Monthly Market Commentary
May 2023

Staring at the ceiling.

- Global equity markets experienced a modest downturn in May amid periods of volatility in response to the latest developments in the politically charged debt-ceiling standoff in the U.S., ongoing concerns about the stability of regional banks, as well as economic data. Both developed and emerging markets recorded negative returns for the month.
- Fixed-income assets posted losses in May. Yields rose across the curve as inflation remained stubbornly high.
- We remain cautious on equity markets from a top-down perspective. Within equities, we continue to focus on our core approach: favouring high-quality companies with positive earnings momentum at reasonable valuations.

Economic Backdrop

Global equity markets experienced a modest downturn in May amid periods of volatility in response to the latest developments in the politically charged debt-ceiling standoff in the U.S., ongoing concerns about the stability of U.S. regional banks, as well as economic data. Developed markets slightly outperformed emerging markets. The Far East garnered a moderately positive return and was the top-performing region among developed markets in May attributable primarily to strength in Japan. Europe was the primary market laggard due to weakness in Belgium and Portugal. Despite posting a negative return, Latin America was the top performer within the emerging markets in May, buoyed by the relatively strong performance of Brazil. Conversely, the Europe, Middle East and Africa (EMEA) region saw a significant downturn and was the weakest performer among emerging markets as stock prices in South Africa fell sharply over the month.

President Joe Biden and Kevin McCarthy, Speaker of the U.S. House of Representatives, reached an agreement on raising the $31.4 trillion debt ceiling during the last week of May. Both the U.S. House of Representatives and the Senate passed the legislation–the Fiscal Responsibility Act–by wide margins, with strong support from Republicans and Democrats. The bill suspends the debt ceiling through January 1, 2025, maintains non-military spending close to current levels for the 2024 fiscal year, which begins in October, and implements a 1% cap on increases in non-military spending for the 2025 fiscal year. The fast-track approval of the legislation, which Biden subsequently signed into law, enabled the government to avoid a potential default on its debt on June 5, the "X-date" on which Treasury Secretary Janet Yellen had warned that the U.S. would no longer be able to meet its financial obligations. During a nationally televised address following the vote in the Senate, Biden said, "No one gets everything they want in a negotiation, but make no mistake: This bipartisan agreement is a big win for our economy and the American people."

Shortly before the initial announcement of the debt-ceiling agreement, credit-rating agency Fitch placed the United States' AAA-rated debt on "Rating Watch Negative," citing "increased political partisanship that is hindering reaching a resolution to raise or suspend the debt limit." Similarly, DBRS Morningstar, the world's fourth-largest credit-rating agency, expressed concerns that "political polarization in the context of a divided congress poses some risk to the U.S. government's willingness to ensure all debts are paid on time and in full."

U.S. regional bank stocks encountered significant volatility again in May, and ended the month with notable losses. Early in the month, U.S. regulators took control of California-based First Republic Bank. The California Department of Financial Protection and Innovation–which oversees the operations of state-licensed financial institutions, including banks and credit unions–issued a statement announcing that it had taken over the bank and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. The FDIC subsequently accepted J.P. Morgan Chase Bank's bid "to assume all deposits, including all uninsured deposits, and substantially all assets of First Republic Bank." The KBW Regional Banking Index, which tracks the performance of publicly traded U.S. regional banks and thrifts, fell 9.2% in May, and was down nearly 29% for the year to date.

Global fixed-income assets lost ground in May. In the U.S. market, high-yield bonds recorded the smallest losses and were the top performers for the month, followed by mortgage-backed securities (MBS). U.S. Treasurys and corporate bonds were the weakest performers. U.S. Treasury yields moved sharply higher across the curve in May. Yields on 1-month U.S. Treasury bills (T-bills) with maturities close to the U.S. government's "X-date" of June 5 for the default on its financial obligations climbed 167 basis points (1.67%) to 6.02%–the highest level since the introduction of the 1-month T-bill in July 2001–before tumbling to 5.28% over the last two days of the month following the announcement of a potential agreement on raising the debt ceiling. Investors demanded higher yields as compensation for the additional risk that the U.S. government could default on its debt in early June. The yields on 2-, 3-, 5-, and 10-year Treasury notes climbed 0.36%, 0.29%, 0.23%, and 0.20%, respectively, in May. The spread between 10- and 2-year notes widened from -0.60% to -0.76% during the month, further inverting the yield curve.

Global commodity prices moved lower during the month. The West Texas Intermediate (WTI) crude-oil spot price and the Brent crude oil price fell 11.3% and 9.6%, respectively, in U.S. dollar terms, hampered by the strong performance of the greenback in May, as well as investors' fears of waning demand for oil. The 12.1% decline in the New York Mercantile Exchange (NYMEX) natural gas price in May was attributable to concerns about lower demand, as well as an increase in supply. Wheat prices fell 6.3% in May after Ukraine and Russia renewed an agreement that allows the shipment of Ukrainian grain through the Black Sea. The gold spot price dipped 0.9% during the month as progress in the debt-ceiling negotiations in the U.S. reduced the demand for the precious metal as a "safe-haven" asset.

Geopolitical tensions rose in the Asia-Pacific region in late May. North Korea notified the International Maritime Organization, the United Nations' specialized agency with responsibility for the security of shipping and the prevention of marine and atmospheric pollution by ships, of its intention to launch its first military reconnaissance satellite between May 31 and June 11. Japan's Ministry of Defense subsequently announced that it had placed its ballistic missile defenses on alert and vowed to shoot down any North Korean missile or debris if it entered Japan's territory. A reconnaissance satellite would enhance North Korea's capability to carry out a preemptive military strike and monitor potential incoming threats from the U.S. and South Korea. Japan, the U.S. and South Korea issued a joint statement warning that, if North Korea proceeds with the satellite launch, "there will be a stern, unified response from the international community."

Regarding the ongoing Russia-Ukraine conflict, the Wagner Group, a Russian paramilitary organization, began to retreat from the city of Bakhmut, Ukraine, in late May. The mercenaries were scheduled to complete their retreat by the beginning of June, and would be replaced by regular Russian troops. The Wagner Group had been fighting in Bakhmut since the summer of 2022. The withdrawal from the city occurred after the group's leader, Yevgeny Prigozhin, claimed that Russian Defense Minister Sergei Shoigu and Valery Gerasimov, Chief of the General Staff, had intentionally withheld ammunition from Wagner Group fighters.

Central Banks

- The Bank of Canada (BoC) did not meet in May. The central bank hiked its overnight interest rate by 0.25% to 4.75% following its June 7 meeting. This increase—to the highest level in 22 years—was somewhat of a surprise as most market observers had expected the BoC to stand pat as it had done the previous two meetings. In support of this decision, the BoC noted that underlying inflation remains stubbornly high even though global inflation is coming down as energy prices have cooled from a year ago. Furthermore, global growth has slowed or even stalled in many countries. The BoC's next scheduled meeting is on July 12.

- The U.S. Federal Reserve (Fed) raised the federal-funds rate by 25 basis points (0.25%) to a range of 5.00%-5.25% at its meeting in early May—the central bank's tenth increase since it began its rate-hiking cycle to combat inflation in March 2022. In a statement announcing the rate hike, the Federal Open Market Committee (FOMC) commented that "[we] will closely monitor incoming information and assess the implications for monetary policy. In determining the extent to which additional policy firming may be appropriate to return inflation to 2 percent over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments." Regarding concerns about the stability of the banking sector, the Fed stated: "The extent of these effects remains uncertain."

- The minutes from the FOMC's meeting revealed that, "Participants generally expressed uncertainty about how much more policy tightening may be appropriate." While some investors believe that the Fed is preparing to pause its rate-hiking cycle, the FOMC's meeting minutes stress that, "Many participants focused on the need to retain optionality," leaving the door open for further rate hikes. The next FOMC meeting is scheduled for June 13-14.

- In a split 7-2 vote, the Bank of England (BOE) raised its benchmark rate by 0.25% to 4.50% on May 11. The BOE's Monetary Policy Committee (MPC) expects U.K. gross domestic product (GDP) to be virtually flat over the first half of 2023; however, it anticipates that there will be a modest increase in underlying economic output. Additionally, the MPC projects that the UK's inflation rate, as measured by the consumer-price index, will drop below 2% within the next two to three years.

- The European Central Bank (ECB) increased its benchmark interest rate by 0.25% to 3.75% following its meeting on May 10. In a statement announcing the rate hike, the central bank noted, "The inflation outlook continues to be too high for too long…Headline inflation has declined over recent months, but underlying price pressures remain strong."

- The Bank of Japan's (BOJ) next monetary policy meeting is scheduled for June 15-16. The central bank left its benchmark interest rate unchanged at -0.1% on April 28 following the first monetary policy meeting under new BOJ Governor Kazuo Ueda. In its Outlook for Economic Activity and Prices for April, which was released in early May, the BOJ commented, "Japan's economy is likely to recover moderately toward around the middle of fiscal 2023, supported by factors such as the materialization of pent-up demand, although it is expected to be under downward pressure stemming from past high commodity prices and a slowdown in the pace of recovery in overseas economies."

Economic Data (unless otherwise noted, data sourced to Bloomberg)

- According to Statistics Canada, the rate of inflation rose (as measured by the change in the Consumer Price Index (CPI)) 0.7% for April, and ticked 0.1% higher to 4.4% increase for the one-year period. Although shelter and grocery costs moderated, prices remain broadly elevated. Despite being down 7.7% from a year ago, gasoline prices were up 6.3% in April—the largest monthly increase since October 2023. Producer prices were mixed in April, but cost pressures eased considerably from a year ago. The Industrial Product Price Index (IPPI) and Raw Materials Price Index (RMPI) fell 0.2% and climbed 2.9%, respectively in April. Year-over-year prices slumped 3.5% for the IPPI and plunged 10.8% for the RMPI. These trends were mirrored by energy costs. The Canadian labor market stalled in May as the economy shed 17,000 jobs. The unemployment rate was up 0.2% to 5.2%, primarily due to population growth and a slow start to the summer for seasonal jobs.

- According to the U.S. Department of Commerce, the personal-consumption-expenditures (PCE) price index rose 0.4% in April and 4.4% over the previous 12-month period, fueling speculation over the possibility of further Fed rate hikes to combat inflation. Food prices dipped less than 0.1% during the month and were up 6.9% year-over-year. Energy prices increased 0.7% in April but fell 6.3% over the previous 12 months. The PCE price index is the Fed's preferred gauge of inflation, as it tracks the change in prices paid by or on behalf of consumers for a more comprehensive set of goods and services than that of the consumer-price index (CPI). The Department of Labor also reported that U.S. payrolls expanded by 253,000 in April, up from 236,000 in March. The unemployment rate dipped 0.2% to 3.4%. The professional and business services, health care, and leisure and hospitality sectors saw the largest employment gains in April. Despite the greater-than-expected growth in payrolls during the month, the total lagged the 400,000 monthly average job gains for the 2022 calendar year. Average hourly earnings rose 0.5% In April and 4.4% year-over-year. The 12-month increase was modestly higher than the 4.2% annual rise in March. Higher mortgage rates continue to weigh on the U.S. housing market. The National Association of Realtors (NAR) reported that sales of existing homes fell 3.4% in April and plummeted 23.2% versus the same period in 2022. The median existing-home price was down 1.7% year-over-year to $388,000—the biggest 12-month decline since January 2012. The inventory of unsold existing homes increased 7.2% from the previous month to 1.04 million at the end of April, equivalent to 2.9 months' supply at the current monthly sales pace. According to the NAR, a six-month supply of homes historically has indicated a "balanced market," in which prices rise modestly. Inventories of greater than six months typically favour buyers; inventories of less than six months typically favour sellers. According to the second estimate of the Department of Commerce, U.S. GDP grew at an annualized rate of 1.3% in the first quarter of 2023, up modestly from the initial estimate of 1.1%, but down from the 2.6% rise in the fourth quarter of 2022. The largest increases for the first quarter of this year were in consumer spending, exports, and federal government spending. These gains offset reductions in private inventory investment (a measure of the changes in values of inventories from one time period to the next) and residential fixed investment (purchases of private residential structures and residential equipment that property owners use for rentals). The government attributed the slower GDP growth rate relative to the fourth quarter of 2022 to a downturn in private inventory investment and a decline in nonresidential fixed investment (purchases of both nonresidential structures and equipment and software).

- According to the Office for National Statistics (ONS), consumer prices in the U.K. rose 1.2% month-over-month in April, up from the 0.8% increase in March. The inflation rate rose 7.8% over the previous 12-month period, but was significantly lower than the 8.9% year-over-year rise in March. Food and non-alcoholic beverages, as well as housing and household services (particularly electricity) were the most notable contributors to the annual increase in prices. Core inflation, which excludes volatile food and energy prices, rose at an annual rate of 6.2% in April, unchanged from the increase in March. The ONS also reported that U.K. GDP ticked up 0.1% in the first quarter of 2023, with a 0.5% expansion in January, flat growth in February, and a 0.3% decline in March. The services and production sectors recorded marginal growth rates for the quarter, while household consumption was flat. The S&P Global/CIPS Flash UK Manufacturing Output Index declined 1.9 to a four-month low of 47.4 in May due to a decrease in orders, along with customer destocking (a planned reduction in stock or inventory). A reading below 50 indicates contraction in the manufacturing sector. The S&P Global/CIPS Flash UK Services PMI Business Activity Index dipped 0.8 to 55.1 in May, but indicated expansion for the third consecutive month. The slowdown in the rate of growth relative to the previous month resulted mainly from budget pressures among corporate clients, rising economic uncertainty, and higher borrowing costs.

- Inflation in the eurozone ticked up 0.1% to 7.0% for the 12-month period ending in April. Prices for food, alcohol and tobacco, as well as non-energy industrial goods, led the upturn in the year-over-year inflation rate. Eurozone manufacturing decreased in April, with the HCOB Flash Eurozone Manufacturing Output Index falling 2.2 to a six-month low of 46.3. Services activity in the eurozone expanded in April, but the HCOB Flash Eurozone Services PMI Activity Index dipped 0.3 to 55.9. According to Eurostat's second estimate, eurozone GDP increased 0.1% in the first quarter of 2023, unchanged from the initial estimate. The eurozone saw flat economic growth in the fourth quarter of 2022. GDP increased 1.3% over the previous 12 months. Poland's economy was the strongest performer, expanding 3.9% in the first quarter, while Lithuania's GDP decreased 3.0% during the period.

Index Data (May 2023)

- The S&P/TSX Composite Index fell 4.95%.
- The FTSE Canada Universe Bond Index returned -1.69%.
- The S&P 500 Index, which measures U.S. equities, rose 0.66%.
- The MSCI ACWI (Net) Index, used to gauge global equity performance, was down 0.85%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned -1.01% (currency hedged) and -0.73% (unhedged).
- The Chicago Board Options Exchange Volatility Index—a measure of implied volatility in the S&P 500 Index that is also known as the "fear index"—moved higher from 15.78 to 17.94.
- WTI Cushing crude oil prices—a key indicator of movements in the oil market—moved lower from US$76.78 to US$68.09 a barrel to end May.
- The Canadian dollar was little changed at C$1.36 per U.S. dollar. The U.S. dollar was generally stronger versus the world's other major currencies; it ended May at US$1.07 versus the euro, US$1.24 against sterling and at 139.72 yen.

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