

In Brief

The S&P-500 added 1% in May and the Nasdaq gained 5.8%, driven by technology which was up 9.46%. All sectors, with the exception of technology, communications and consumer discretionary were in the red led by energy, -11.%, utilities, -7.22% and financials, -6.85%. Market drivers for the year have been technology, + 33.95%, communications, + 32.81% and consumer discretionary, +18.64%.

The Federal Reserve Bank (Fed) has raised interest rates by 5% in the past 14 months. The Fed indicated that they will not increase interest rates further at their June 13-14 meeting in order to give the economy time to digest the rapid pace of monetary tightening.

Despite the doomsayers expecting that the economy is headed for a recession, the economy has proven surprisingly resilient. The pandemic has significantly distorted the usual economic cycle. Macroeconomic models do not take major distortions into account, and are, therefore, missing important developments. The shockwaves of the latest pandemic continue, but seem to have been offset by significant shock absorbers for example:

- The economy is still awash in the liquidity that was provided by monetary and fiscal policies during the pandemic. As of April, demand deposits still accounted for 24.1% of M2, up from 10.3% just before the pandemic. This is a significant shock absorber, offsetting much of the Fed's tightening shock.
- The epicenter of the economy's resilience has been the labor market. The Fed's monetary tightening cycle since early last year has been aimed at boosting the unemployment rate to slow wage inflation. Instead, the unemployment rate has declined from 4.0% in January 2022 to 3.4% in April 2023.
- At the end of last year, the retired Baby Boomers had a net worth of 73.1 trillion which amounted to 52.3% of the total net worth of all households. During April, consumers had record or near-record amounts of proprietor's income (\$1.9 trillion), interest income (\$1.8 trillion), dividend income (\$1.7 trillion), and rental income (\$0.9 trillion).
- Onshoring and infrastructure spending. Manufacturers of all sizes, foreign and domestic, are tapping into the trillions of dollars of incentives available in the CHIPS and Science Act, the Inflation Reduction Act (IRA), and the Infrastructure Investment and Jobs Act to build factories in the US for batteries, solar equipment, electric vehicles (EVs), and green hydrogen, among other things.
- Capital spending in real GDP rose to a record high of \$3 trillion during Q1-2023. Manufacturing construction, and in particular, infrastructure construction jumped 62.3% y/y through March. Many of the proposed factories have yet to break ground and are not reflected in these numbers. Once these projects go forward, they provide tailwind for the economy.

The pandemic was a temporary setback to the productivity growth boom that started in late 2015. The pandemic might have accelerated the pace at which technological innovations (including state-of-the-art onshoring) are used to boost productivity growth and to offset labor shortages. We expect productivity to recover and grow in the 4%-5% range.

Employment growth at US companies, led by leisure and hospitality and followed by natural resources and construction, exceeded all projections in May, highlighting a durable labor market and underpinning household spending. While layoffs that began at technology firms are extending somewhat to other industries, many companies continue to have difficulty attracting and retaining workers. The unemployment rate rose to 3.7%, while wage growth slowed to 4.3% and has become less of an inflationary concern for the economy despite robust hiring.

The US government will not default on its debts. There are plenty of jobs. Wage inflation is moderating. The banking crisis is abating. The recession is still a no-show. Earnings were better than expected during Q1 and are probably bottoming during the current quarter. The FOMC likely will pause its rate hiking for at least one meeting. AI will boost productivity. We are confident that the markets will continue to pay tribute to all this good news.

Your Terra Nova Team!