rate cut by the Fed around the September timeframe. To go from hiking to cutting in that short period of time would fall into the 'shorter-than-average' category. In the history of the Fed's rate hiking cycles, the average time after the Fed had made its final rate hike to when it cut rates is about seven months, contrasted with the four months that markets have priced in.[6]
- Debt ceiling discussions between the White House and Congressional leadership yielded little progress last week, and the group is slated to reconvene later this week. Staff-level discussions continue behind the scenes and some headway on certain compromises appears to be closer.[7]

ONE MORE THOUGHT: *The ever narrowing market*[1]

The S&P 500 Index closed up +8.1% year-to-date (YTD) as of last Friday, but these gains have been driven by an increasingly small number of firms. In fact (see Chart of the Week), only five names have driven the preponderance

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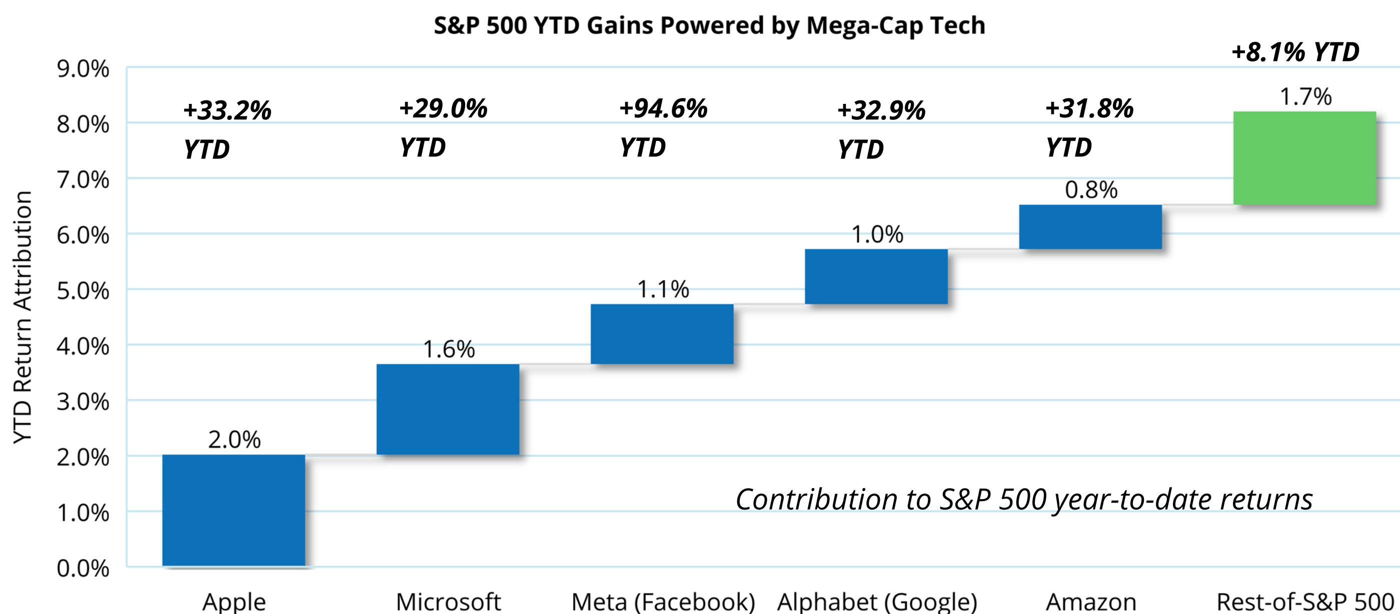
[1] *Bloomberg LP*
[2] *https://www.fdic.gov/news/fact-sheets/systemic-risk-determination-5-11-23.html*
[3] *https://www.sec.gov/ix?doc=/Archives/edgar/data/1102112/000162828023017382/pacw-20230331.htm*
[4] *https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-report/2023/may/monetary-policy-report-may-2023.pdf*
[5] *https://www.federalreserve.gov/data/sloos/sloos-202304-chart-data.htm*
[6] *https://www.ft.com/content/31671580-7d4b-4002-bc09-b19c5a6ae2d7*
[7] *https://www.politico.com/news/2023/05/12/the-eight-year-gap-splitting-negotiators-on-a-debt-deal-00096609*

of returns for the index YTD—Apple, Microsoft, Meta (Facebook), Alphabet (Google), and Amazon. Collectively, these five firms account for 80% of the gains in the index YTD, whereas the entire rest of the S&P 500 has returned about 1.7% YTD—the median S&P 500 firm has returned only 0.7%. The narrowness of the market rally thus far in 2023 adds to the uncertainty in the investor community. On one hand, should the rest of the S&P 500 begin to "catch up" and rally to a similar extent as these big five tech firms, the S&P 500 would be propelled into a new bull market. Equally, market bears look at the small number of firms that have powered the S&P 500's YTD gains and fret that this simply masks the underlying weakness in today's equity markets. Which narrative prevails in the coming months is uncertain, but it probably hinges, in large part, on the trajectory of inflation and the continued strength in the labor market. Should inflation continue to steadily decline, and the unemployment rate remain below 4%—some have termed this immaculate disinflation—then the more optimistic scenario could play out in the back-half of the year. Conversely, if inflation remains stubbornly high and the labor market begins to weaken materially, markets will begin to price in a recession, which may spur a sell-off in many stocks, not least of which could be today's high flying tech winners. In the meantime, be prepared for a continued sideways market.

CHART OF THE WEEK



Source: Clearstead, Bloomberg, Total Returns YTD as of 5/11/2023

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