May 2023: Market Review

Stocks associated with artificial intelligence moved sharply higher during May and contributed to the continued outperformance of technology-oriented stocks thus far in 2023. The tech-heavy NASDAQ Composite rose +5.9%, predominantly driven by just a few names including the large U.S. chip maker Nvidia, whose stock price jumped 24% in just one day during the month. However, mixed global economic data, lingering effects of the bank failures, and political tension caused investors to stay cautious in other sectors of the market. The broad market posted only modest gains in May (S&P 500 Index +0.4%), while the more cyclically-oriented Dow Jones Industrial Average fell -3.2% highlighting the narrowness of the market. The U.S. debt ceiling negotiations were deadlocked for most of the month, but talks gained momentum as the early June "x-date" approached. The President and Republican leadership struck a deal in late May and the legislation has since passed the House, waiting only for Senate approval. The Federal Reserve raised the Fed Funds rate by 25 basis points to 5.00-5.25% at the May meeting, bringing short-term rates to their highest levels in 16 years. While the market initially interpreted Fed action as a sign of a future pause in the tightening cycle, resilient consumer spending and relative strength in corporate earnings have caused markets to assign a greater than 50% chance of another hike in the June meeting.

In domestic equity markets, growth-style equities outperformed value across all capitalization sizes. The Russell 1000 Growth Index rose +4.6% for the month while the Russell 1000 Value Index fell -3.9%. The Russell Mid Cap Growth Index increased +0.1% versus the Russell Mid Cap Value Index return of -4.4%. The Russell 2000 Growth Index was flat while the Russell 2000 Value Index declined -2.0%. Small-cap banks continued to decline in May, putting pressure on the Russell 2000 Value Index, which has a large exposure to the financial sector (29%). WTI crude oil fell to $68 per barrel, from $77 per barrel at the end of April.

Developed international equities underperformed U.S. equities this month, as stock prices fell on signs that the economic outlook may be worsening as the German economy slipped into a technical recession. The MSCI EAFE Index declined -4.2%, while the MSCI ACWI ex USA Index (which included emerging markets) fell -3.6%. The Japanese equity market (+1.9%) was the only developed market to rise in the month, as growth in the manufacturing and services sectors was a tailwind for their markets. The MSCI Emerging Markets Index declined -1.7%, weighed down by China (-8.7%), as the post-pandemic recovery momentum slowed with weaker than expected manufacturing and retail data. Emerging markets did outperform developed markets because of support from Taiwan (+7.3%), as the country's largest company, Taiwan Semiconductor, rose sharply during the month.

U.S. fixed-income markets declined in May, as yield rose due to the uncertainty regarding the U.S. debt ceiling negotiations coupled with hawkish rhetoric from Fed officials. Markets are beginning to take the Fed's guidance on interst rates more seriously, as only one 25 basis point rate cut is expected by year-end, down from three earlier in the year. The Bloomberg Aggregate Bond Index declined -1.1% during the month while the Bloomberg U.S. Corporate High Yield Index fell -0.9%. The inversion between the 2-year and 10-year widened this month, ending at -0.76%. The spread between the 3-month and the 10-year U.S. treasury widened to -1.88%.

Mixed global economic data and contentious U.S. debt ceiling debates have further clouded investors' short-term expectations on markets. While U.S. consumers' continued appetite to spend has supported U.S. earnings, weakness in the domestic and global economy has started to become more prevalent. Persistently high inflation in the eurozone has led European Central Bank policymakers to voice their views that interest rates would need to rise further and remain elevated longer to curb inflation. Similarly in the U.S., the Federal Reserve has been signaling keeping rates higher for longer. Tighter credit conditions from central banks, in conjuction with tighter lending from traditional banks, remain a headwind for economic growth.

See footnotes on the following page.

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