Commerce Trust
Banking | Investments | Planning™

# Commerce Trust Market Brief with Scott Colbert
## 05/30/2023

**Scott Colbert:** Good morning. It's Tuesday, May 30th, the day after Memorial Day, and the markets are open. So far this year, for the first five months of the year, the S&P 500 (Index) has done quite well. It's up a bit over 10%, including dividends, but that contrasts with the smaller cap stock indexes, where the Dow (Jones Industrial Average) is only up 70 basis points and the Russell 2000 (Index), a measure of the 2000 smaller stocks in the equity market, are only up about 1.5%. Bonds have buoyed your returns this year as well, positive for both taxable and tax-exempt, but oddly enough, they aren't up quite as much as cash returns are, where the average money market fund has returned about 1.75% so far this year.

There are probably four overarching themes that the market is trying to work through and digest as we sit here today. Number one, of course, has to do with the debt ceiling which created quite a bit of consternation last month but is beginning to be pushed aside. Secondly, would be how narrow the stock market returns have been and what's driven them forward. The third thing would be, will they or won't they be raising short-term interest rates here in the near term? Then finally, will we, or won't we as the year progresses, have a recession?

Let's unpack these four overarching economic themes that the market is digesting. First, we have the debt ceiling. The administration made tremendous progress over the weekend in conjunction with the Republican House of Representatives and Speaker (Kevin) McCarthy in coming up with a compromise. Basically, for spending caps, the Republicans are likely to agree to postpone the debt ceiling (by raising the debt ceiling limit.) Now, they're only going to postpone it for 17 months. In effect, we might have to fight the same fight that we're fighting today come January of 2025 but nonetheless, it looks like an extension is possible.

If the bill comes to a vote in both the House and the Senate, I think this is likely to get passed. It needs to get passed because basically, there's only about $30 billion in the U.S. Treasury. We run deficits of, gosh, near $80 billion per month, which would tell us that we have to borrow $50 billion in the month of June just to basically pay all of our bills. At some point in June, we really will run out of money, and we probably don't have a lot of time left.

With regards to the narrowness of the stock market, we all know those seven relatively famous stocks that are driving the market forward. Collectively, those seven stocks are up on average 44% (year to date) and because they make up such a large weight of the S&P 500, they've pulled the entire market up 10%. If we took the other 493 stocks in the S&P 500, their total return would only be 1%.

We view this narrowness in the stock market as a dangerous signal. There's only one of two ways to basically continue to move forward. It's for this market to continue to remain narrow and these mega-cap, super high valuation stocks continue to pull the market forward or we have some type of correction. We would lean more towards the narrowness as a more of a dangerous signal than not.

We've got our short-term interest rate outlook, which has gotten clouded recently by basically a move in the market that almost now expects the Federal Reserve (Fed) to raise rates in June. We had told you about a month ago, we thought it was likely that the Fed would pause in June and then raise rates once again in July, but the market has flip-flopped that on us now and thinks that there's likely to be a rate hike in June and perhaps a pause in July.

We're not exactly sure how this will work out, and we don't know that it makes a heck of a lot of difference 30 days one way or the other but we would still tell if the Federal Reserve was asking us that after having raised rates at 10 consecutive meetings by 5% in entirety, it's probably worth taking a breather to see what kind of damage this is done to economic activity. We clearly know economic activity is cooling, we just don't know how fast it's cooling.

Then finally we get to that last thought: Will we or won't we have a recession? We're firmly in the camp that we're most likely to have a recession. We'll put the odds of that at well over 50% for four material reasons.

Number one would be the inversion in the yield curve. You may have heard our podcast where we talk specifically about this inversion, but basically, it's identified 10 out of the last 10 recessions. We know that the leading economic indicators are in a negative territory and when they fall as much as they' fallen, they've also been a perfect indicator of recession.

Then we would also add anecdotally to that, the money supply continues to contract. We aren't used to having the money supply ever go backwards basically post World War II. We don't know how much damage that does to the economy, but we've clearly seen the crack show up in the financial system as four major banks have failed already this year.

Then, finally, you've got the trends on inflation. Inflation is cooling, but it's not cooling very rapidly. To the extent the inflation doesn't cool fairly rapidly, then the Fed of course is forced to maintain a higher interest rate policy longer than one would like. Now, as we go forward for the rest of the year though, the real key thing will be will we or won't we get enough inflation to roll over to allow the Fed to ease up and perhaps lower rates and bring us into that soft landing.

Our next time, we come back, we'll talk a little bit about what the inflationary trends are. They've been sticky so far, but they do have the potential to begin to decline considerably in the back half of the year, particularly as a couple of economic statistics roll into the CPI (consumer price index.)

Disclosures:

Important material disclosures regarding the content of this program follow. Commerce Trust is a division of Commerce Bank. Generally, non-depository investments offered in connection with Commerce Trust and its affiliates are not guaranteed, are not FDIC insured, and may lose value.

Opinions and other information provided are effective as of the date of the recording and presented for the purpose of general education information or illustration only. Neither Commerce nor any of its affiliates, officers, employees, or agents have made any recommendations to buy, hold, or sell securities, or given any advice as to the terms, beneficial interests, or profitability of any investment strategy or market activity. And information provided may not be relied upon as such.

You as the investor, are fully responsible for any investment transaction you choose to enter into, including determining whether such investment is appropriate in light of your investment objectives and personal circumstance. And you shall not have relied on any of the proceeding or following information from Commerce as the basis for any investment decision. This material is not intended to replace the advice of a qualified attorney, tax advisor, or investment professional.

In considering whether to trade or invest, you should inform yourself and be aware of the risks. Past performance is no guarantee of future results. And the information in the commentary provided is subject to change based on market or other conditions. Diversification does not guarantee a profit or protect against all risk.

Commerce Trust does not offer tax, legal, or specific estate planning advice. And while we may provide information or express general opinions from time to time, such information or opinions are not offered as professional tax or legal advice. Commerce Trust does not provide advice relating to rolling over retirement accounts. Commerce Trust is not a municipal advisor under Section 15B of the Securities Exchange Act and therefore does not offer advice or recommendations concerning bond proceeds or other municipal advice, subject to this section. Any data contained herein from third party providers is obtained from what are considered reliable sources. However, its accuracy, completeness, or reliability cannot be guaranteed.

May 30, 2023
Commerce Trust is a division of Commerce Bank.