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Dear Friends,

Please see our Monthly Market Update for May 2023 below.

Positioning Summary

We favor positioning for an environment of slowing growth and inflation with elevated recession risk.

- **Equities: Underweight**

We favor being underweight equities because we believe the risk of recession is high, and elevated valuations combined with extremely tight labor market conditions limit potential upside over the medium term. However, we are now 16 months into this bear market, and 4 of our 11 market bottoming indicators have now triggered. This suggests the bottoming process may be underway even if more downside lies ahead, which favors a marginal increase in exposure to stocks year over year.

- **Fixed Income: Neutral**

We favor increasing fixed income exposure to neutral because we believe inflation has peaked and that the Fed's rate hiking cycle is nearing its end.

- **Commodities: Overweight**

We favor being overweight gold to hedge against slowing economic activity or an unanchoring of long-term inflation expectations, either of which would push real interest rates lower and the gold price higher. We are less keen on broad commodities, which generally underperform when economic growth slows.

- **Cash: Overweight**

We have favored being overweight cash because of rising interest rates and elevated recession risk. Cash should help portfolios achieve lower levels of performance volatility while providing them with dry powder to reinvest opportunistically. Within cash, we favor holding short-term treasury bills.

Performance Recap

- **Equities:** The MSCI All Country World Index advanced **+1.4%** in April and is up **+8.9%** year-to-date (YTD).
- **Fixed income:** The US Aggregate Bond Index gained **+0.6%** in April and is up **+3.6%** YTD.
- **Commodities:** The S&P Goldman Sachs Commodity Index declined by **-0.8%** in April and is down **-5.7%** YTD. Gold gained **+0.1%** during the month and is up **+9.3%** YTD.
- **Cash:** The Bloomberg US Treasury Bill index is currently yielding 5.0% and has realized **+1.5%** of return YTD.

Recent Developments

- The Fed raised interest rates 25 basis points in what the market expects will be its last rate increase—the market is currently pricing in nearly five rate cuts through January.
- [Small businesses say it hasn't been this difficult to borrow in a decade](#) as tighter lending standards have effectively locked a growing portion of businesses out of financial markets. Loan defaults and corporate bankruptcies are on the rise, particularly in the construction and retail industries. Legendary credit manager [Boaz Weinstein believes the credit crunch is only just getting started](#).
- Regulators seized control of First Republic Bank and sold it to JP Morgan on Monday. JP Morgan CEO Jamie Dimon said he believes “this part of the crisis is over.” Even if he is correct, we believe the US economy still faces material headwinds.

Market Outlook

- **Import growth contracted** on a year-over-year (YoY) basis in Q1 (**Figure 1**), **triggering the fifth of five indicators in our recession model (Figure 2)**. In the past 50 years, there have only been two other times where all five indicators triggered (2001 and 2019). In each instance, the S&P 500 subsequently declined by at least **-20%**.
 - **Credit conditions are tightening, presenting a material risk to the growth outlook over the next 12 months.** Tighter credit conditions have historically preceded rising unemployment (**Figure 3**).
 - Notwithstanding resilient nonfarm payrolls, **cracks are forming beneath the surface of the labor market**, as evidenced by rising jobless claims and reduced demand for temporary workers (**Figure 4**). The rise in jobless claims over the past seven months is consistent with patterns observed at the start of historical recessions (**Figure 5**). These indicators can offer
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more accurate real-time insights than NFP data, which is heavily subject to revisions after the initial release ([Figure 6](#)).

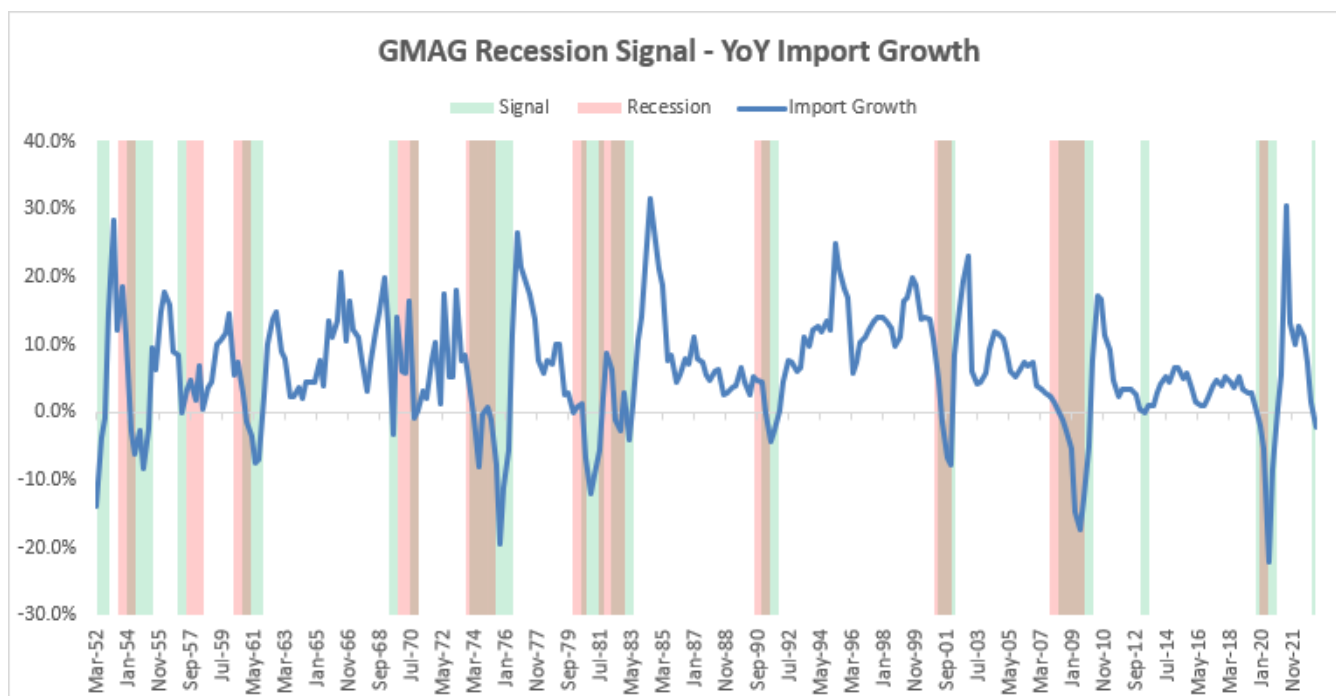
- Leading data suggest earnings will deteriorate over the next 12 months, which should present a headwind to stocks. Historically, stocks have bottomed well before earnings do, but our earnings forecasts do not show signs of bottoming yet ([Figure 7](#)).
- We remain concerned that a material decline in [commercial real estate prices](#) could have a cascading impact on the broader economy and financial markets.

As always, we thank you for your ongoing trust and confidence. Please do not hesitate to reach out with any questions relating to our outlook or the management of your individual portfolio.

Best regards,

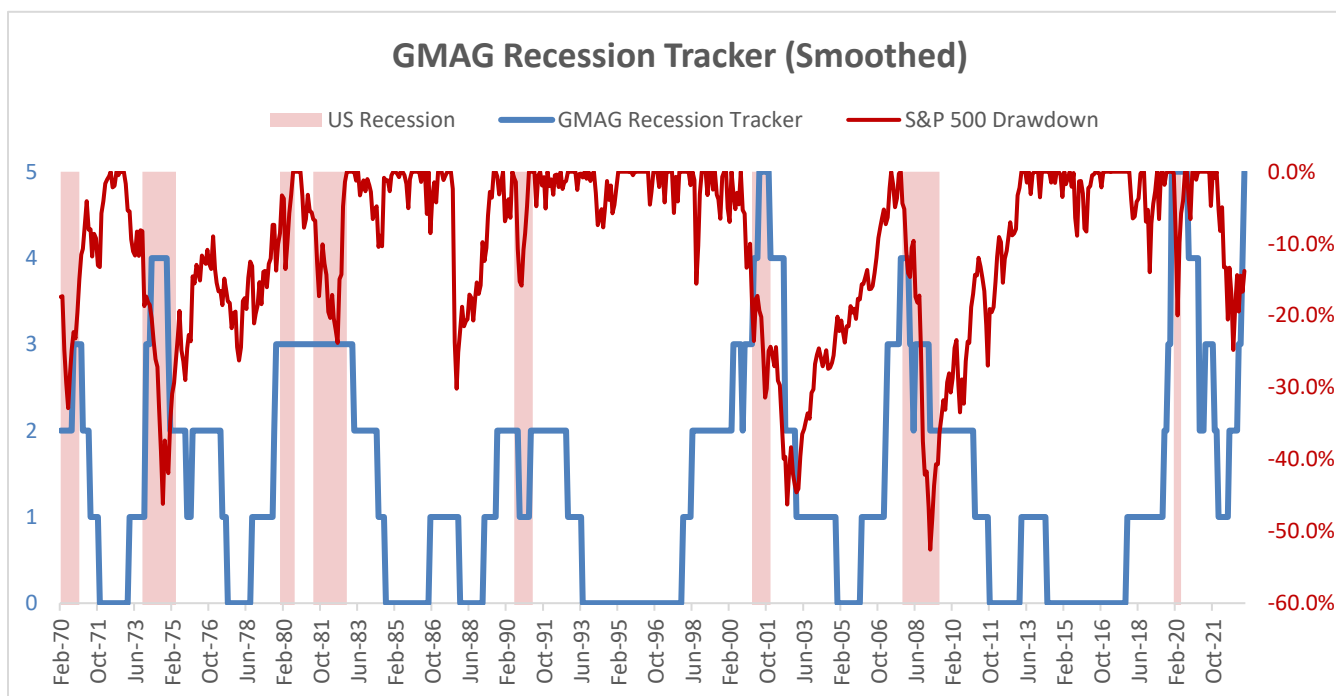
The logo for Goldman Sachs, featuring the word "gmac" in a stylized, cursive script. The letters are blue and have a slight shadow effect.

Figure 1: YoY import growth contracted in Q1, triggering the last indicator in our recession model.



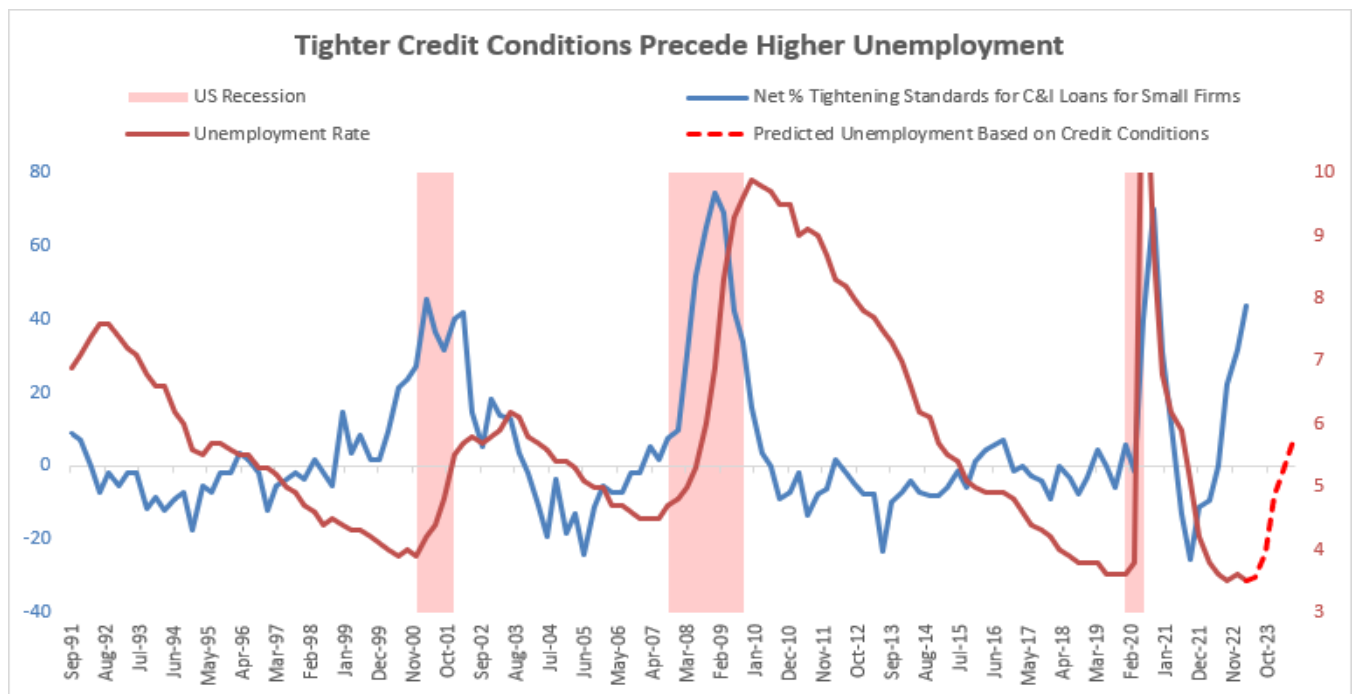
Source: Bloomberg, GMAG Research

Figure 2: All five indicators in our recession model have now triggered. The only other two times where all five indicators triggered were 2001 and 2019.



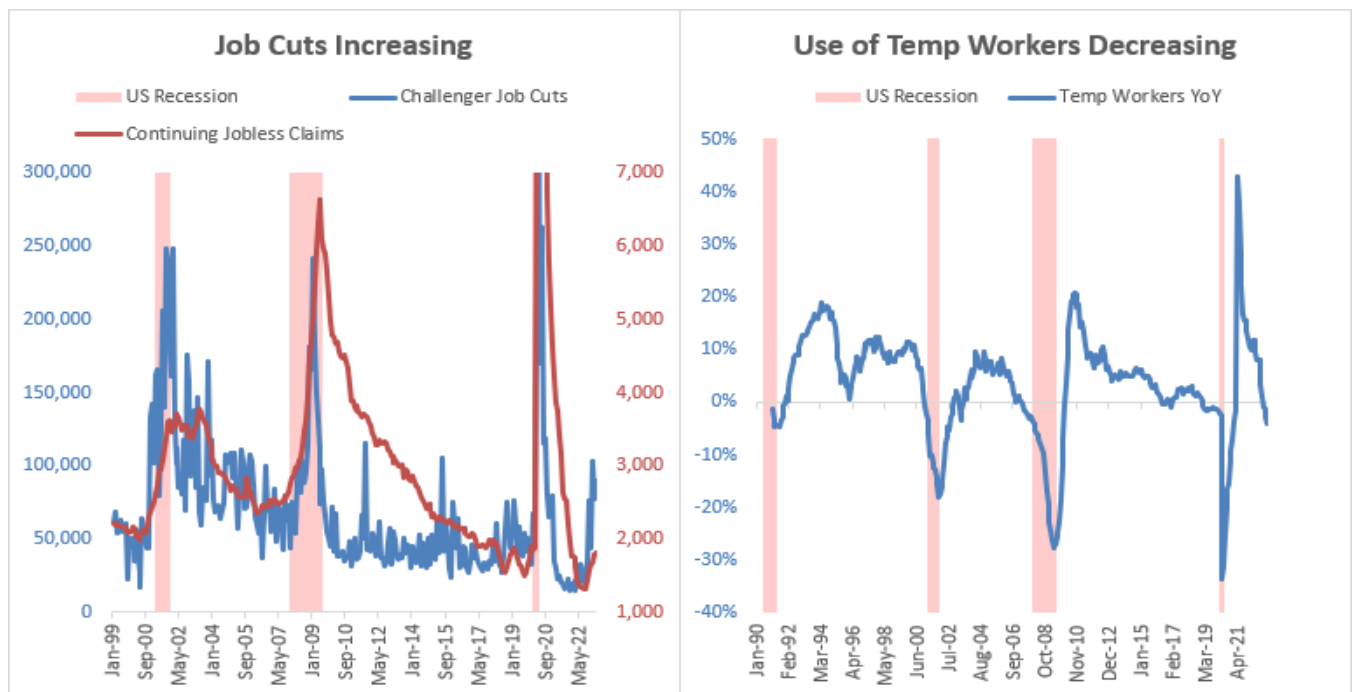
Source: Bloomberg, GMAG Research

Figure 3: Credit conditions are tightening, presenting a material risk to the growth outlook over the next 12 months. Tighter credit conditions have historically preceded rising unemployment.



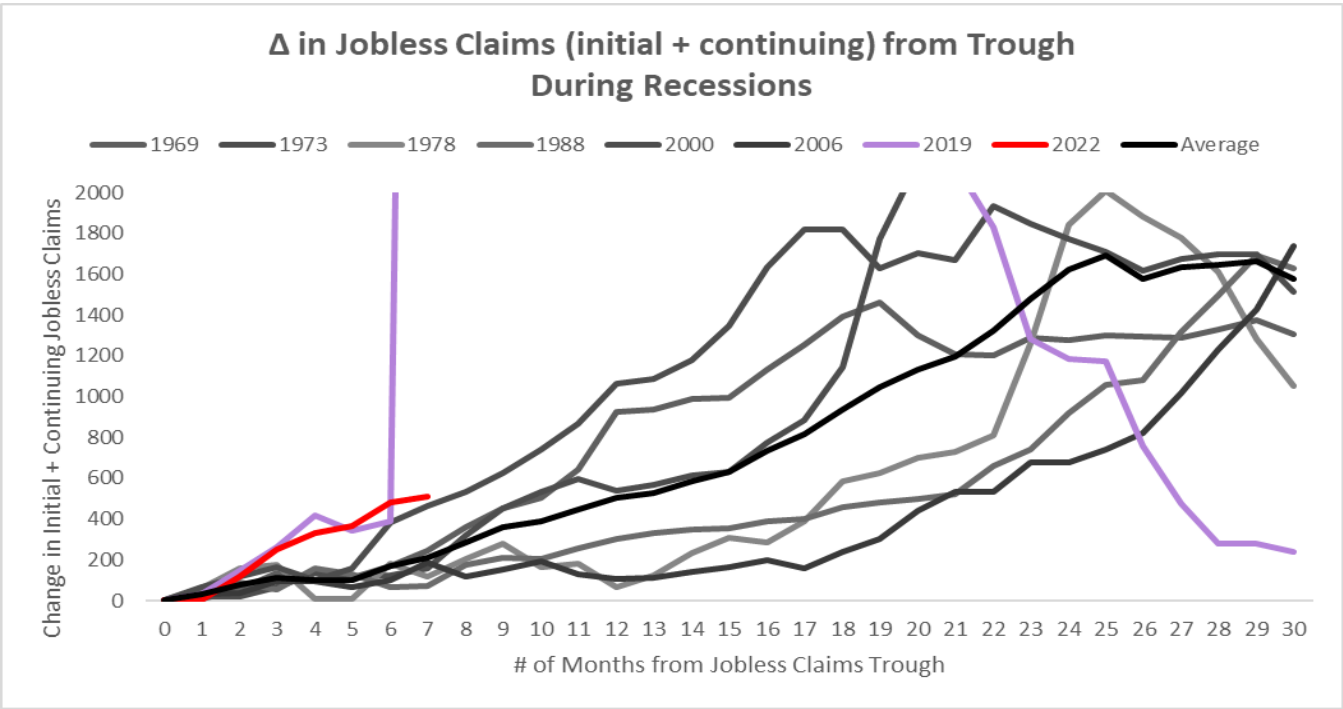
Source: Bloomberg, GMAG Research

Figure 4: Although nonfarm payroll data (NFP) remains robust, rising Challenger job cuts and jobless claims, combined with slowing demand for temporary workers, indicate cracks are forming beneath the surface of the labor market.



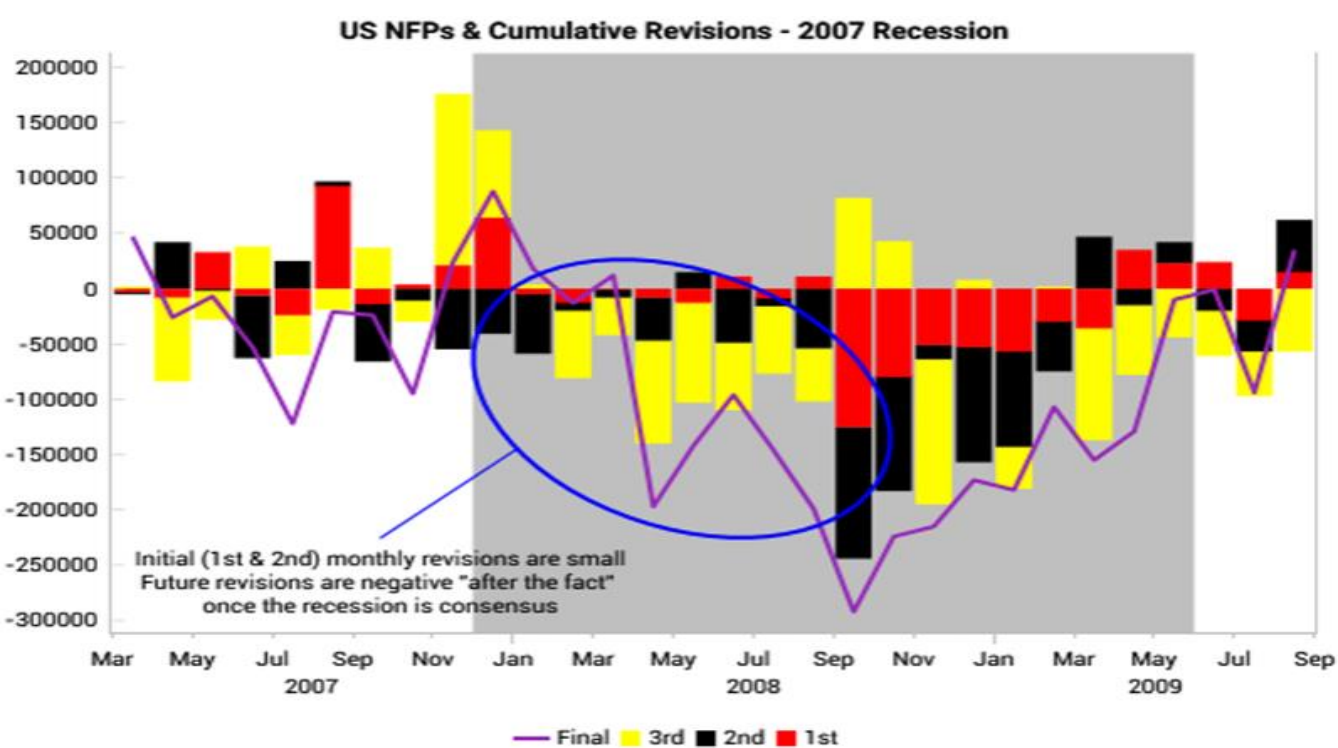
Source: Bloomberg, GMAG Research

Figure 5: The rise in jobless claims over the past seven months is consistent with patterns observed at the start of historical recessions.



Source: Bloomberg, GMAG Research

Figure 6: The previously mentioned labor market indicators can offer more accurate real-time insights than NFP data, which is heavily subject to revisions after the initial release.



Source: Variant Perception

Figure 7: Leading data suggest earnings will deteriorate over the next 12 months which should present a headwind to stocks. Historically, stocks have bottomed well before earnings do, but our earnings forecasts do not show signs of bottoming yet.



Source: Bloomberg, GMAG Research

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