Highland Associates

Multi-Asset Solutions
Weekly Commentary
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Stocks: Indecisiveness On Display As Market Participants Process Conflicting Signals; S&P 500 Still Stuck Between 4,100 / 4,200

There was minimal movement at the index-level last week as the S&P 500 fell 0.2% and the small-cap Russell 2000 declined by 1%. The S&P 500 has gone virtually nowhere since the end of March, rising just 0.4% over that time frame, and complacency appears to have crept back in as investors have crowded into a select/small number of communication services, consumer discretionary, and technology names. Case in point, the S&P 500 was again buoyed by the performance of just a few mega-cap names last week as Amazon (AMZN) and Alphabet (GOOG), each top 5 weights within the index, rose 4.3% and 11%, respectively. With debt ceiling discussions ongoing, we are debating whether the next few months will rhyme with 2011, 2013, or prove to be an entirely different adventure. Following the debt ceiling discussions in 2011, stocks sold off and long-term Treasuries rallied/yields fell, despite S&P lowering the U.S. Government's credit rating, while a resolution of the debt ceiling in 2013 led to a rally in stocks and generated a selloff in long-term Treasury bonds. With market leadership narrow and skewing toward defensive sectors, we lean toward 2011 providing investors with a better blueprint of what may lie ahead, but given how many moving parts are involved, now is the time to rely on a strategic asset allocation framework and avoid making too many tactical shifts as one can find themselves offsides in short order.

- Japan was again a standout performer abroad as the MSCI Japan index rose 1.1% on the week, but broad-based weakness out of the euro area and U.K. offset those gains and the MSCI EAFE ended the week lower by 1%. The MSCI EAFE index has outperformed the S&P 500 year-to-date, rising 9.4% vs. 7.4%, as earnings expectations for euro area equities have been ratcheted higher while S&P 500 earnings estimates have moved lower. However, there are some early signs that economic growth in the euro area is slowing and lost momentum on the economic growth front could translate into positive earnings revisions stalling out or moving lower, and lead to profit taking over the balance of 2023. We will be focused on forthcoming economic data out of Germany, specifically, as exports and manufacturing orders for March showed a pronounced deceleration month over month. Some of the weakness in German manufacturing orders can be attributed to a choppy and uneven opening of China's economy but could also be a sign of weakening demand out of the U.S. as well.
- The MSCI Emerging Markets (EM) index fell 0.8% on the week as China, South Korea, and Taiwan were drags as each country index fell 2.5% or more on the week. The MSCI China index fell 3.4% on the week as imports fell 7.9% year over year in April, which along with

cool inflation data during the month, painted a picture of lackluster consumer demand that further called into question the strength of China's reopening from COVID lockdowns. Policymakers in China will likely respond by attempting to stimulate economic growth by lowering interest rates and increasing access to capital, thus we can't rule out a rebound in Chinese and emerging market equities driven by this stimulus.

Bonds: Some Reasons For Optimism As Debt Ceiling Discussions Get Underway; A Fed Pause in June Likely

President Biden met with congressional leaders last Tuesday to discuss raising the debt ceiling and as expected, neither side appeared to budge off their initial position. The two sides initially agreed to meet again last Friday, an encouraging signal that both Democrats and Republicans are motivated to get a deal done. However, Friday's meeting was postponed until this Tuesday given minimal progress on talks at the staff level last week. On balance, last week's debt ceiling/budget discussions were viewed as less combative and more constructive than feared, but there's still a long way to go and a short time to get there for a deal to materialize. The 1-month T-bill yield rose 20 basis points on the week and closed at 5.79% amid debt ceiling discussions and a $35B auction of 4-week T-bills mid-week, and we expect volatility on the short-end of the Treasury curve to persist throughout May, particularly with Treasury's "X-date" remaining in-flux and heavily dependent upon corporate tax receipts received prior to the June 15 deadline for corporations to file.

- Economic data releases pushed yields in the belly of the yield curve around over the balance of last week. Inflation data (CPI, PPI) cooled month over month in April and initial jobless claims for the week ended May 6 rose more than expected to a level last seen in October of 2021, pulling yields on long-dated U.S. Treasuries lower as economic downturn/recession fears rose. The 10-year Treasury yield ultimately ended the week just 2-basis points higher at 3.46% as buying early in the week on cooler inflation readings was offset by the University of Michigan Consumer Sentiment Survey for May which showed 5-year consumer inflation expectations moved higher month over month to 3.2% - the highest level seen dating back to 2011. Inflation becoming entrenched is of significant concern to the FOMC and while this is just one data point, will be worthy of discussion and weigh on the Committee's decision to either pause or hike by another 25-basis points when it meets in June.
- April Consumer Price Index (CPI) was released last Wednesday with both headline and core CPI rising 0.4% month over month, in-line with the consensus estimate. Year over year, headline CPI rose 4.9% vs. the 5.0% estimate, while core CPI rose 5.5% year over year, a bit hotter than the 5.4% estimate.

Headline inflation continuing to tick lower month after month is a feather in the cap of the FOMC, which will view this as evidence that tighter monetary policy is having a desired effect; however, the Committee will be less enthused about a core CPI reading of 5.5% year over year as ex food and energy inflationary pressures remain far too sticky for comfort. The FOMC was already likely to pause in June, and nothing in the April CPI report would lead us to alter our stance that the FOMC is likely to remain on the sidelines when it meets next month.

- The Bank of England (BoE) delivered another 25-basis point hike to its key policy rate last Thursday, taking it to 4.5%. Inflation in the U.K. remains elevated, with the Consumer Price Index (CPI) for March coming in at 10.1%, above the 9.7% estimate. U.K. CPI for April is released on May 24 and is expected to slow to 7.9% year over year, which would be a notable downshift from the March reading. The BoE is still narrowly expected to hike by another 25-basis points when it meets on June 22, but a sharp month over month move lower in CPI would potentially allow for a pause at the next meeting. Interestingly, the BoE did upgrade to its economic growth estimate for the U.K. economy and no longer expects a recession in 2023.

What We're Watching:

- U.S. Retail Sales for April are released Tuesday and are expected to have risen 0.8% month over month after a 0.62% month over month increase in March.
- U.S. Industrial Production for April is also released Tuesday with a flat month over month reading expected after a 0.4% increase in March versus February.
- Final Eurozone Consumer Price Index (CPI) for April is released Wednesday and is expected to show a 7.0% year over year increase, in-line with the prior reading. Month over month, CPI is expected to rise 0.7% in April, down from 0.9% month over month in March.
- Japan's Consumer Price Index (CPI) for April is released Thursday and a national reading of 3.4% year over year is expected after a 3.2% year over year reading in March.

HIGHLAND

* 3- and 5-Year Returns Annualized							
	Price/Yield			Total Return (%)			
	5/12/2023	1 Week Ago	1 Month Ago	Year to Date	1 Year	3 Years	5 Years
Dow Jones Industrial Average	33300.62	-1.04	-0.91	1.22	7.22	14.19	8.30
S&P 500	4124.08	-0.24	0.91	8.48	6.73	14.63	10.50
NASDAQ	12284.74	0.44	3.04	18.63	9.04	11.82	11.67
Russell 2000 Index	1740.85	-1.04	-1.75	-0.06	1.61	12.29	3.02
MSCI World ex US	300.76	-0.74	-0.05	8.06	10.39	10.41	2.67
MSCI EM	973.00	-0.86	-1.86	2.52	1.86	5.13	-0.86
Bloomberg U.S. Aggregate	4.37	-0.23	-0.29	2.93	-0.87	-3.08	1.15
Bloomberg Global Aggregate	3.50	-0.46	-0.33	2.82	-2.06	-3.76	-0.88
Bloomberg Corporate Index	5.19	-0.18	-0.63	3.14	0.09	-1.77	1.84
Bloomberg 10-Year Muni Index	3.35	0.05	-0.98	2.85	4.52	0.39	2.00
Bloomberg U.S.High Yield Index	8.61	-0.05	0.03	3.62	3.35	4.20	3.13
				Price/Yield			
	5/12/2023	1 Week Ago	1 Month Ago	12/31/2022	1 Year Ago	3 Years Ago	5 Years Ago
Secured Overnight Financing Rate (yield)	5.05	5.06	4.80	4.30	0.79	0.06	1.73
30 Year Mortgage (average rate)	6.89	6.83	6.81	6.66	5.57	3.57	4.42
2 Year Treasury (yield)	4.01	3.91	3.96	4.43	2.56	0.16	2.53
10 Year Treasury (yield)	3.50	3.44	3.39	3.87	2.85	0.67	2.97
30 Year Treasury (yield)	3.82	3.75	3.62	3.96	3.02	1.37	3.10
WTI Crude (closing price)	70.04	71.34	83.26	80.26	106.13	25.78	70.70
Brent Crude (closing price)	74.17	75.30	87.33	85.91	107.45	29.98	77.12
Gold (NYM $/oz)	2019.80	2024.80	2010.90	1826.20	1824.60	1706.80	1320.70

Source: Bloomberg (3-and 5-Year Returns Annualized)

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