<u>OBSERVATIONS</u>: S*mall cap stocks and regional banks leading the way, crypto in regulator's cross hairs*

- The S&P 500 index entered into a new bull market last week as it closed up over 20.0% higher from its Oct-2022 low—gaining 0.4% for the week. Last week was good for equities of all types as the VIX index—aka the fear gauge—fell steadily last week as equity volatility collapsed and the NASDAQ (+0.2%), small caps (Russell 2000 Index +1.9%), and regional banks (KBW Regional Bank Index +2.3%) all traded higher.[1]
- Stock market volatility remains well below average while interest rate uncertainty has led to bond market volatility remaining above average. Equity market volatility, as measured by the VIX index, reached 14.0 last week, the lowest level since February 2020 and well below the long term-average of 19.5. While bond market volatility, as measured by the MOVE Index, stands at 120.0—above its long-term average of 92.0.[1]
- SEC goes after Crypto platforms operating as exchanges. Last week the regulator sued both Binance and Coinbase (the number 1 and 2 largest exchanges by volume), accusing the former of multiple securities violations and the latter of operating as an unregulated exchange—among other allegations.[2]
- China's export economy dropped -7.5% in May on a year-over-year basis, while US trade data showed that goods imported from China represented just 15.4% of total US imports for the year ended in April, a near 17-year low.[3]
- China's post-Covid lockdown economic bounce was short-lived as a variety of economic indicators—exports, manufacturing PMIs, industrial activity came in below expectations.[1]
- Initial unemployment claims rose last week to 261k, the highest level since October-2021. Claims have been volatile lately, but over the past 8-weeks, initial weekly claims have averaged about 27k higher than the same period last year.[1]

<u>EXPECTATIONS:</u> *Bank of Canada lifts after a pause, Federal Reserve and European Central Bank meet this week*

- The Bank of Canada lifted its policy rate by +25bps to 4.75% after a pause in its rate hiking cycle in January 2023, another hike of +25bps is expected in July. The Royal Bank of Australia also hiked by +25bps last week. The Fed will release its policy decision after its two-day meeting next week (6/13-6/14), with markets looking for a pause in the Fed's hiking cycle. The European Central Bank meets on 6/15 with markets expecting another +25bps hike.[1]
- National housing prices are on the edge of falling year-over-year. After housing price increases peaked in the Spring of 2022—at that time housing prices registered 20% YoY gains—the latest Core-Logic housing price index shows that in April-2023 national housing prices gained only 2% YoY, which is lower than March's 3.1% YoY gain.[1] Another sign of moribund activity in the housing market, mortgage applications declined 1.4% last week from the week before, marking the fourth straight week of weekly declines while refinancing activity—heavily impacted by the Fed's tightening cycle—has declined 42% YoY.[1]

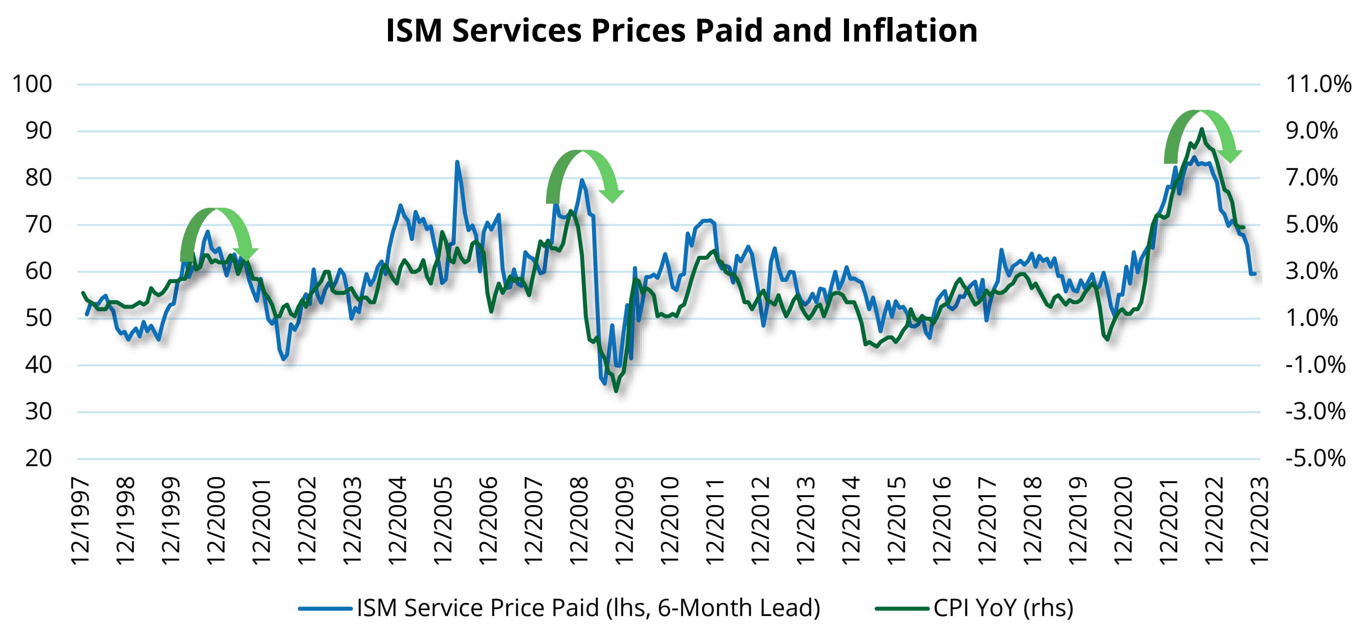
<u>ONE MORE THOUGHT</u>: *Softer inflation readings coming?*[1]

Recent data from the Institute for Supply Management (ISM) has continued to drift lower for both the manufacturing sector as well as the service sector of the economy. The slowing has been more prevalent in the manufacturing sector as it normalizes from the post pandemic bump in goods spending. The ISM manufacturing index has now dropped for seven consecutive months and remains in contractionary territory. Last week's ISM

[1] *Bloomberg LP*
[2] *https://www.coindesk.com/, https://coinmarketcap.com/rankings/exchanges/*
[3] *https://www.wsj.com/articles/u-s-imported-more-cars-phones-supplies-from-abroad-9157aca6?mod=economy_lead_pos1, https://www.cnbc.com/2023/06/07/chinas-exports-plunge-by-7point5percent-in-may-far-more-than-expected.html*

Services report showed that the services sector declined in May with the ISM Services index falling to 50.3—the lowest since December 2022 and barely above the 50.0 level, which signifies expansion. *The index fell from April's 51.9 reading and was below the estimate of 52.4.* One notable data point from the manufacturing and services surveys was the prices paid component which continues to fall and may portend softer CPI inflation reading in the months ahead. For the manufacturing side, prices paid have declined to levels last seen in December 2022, while ISM Services prices paid have declined to the lowest level since November 2020. Looking back in history, we have observed that the prices paid component of the ISM Services index has led overall inflation rates by three to six-months—meaning that declines in prices paid witnessed recently and today could result in lower CPI by late fall/early winter (Chart of the Week). There are many factors that could cause this relationship to manifest itself differently this time, but still the long-term evidence looks compelling for using this relationship to inform one's thinking of the path for inflation. This of course could have ramifications for Fed policy, notably that banking on further rate hikes, beyond a possible July increase, may not be the right bet. That said, 'higher for longer' remains the base case given that even if a softening of inflation were to come, it is likely to remain higher than the Fed's intended inflation target of 2.0% (notwithstanding something in the financial system breaking).

CHART OF THE WEEK



Source: Clearstead, Bloomberg LP, as of 5/31/2023

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