OBSERVATIONS: *Markets up, manufacturing activity still weak, employment remains strong*

- Markets traded up during the holiday shortened week following the debt ceiling resolution and a strong jobs report. The S&P 500 rose +1.9%, while small cap stocks (Russell 2000) gained +3.3%. The Nasdaq 100 reached a 14-month high after rising +1.8%.[1]
- Narrow markets year-to-date: As of 5/31/2023, the S&P 500 has gained 9.6% with 100% of gains attributable to the "Magnificent Seven": Apple, Microsoft, Alphabet, Amazon, Meta (Facebook), Tesla, and Nvidia. On an equal weighted basis—that is, holding the stocks in the S&P 500 equally rather than by market capitalization weighted—the S&P 500 has declined by -0.7%.[1]
- Broad commodity index prices (Bloomberg Commodity Index) have now fallen -28%, as of 5/31/2023, since peaking in mid-2022 and are now sitting at 16-month lows.[1]
- Manufacturing activity in China fell unexpectedly for the second consecutive month, remaining in contraction territory with its purchasing manager index dipping to 48.8, below the forecast of 49.7 and the prior month's 49.2.[2]
- Meanwhile, China's services sector remained in expansion territory, albeit at a slower rate, with a reading of 54.5—less than April's 56.4 reading.[2]
- US Manufacturing activity (ISM Manufacturing Index) dropped for a seventh consecutive month to 46.9 and remains in contraction territory (below 50.0). This marks the longest stretch of below 50 readings since 2009 during the Great Financial Crisis.[1]
- Last week's Job Openings and Labor Turnover Survey (JOLTS) reported an increase from 9.8 million to 10.1 million job openings in April, better than estimates of 9.4 million and the first increase in 2023. The increase was driven by job openings in retail trade, health care and services, and transportation and warehousing.[1]
- Another month, another incredibly strong jobs report. May saw 339k new jobs created—above expectations of 195k but in line with the average monthly gain of +341k for the prior 12-month period. April and March were both revised up by +41k to 294k and +52k to 217k, respectively.[3]

EXPECTATIONS: *Quiet on the macro front this week, Federal Reserve and European Central bank meet next week*

- Eurozone headline inflation dropped to a 15-month low of 6.1% on a year-over-year (YoY) basis, the lowest level since Russia's invasion of Ukraine. Core inflation (ex. food and energy) dropped to a 2-month low of 5.3% YoY. Despite slowing inflation, markets widely expect the European Central Bank to proceed with another +25bps rate hike in the June 15 meeting, with a potential pause coming later in the summer.[1]

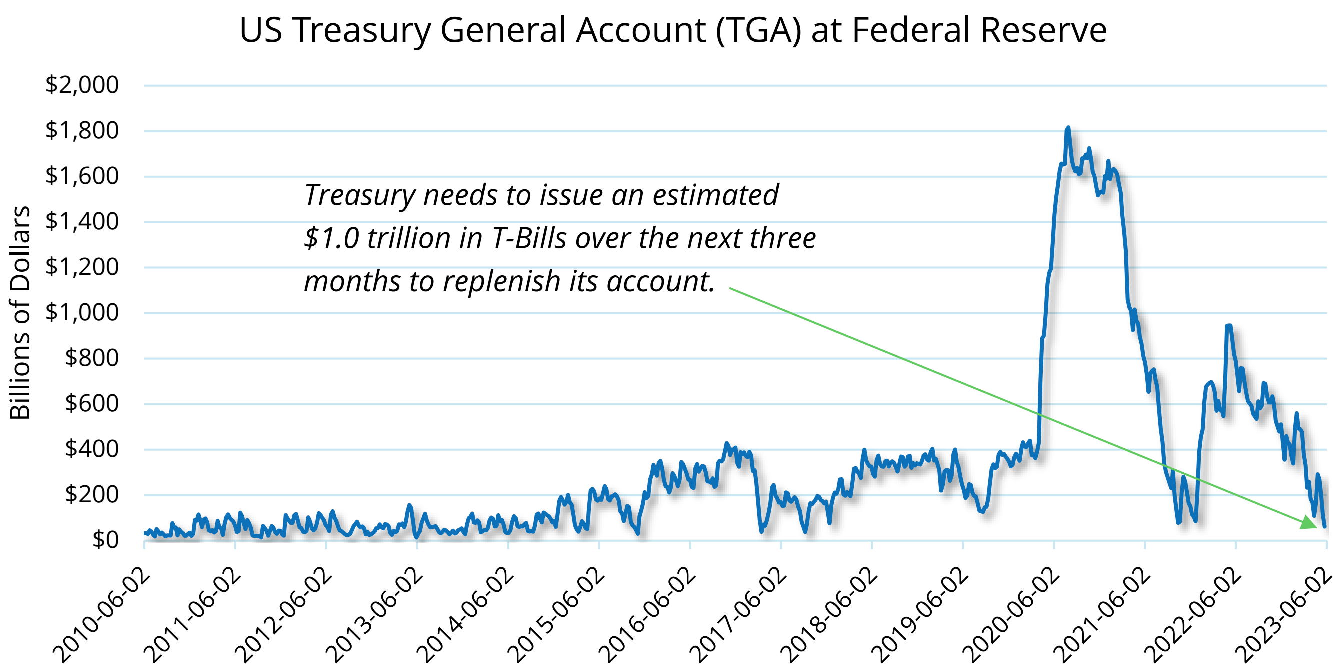
ONE MORE THOUGHT: *Debt ceiling and expected T-Bill issuance*[4]

Last week brought closure to the debt ceiling drama that has been atop investor's minds for recent weeks. The House passed the bill in a 314-117 vote, followed by the Senate in a 63-36 vote. The deal suspends the debt ceiling until January 2025, after the next election, allowing the US debt to grow beyond the current ceiling of $31.4 trillion. So, yes, we will be doing this all over again in two years. The bill caps non-defense spending in 2024, increasing by 1% in 2025 and expands work requirements, a claw back of certain Covid-19 relief funds, cuts to IRS funding, and restarts student loan payments by fall 2023. One of the byproducts of the three-month long standoff has been the dwindling cash available for the US Treasury to make payments. The Treasury holds those balances with the Federal Reserve in its Treasury General Account (TGA), and those balances have been drawn down to less than $50 billion

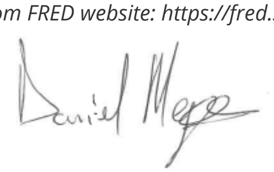
[1] *Bloomberg LP*
[2] *https://www.wsj.com/articles/chinas-recovery-slows-further-as-factory-services-activity-pulls-back-9384124d?mod=economy_lead_pos5*
[3] *https://www.bls.gov/news.release/empsit.nr0.htm, Bloomberg LP*
[4] *Clearstead, WSJ, AP, Marketwatch, Bank of America Global Strategists team*

(Chart of the Week). With the suspension of the debt limit, attention now turns to the Treasury needing to refill the TGA in order to continue making payments. Estimates vary, but the prevailing thought is that the Treasury will need to raise nearly $1.4 trillion by the end of 2023 to replenish the TGA. Nearly $1 trillion of the expected $1.4 trillion of T-Bills are expected to be issued over a three month stretch through August—a fivefold increase in T-Bill issuance during prior three month stretches in the pre pandemic period. Concerns are now being raised over how the volume of issuance will be absorbed by markets in a compressed period of time, particularly by money market mutual funds who have otherwise opted to use the Federal Reserve's Reverse Repurchase facility—to the tune of over $2 trillion—given its higher yields versus prevailing T-Bills. While there is a lot to be sorted out in terms of demand dynamics for the expected volume of Treasury Bills, focus now shifts from a technical default to ensuring the cash market remains orderly with an expectation that the flood in T-Bills may add some noise into the summer market doldrums.

CHART OF THE WEEK



Source: Board of Governors of the Federal Reserve System (US), Liabilities and Capital: Liabilities: Deposits with F.R. Banks, Other Than Reserve Balances: U.S. Treasury, General Account: Week Average [WTREGEN], retrieved from FRED website: https://fred.stlouisfed.org/series/WTREGEN, June 1, 2023.



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