

WeeklyMarket Update



General Market News

- Following the much-anticipated May Federal Open Market Committee (FOMC) meeting on May 3 and 4, we saw a moderate steepening on the back end of the curve. The Federal Reserve (Fed) hiked 50 basis points (bps) as widely expected. The moderate surprise this week was two-fold: the Fed announced plans to reduce their balance sheet by \$30 billion in Treasuries and \$17.5 billion in mortgage-backed securities, starting in June. After three months, these values will double to \$60 billion and \$35 billion, respectively. Additional surprise came via a press conference in which Fed Chairman Jerome Powell took a 75 bps June hike off the table, stating, "A 75 bps increase is not something the committee is actively considering". We expect this topic to be debated by Fed members in the coming weeks.
- Global markets sold off last week, due to both global growth and inflation concerns. The Fed voted to hike rates 50 bps higher in May and to begin tapering their balance sheet in June. The continued Ukraine/Russia conflict and lockdowns in China have led to concerns over expected inflation and food security. The move by the Fed represents a shift in a move away from accommodative policy following the global spread of Covid-19 in 2020 and cements the shift from its focus on employment back to stable prices and slowing inflation. As a result, the central bank is currently hiking rates, which should ease demand and help certain supply chains play catch-up. Between elevated prices and elevated financing costs, there is concern that consumption and the global economy could be slowed in the near-term. The top performers were mixed between sectors that benefit from inflation (energy, utilities, telecom, industrials) and higher rates (financials). These two factors tend to act against each other, but the performance of these sectors provides an indication of investor sentiment about the Fed moving too slowly to tighten policy. Sectors that underperformed included REITs, consumer discretionary, consumer staples, and technology. REITs and consumer discretionary were directly impacted by higher rates.
- The ISM Manufacturing survey for April was released on Monday. This measure of manufacturer confidence surprisingly dropped from 57.1 in March to 55.4 in April, against calls for an increase to 57.6. This is a diffusion index, with values above 50 indicating growth, so this report showed continued expansion for the manufacturing industry despite the miss against expectations. The drop for the index was largely attributable to softer demand for manufactured goods; the measure of new orders fell to its lowest level since May 2020. Hiring also showed some signs of weakness. All in all, this report showed that recovery for the manufacturing industry slowed; slower growth is still growth, however, and the industry is expected to continue to improve in the months ahead.
- On Wednesday, the March international trade balance report was released. The report showed that the trade deficit increased by more than expected. The monthly trade deficit widened from an upwardly revised \$89.8 billion in February to \$109.8 billion in March, against calls for \$107.1 billion. The trade deficit has increased in each of the past five months, and the March result marks a new record deficit. The larger-than-expected increase in March was attributable to a 10.3 percent increase in imports that more than offset the 5.6 percent rise in exports. Record imports drove the large first-quarter monthly trade deficits, indicating high levels of domestic demand for goods and services. That said, the slower export growth over the quarter due to faltering international demand caused net trade to serve as a drag on overall economic growth during the quarter. Economists largely expect to see the trade deficit start to normalize in the months ahead, which could in turn help support overall economic growth.
- Wednesday also saw the release of the ISM Services index for April. Service sector confidence declined during the month, with the index falling from 58.3 in March to 57.1 in April against calls for a modest increase to 58.5. This is another diffusion index, with values above 50 indicating growth, so this result still signals continued expansion for the service sector. The decline in April was largely attributable to a slowdown in service sector hiring, which is turn was caused by the current labor shortage and rising employment costs. Although the headline index dropped, there were positive signs in the underlying data, including an increase in business activity. Economists largely expect to see service sector confidence improve as we head toward the summer months, when consumers continue to pivot from spending on goods to spending on services.

- Wednesday also saw the release of the FOMC rate decision from the Fed's May meeting. The Fed raised the upper limit for the federal funds rate from 0.50 percent to 1 percent at this meeting, as expected by markets and economists. This 50 bps interest rate hike is part of the Fed's larger plan to tighten monetary policy throughout the year to combat inflation. Fed Chair Jerome Powell indicated at his post-meeting press conference that the central bank is planning on further rate hikes at future meetings, with markets largely expecting another 50 bps increase when the Fed meets again in June. Aside from the rate hike announcement, the Fed also announced plans to begin trimming its balance sheet starting in June. The balance sheet reductions will start at just under \$50 billion per month and will increase to \$95 billion per month later in the year, although the pace of balance sheet reductions will depend on market and economic conditions. Looking forward, the Fed remains committed to tightening monetary policy throughout the year to normalize interest rates to combat inflation.
- We finished the week with the release of the April employment report, which showed that 428,000 jobs were added during the month, slightly above economist estimates of 380,000 jobs. With only a slight downward revision of 3,000 jobs, this is now the twelfth straight month with job gains greater than 400,000 and the sixteenth straight month of job growth overall, showing the continued strength of the labor market. The unemployment rate remained unchanged at 3.6 percent, slightly above the expectation for 3.5 percent. The participation rate fell from 62.4 percent to 62.2 percent, against the expectation for a rise to 62.5 percent. Both numbers indicate the tightness of the labor market overall as we move closer to pre-pandemic lows in unemployment and highs in participation. Average hourly earnings came in with an increase of 0.3 percent for the month and 5.5 percent on a year-over-year basis, slightly below expectations for 0.4 percent and 5.6 percent, respectively. Although less than expected, these numbers still represent much faster wage growth than before the pandemic, but still behind the pace of inflation. Economists expect the pace of jobs gains to slow going forward, but this report overall shows the continued strength of the jobs market as a major factor in post-pandemic recovery.
- We finished the week with the release of the April employment report, which showed that 428,000 jobs were added during the month, slightly above

Market Index Performance Data

EQUITIES

| Index | Week-to-Date | Month-to-Date | Year-to-Date | 12-Month |
|-----------------------|--------------|---------------|--------------|----------|
| S&P 500 | -0.18 | -0.18 | -13.07 | -1.22 |
| Nasdaq Composite | -1.50 | -1.50 | -22.19 | -11.10 |
| DJIA | -0.21 | -0.21 | -8.92 | -3.65 |
| MSCI EAFE | -2.83 | -2.83 | -14.49 | -13.00 |
| MSCI Emerging Markets | -4.12 | -4.12 | -15.77 | -21.77 |
| Russell 2000 | -1.29 | -1.29 | -17.77 | -18.15 |

Source: Bloomberg, as of May 6, 2022

FIXED INCOME

| Index | Month-to-Date % | Year-to-Date % | 12-Month % |
|-------------------|-----------------|----------------|------------|
| U.S. Broad Market | -1.11 | -10.51 | -9.78 |
| U.S. Treasury | -1.19 | -9.59 | -8.73 |
| U.S. Mortgages | -0.91 | -9.14 | -9.59 |
| Municipal Bond | -0.75 | -9.50 | -8.75 |

Source: Morningstar Direct, as of May 6, 2022



What to Look Forward To

On Wednesday, the April Consumer Price Index report is set to be released. Consumer inflation is expected to slow down during the month, with economists forecasting a 0.2 percent rise in prices in April following a 1.2 percent increase in March. On a year-over-year basis, headline consumer prices are expected to increase 8.1 percent in April, down from 8.5 percent in March. Part of the anticipated slowdown in headline consumer inflation in April is due to relatively steady gas prices, as the surge in gas prices in March was a major driver of inflation. Core consumer prices, which strip out the impact of volatile food and energy prices, are set to increase 0.4 percent during the month and 6.1 percent on a year-over-year basis. Consumer prices have experienced significant inflationary pressure throughout the past year driven by high levels of consumer demand, shipping bottlenecks, and rising material and labor costs.

On Thursday, the Producer Price Index report will be released. As was the case with consumer inflation, producer inflation is expected to moderate in April. Headline producer prices are expected to rise 0.5 percent during the month, down from 1.4 percent in March. On a year-over-year basis, producer prices are expected to increase 10.6 percent in April, down from 11.2 percent in March. Core producer prices, which strip out the impact of volatile food and energy prices, are also expected to show slower growth in April. Core producer prices are expected to increase 0.7 percent during the month and 8.9 percent on a year-over-year basis, down from the 1 percent monthly and 9.2 percent

year-over-year increases we saw in March. In the past year, producer prices have experienced similar upward pressure as consumer prices due to high levels of demand and tangled supply chains. This year, the Fed is expected to continue focusing its efforts on combating inflation through the use of tighter monetary policy. So, both the consumer and producer inflation reports will be closely watched by investors and economists in the months ahead.

We'll finish the week with Friday's release of the preliminary estimate of the University of Michigan consumer sentiment survey for May. Economists expect to see the index decline modestly during the month, with forecasts calling for a drop from 65.2 in April to 63.6 in May. Consumer sentiment has been challenged during the year by the impact of the Omicron variant, rising prices, and market volatility. Additionally, the war in Ukraine and the surge in Covid-19 cases in China have also increased geopolitical risk over the past two months. While there have been several challenges for consumer confidence throughout the year, consumer spending growth has remained relatively strong; so the declines in confidence have yet to negatively impact the current economic recovery. Looking forward, we'll likely need to see progress in getting inflation under control before we see sentiment recover to the recent highs we saw early last year.

Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. All indices are unmanaged and are not available for direct investment by the public. Past performance is not indicative of future results. The S&P 500 is based on the average performance of the 500 industrial stocks monitored by Standard & Poor's. The Nasdaq Composite Index measures the performance of all issues listed in the Nasdaq Stock Market, except for rights, warrants, units, and convertible debentures. The Dow Jones Industrial Average is computed by summing the prices of the stocks of 30 large companies and then dividing that total by an adjusted value, one which has been adjusted over the years to account for the effects of stock splits on the prices of the 30 companies. Dividends are reinvested to reflect the actual performance of the underlying securities. The MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets Index is a market capitalization-weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin. The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The Bloomberg US Aggregate Bond Index is an unmanaged market value-weighted performance benchmark for investment-grade fixed-rate debt issues, including government, corporate, asset-backed, and mortgage-backed securities with maturities of at least one year. The U.S. Treasury Index is based on the auctions of U.S. Treasury bills, or on the U.S. Treasury's daily yield curve. The Bloomberg US Mortgage Backed Securities (MBS) Index is an unmanaged market value-weighted index of 15- and 30-year fixed-rate securities backed by mortgage pools of the Government National Mortgage Association (GNMA), Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (FHLMC), and balloon mortgages with fixed-rate coupons. The Bloomberg US Municipal Index includes investment-grade, tax-exempt, and fixed-rate bonds with long-term maturities (greater than 2 years) selected from issues larger than \$50 million. One basis point is equal to 1/100th of 1 percent, or 0.01 percent. Rev. 05/22.

Authored by the Investment Research team at Commonwealth Financial Network.