May Overview

- US equities were mostly higher in May trading, with the S&P logging its fourth consecutive monthly rise, though at a notable deceleration from the February-April period. Value outperformed growth, with the IVE +2.4% beating the IVW (0.9%) amid rising inflationary fears and stretched valuations within growth. The FANMAG complex was mostly lower, with AMZN (7.1%) and AAPL (5.2%) posting big drops. Treasuries were firmer across the curve, with the 10Y yield below the 1.60% mark at month's end. May's Treasury auctions were generally well received across a range of maturities. The dollar was weaker overall, sliding on the euro cross but better vs the yen. Gold added to April's strength, rising 7.8% and logging its best month since July 2020. Oil was higher, with WTI up 4.3% on continued improvements in global demand.
- **Materials** led the market, boosted by a solid commodities backdrop. Industrial metals, chemicals, and precious-metals miners were all stronger. **Energy** benefited from higher crude prices. Oil-services names and E&Ps logged strong returns. Banks were higher in **financials**, with the BKX +5.0% logging its fourth consecutive month of gains (and the seventh rise in eight months). Regional banks were more modest performers; KRX +2.4%. Multis, A&D, and building products all helped **industrials**. Hospitals and managed care were better in **healthcare**, though there was scattered weakness in biotech and MedTech. **Consumer staples** was cushioned by food-products firms, though the sector saw some drag from select HPCs and cosmetics firms. **Communication services** lagged the tape, with GOOGL +0.1% largely flat and some big decliners in media including DIS (4.0%) and NFLX (2.1%). **Tech**was weaker, with AAPL (5.2%) and MSFT (1.0%). Semis finished higher after an up-and-down month; SOX +2.5%. **Consumer discretionary** trailed the market. Retailers were mostly better but AMZN (7.1%) and TSLA (11.9%) were among the big drags.

What happened?

- **Inflation remained top of mind for many investors**, with pressures from disrupted supply chains, high raw-material costs, shipping challenges, and a tightening labor market remaining a major theme of Q1 earnings calls. The 10-year breakeven inflation rate hit a high of 2.54% in May, its highest level since 2011, while the y/y reading for April headline CPI came in at 4.16% (the highest since 2011). Several industries reported widespread difficulties in hiring workers, and April's employment report showed average hourly earnings growing faster than consensus. A major debate this month was the degree to which these inflationary pressures were temporary or likely to become embedded in expectations over time. Fed officials tended strongly toward the transitory theme, generally seeing inflation returning toward the Fed's long-term 2% projection through 2022 and 2023.
- Amid concerns about ramping inflation and fears of a possible policy mistake, **multiple Fed speakers said it might soon be time to begin a discussion on tapering** the bank's $120B/mo asset-purchase plan, with commentators suggesting the debate could begin as soon as the June FOMC meeting. Dallas Fed President Kaplan had been the most outspoken about the possibility, but the minutes from the April FOMC meeting indicated that "a number of participants" had suggested the discussion might become appropriate. Near the end of May Fed vice chairs Clarida

and Quarles both indicated that the time to begin the discussion could be coming, while SF President Daly stressed that while the debate might soon start, the Fed is not doing anything now. Recall that Powell, after the April FOMC meeting, reiterated that the Fed was not even talking about talking about a possible taper, but added that the Fed would prioritize communication about it when the time was right to try and avoid any market shock.

- There was a lot of **back-and-forth on President Biden's stimulus proposals**, but **a bipartisan deal on infrastructure remained elusive**. Recall Biden had initially proposed $2.25T between traditional projects and other "social infrastructure" initiatives. Negotiations toward a bipartisan package with Republicans originally yielded a more focused $568B counteroffer, to which Biden replied with a $1.7T topline (saying he would make reduced requests in other bills). GOP negotiators, led by Sen. Capito (R-WV) replied with a suggestion for $928B, pushing the talks beyond both sides' soft Memorial Day deadline. Despite the apparent movement, the sides ended the month still far apart on the composition of a possible bill as well as about how to pay for it. Biden's push for higher taxes on corporations and high earners has been a nonstarter for Republicans, while GOP calls to repurpose unused Covid relief funds and institute EV user fees have been rejected by the White House. It remains a strong possibility that Democrats will go it alone and use the party-line reconciliation method to pass a plan.
- **The US economic backdrop remained solid despite some bumps** (and the Citi Economic Surprise Index dropped to its lowest level since June 2020). The **April nonfarm payrolls**release may have been the biggest surprise of the month, decelerating to just +266K jobs against consensus for 975K, which sparked a broad discussion about the causes behind some businesses' inability to hire and led to an increasing number of states opting out of federal enhanced unemployment benefits. At the same time, **initial jobless claims** continued to tick down, ending May at their lowest level since March 2020. April **CPI** and **PPI** both came in hotter than expected, both at the headline and core readings. **April retail sales** were little changed m/m against forecasts for a modest rise, though restaurants and autos were among the groups seeing improvements. **New home sales** and **pending home sales** were both light of consensus amid higher costs and lack of supply. **Consumer confidence** was a bit light as well, though the labor-market differential (seeing jobs plentiful vs hard to get) widened to the highest since January 2020.

In other news:

- **The Q1 earnings season wrapped up**, with S&P 500 constituents seeing a blended y/y earnings growth rate of nearly 52% against the 23.8% expected at the end of the quarter. Earnings and revenue beats were well ahead of longer-run averages.
- There was **little market impact from the raft of geopolitical headlines** including the burst of violence between Israel and Hamas. Oil wobbled a bit on concerns diplomatic efforts could result in more Iranian crude coming to market, but the improving demand backdrop seemed of greater importance.
- There was **some contact between US and Chinese trade officials**, notably a high-level telephone call with USTR Tai near the end of the month. While this was characterized as constructive, Tai cautioned the US faces "very large challenges" in its relationship with China.

- **Cryptocurrencies weathered some volatility**, with bitcoin dropping more than 35% for the month. Comments from TSLA's Elon Musk, the ramifications of a crackdown from China, and the possibility of greater US regulation were all in the mix.
- **Covid continued to wane in the US**, with the seven-day new case rate as of 31-May hitting its lowest level since March 2020. Nearly 41% of Americans had received a full vaccination as of the end of the month.

S&P 500 Sector Performance:

- **Outperformers**: Materials +5.04%, Energy +4.90%, Financials +4.68%, Industrials +2.89%, Healthcare +1.74%, Consumer Spls. +1.65%, REITs +1.03%
- **Underperformers**: Consumer Disc. (3.89%), Utilities (2.78%), Tech (1.05%), Communication Svcs. (0.07%)

Source: Canaccord Genuity, Investment and Advisory Services, Kevin Vandermeer