OBSERVATIONS: *Debt ceiling talks continue, GDP rebound in Q2, bond yields higher*

- The S&P 500 Index traded sideways and finished the week +0.2% amid the debt-ceiling talks. With a deal reached over the weekend, the legislative process is set to begin this week—first in the House. Chip maker Nvidia, which is now 8x bigger than Intel in market capitalization terms, led tech stocks higher for the week after reporting a surge in sales on increased demand for AI driven technology—the Nasdaq 100 gained +3.6% for the week.[1]
- Bond yields continued to back up last week as markets wrestled with 'higher for longer' interest rates. Over the last two weeks the 2-Year US Treasury yield has risen +50bps to 4.6%, while the 10-Year US Treasury yield has increased by +30bps to 3.80%, as of 5/26/2023.[1]
- New home sales rose in April to 683k (seasonally adjusted annualized rate) which is 4.1% higher than in March. However, the inventory of unsold new homes remains high at 8-months—up from 7.6 months in March—while the median sales price was down -8.2% in April from April-2022 and recent surveys show that nearly 1-in-3 home builders are offering price reductions to sell newly built homes.[1]
- Architectural billings index—a leading indicator of non-residential construction—weakened in April to 48.5, which suggests that overall commercial real estate investment and construction activity is set to decline modestly over the next nine to twelve months.[2]
- Personal Consumption Expenditures (core PCE) rose in April by +0.4% month-over-month, ticking higher to +4.7% year-over-year. Both were higher than expectations and higher than March's readings of +0.3% and +4.6% respectively.[1]
- The Michigan Consumer Sentiment index deteriorated in May to 59.2—wiping out half of the gains in the index since it hit an historic low (50.0) in June-2022. Consumer expectations for inflation a year from now eased from April's 4.6% expectation down to an anticipated inflation rate of 4.2% in May.[1]

EXPECTATIONS:

- The minutes from the most recent Fed meeting (May 2-3) showed the Fed staff predicted that economic growth would slow in Q2 and Q3 of this year before falling outright in Q4 and again in Q1-2024. Most Fed officials acknowledged that given the lagged effect of monetary policy, the case for additional rate hikes in 2023 had become "less certain" and that the unemployment rate was expected to increase over the remaining months of 2023 before peaking in 2024. Markets, on the other hand, have pivoted and are now pricing in a 100% probability of another +25bps rate hike by the July Fed meeting.[1]
- The BEA revised its estimate of Q1-2023 real GDP growth up to +1.3% annualized rate from +1.1% in the initial estimate. The increase in estimate is largely due to upward revisions in consumer spending, exports, and government spending during Q1. Meanwhile, the Atlanta Fed's GDP Now tracker is now estimating Q2 GDP to increase by +2.9% (seasonally adjusted annual rate).[1]

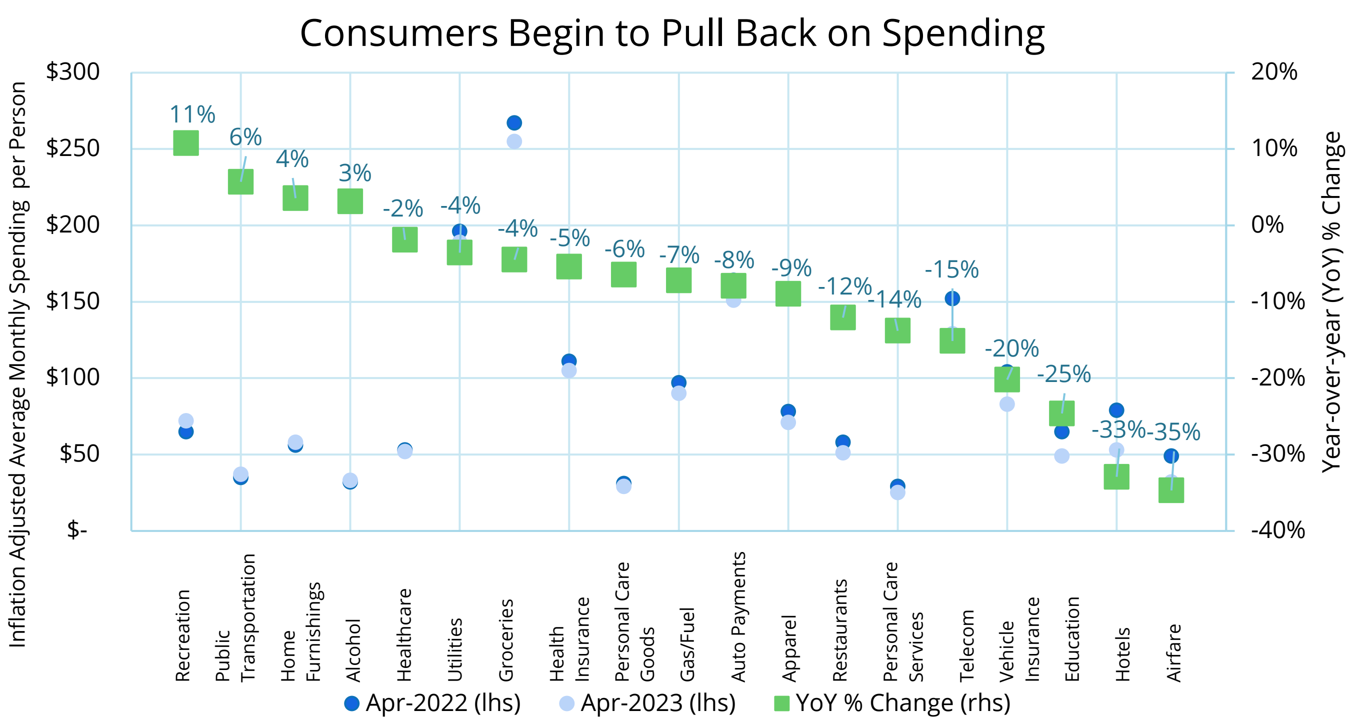
ONE MORE THOUGHT: *How Healthy is the US Consumer?*[3]

The US consumer remains in a healthy place overall, but recent data show clear trends that the average consumer is beginning to pull back on spending in light of more than 12-months of steady price increases and persistent discussion of a looming recession—see Chart of the Week. On the surface, headline retail sales numbers (+1.2% YoY) and corporate sales growth (+4.1% YoY) look positive. However, these figures are not adjusted for inflation—which has averaged 7.2% over the past year. Once these figures are adjusted for inflation, it is clear that US

[1] *Bloomberg LP*
[2] *https://www.aia.org/press-releases/6630516-aiadeltek-architecture-billings-index-refl*
[3] *Morning Consult – Sticky Inflation Brings Another Month of Lower Consumer Spending 5/22/2023; FactSet Earnings Insight 5/19/2023*

consumers are buying less than they had previously. In fact, that is precisely what corporate earnings calls are telling us. Numerous firms this past earnings season noted that volume sales are down modestly, but due to price hikes their overall sales figures ended the quarter higher. Earnings calls also noted that most US consumers are trading-down in their purchases—buying less brand-names and high-end items and focusing more on relative prices and only buying essentials. Equally, data from banks and credit card companies shows that most US consumers have spent down their Covid-period savings and increased their use of credit to make ends meet in 2023. So far, the US labor market has remained strong, and the record low unemployment rate (3.4%) has kept the US consumer employed—thus blunting the full impact of high inflation on the average US wallet. Nonetheless, if the labor market begins to wobble in the second half of the year, we would expect consumer spending will be pulled back even further. Ultimately, the fortunes of the US consumer dictate a large portion of the outlook for US corporate profits. As US equities search for a narrative to guide them in the second half of the year, the job market outlook may have never mattered so much.

CHART OF THE WEEK



Source: Clearstead, Morning Consult, BEA May-2023

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