Convergence Commentary

May 2023 Market Recap

Quick Hits:

- Earnings outperformed expectations, bringing optimism to the market
- The looming debt ceiling deadline creates uncertainty
- Inflation results were mixed
- The hype around AI persisted, driving a rally in large cap growth stocks

Market-Moving Highlights

May brought an end to the earnings season, with about 98% of the S&P 500 results already released. As we noted in our previous market commentary, many analysts had lowered their expectations for the quarter due to decreased investor sentiment. However, the overall earnings were about 4.8% better than expected. This positive surprise instilled some hope that a recession in the second half of the year does not necessarily have to happen. An enormous Nvidia earnings beat driven by AI demand increased its market cap by $184B in one day, one of the largest one-day market-cap moves in history. The results suggested that the AI hype might be here to stay, which caused a rally in all sectors that are expected to benefit from AI advancements.

The debt ceiling was in the spotlight this month as headlines over what would happen in a case of default in combination with political discussion insinuated fear on investors. This fear became more apparent closer to the month's end, as the "X-date" of June 1st was a tight turnaround. Toward the end of the month, it seems progress on the deal was made, and the Federal Reserve reassessed their X-date to June 5th, which calmed investors. A vote passed through the House on Wednesday evening and now needs to pass through the Senate on Friday for the debt ceiling to be increased. Both President Biden and House Speaker McCarthy reassured they believe the deal will go through. While there are still politicians who openly speak against it, investors impatiently wait for the deal to finalize.

Regarding inflation, May's numbers largely aligned with expectations, although they may have disappointed some investors following the results observed in April. Headline CPI increased to 4.9%, in line with estimates of 5%, while monthly CPI rose by the consensus rate of 0.4%. Core CPI met expectations at 5.5% year-over-year. Although inflationary pressures showed signs of easing, the pace of decline may have fallen short of the Federal Reserve's desired level. Market sentiment currently reflects a probability of approximately 60% for another 25bps rate hike in June.

Index Performance

Index	1 Month	YTD	1 Year	5 Year
S&P 500	0.43%	9.65%	2.92%	11.01%
Nasdaq Composite	5.93%	24.06%	8.04%	12.69%
Russell 2000	(0.92%)	(0.04%)	(4.68%)	2.74%
MSCI ACWI ex US	(3.54%)	5.09%	(0.87%)	2.71%
Bloomberg US Aggregate Bond	(1.09%)	2.46%	(2.14%)	0.81%

Whether we are on the brink of a new technological revolution remains to be seen, but many investors are placing huge bets on artificial intelligence. Bolstered by the impressive results of NVIDIA, the Nasdaq run continues with a 5.93% gain in May. While the S&P 500 gained 0.43%, the market breadth has deteriorated slightly, which means many of the gains are provided by a few big names associated with AI, while some companies are struggling amidst the current economic environment.

S&P 500 Sector Highlights & Commentary

Best-Performing Sectors		Worst-Performing Sectors	
Technology	8.92%	Energy	(10.03%)
Communication Services	3.91%	Materials	(6.87%)
Consumer Discretionary	2.54%	Consumer Staples	(6.16%)

Similarly, to last month, most of the month consisted of choppy trading, with a major positive catalyst at the end of the month (NVIDIA) sparking a rally for the cyclical sectors. Once again, AI took center stage, influencing sector performance based on their association with this transformative technology.

What to Watch in June

6/2 – Non-Farm Payrolls, Unemployment Rate

The US economy added 253k jobs in April against the forecasts of 185k, which was positive for the economy but negative for the inflation fight. The current forecast for May is 180k.

6/5 – Debt Ceiling X-date

The X-date is the earliest day the US could default on its debt. Lawmakers still must pass the bill through the senate, and they have until 6/5 to do so.

6/7 – Balance of Trade

With the current headline focus around the debt ceiling, the balance of trade may have a more significant impact than usual. The US will have to start paying down its debt balance at some point. The current forecast for April is -$78.2B.

6/13 - CPI

Inflation continues to be an important driver, and the CPI data will be released a day before the Federal Reserve decision. The current forecast for headline inflation is at 4.7%, down from 4.9% in April. Core inflation is also expected to decrease to 5.4%, down from 5.6% in April.

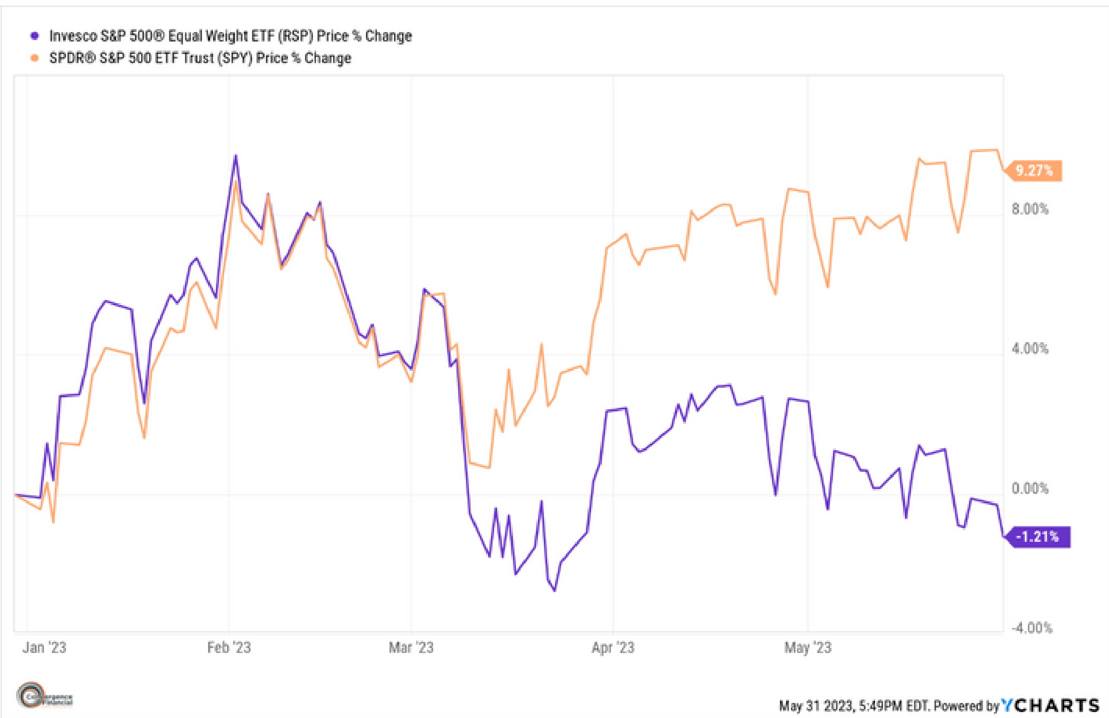
<u>6/14 - PPI + Federal Reserve Interest Rate Decision</u>
The markets are currently pricing a 60% chance of a 25 basis point hike.

<u>6/16 – Michigan Consumer Sentiment</u>
Consumer sentiment remains at the lowest level in six months, mirroring the performance of the 2011 debt ceiling crisis. The outcome will likely depend on the debt ceiling resolution.

Market Wrap

There are two separate stories the markets are telling right now. The first story is a story full of deteriorating economic conditions, low consumer sentiment, debt ceiling fight, a hawkish Federal Reserve, and tighter credit (purple line). The second story is full of unexpectedly low unemployment, high job openings, incredible expected opportunities in AI and a renewed energy for investment in the technology sectors (orange line).

During different periods in the market, there are often companies that will lead upturns. In the beginning phases, that can be concentrated among a smaller group, but history has shown us that the breadth of the market rally typically begins to widen as the uptick continues.
The chart below shows how the divergence of the two weighting methods over the past month has widened as demonstrated in the market cap versus equal weight indexes below. We'll continue to closely observe the impacts of this gap and how this has unfolded during other times in history.



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Your Investment and Research Team

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Jason Buford

Vice President,
Financial Advisor

Dr. John Stansfield, CFA

Director of
Investments

632 E 69th Terrace
Kansas City, MO 64131
816.737.8526
www.convergencefinancial-kc.com