The Weekly Market Update – 5/22/23: Negotiations Continue as Debt Ceiling Deadline Nears

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,191.98	1.65%	2.01%	9.18%	1.45%	4,796.56	14.4%
Dow Jones Industrial Average	33,426.63	0.38%	0.46%	0.84%	1.36%	36,799.65	10.1%
NASDAQ Composite	12,657.90	3.04%	3.57%	20.94%	2.62%	16,057.44	26.9%
Russell 2000	1,773.72	1.89%	-1.60%	0.71%	-4.85%	2,442.74	37.7%
MSCI EAFE (USD)	2,131.59	0.25%	1.86%	9.65%	4.81%	2,398.71	12.5%
MSCI Emerging Markets (USD)	977.24	0.44%	-1.32%	2.18%	-9.19%	1,444.93	47.9%
Bloomberg Commodity Index	101.07	-0.11%	-4.20%	-10.40%	-21.94%	237.95	135.4%
Barclays U.S. Aggregate Bond	89.86	-1.39%	-1.35%	1.10%	-4.27%	112.07	24.7%

Source: FactSet

Debt ceiling negotiations continue as we approach the Treasury Department's 6/1/23 deadline. Despite a common view that U.S. government spending must come to full or partial halt without an increase in the Federal debt limit, equity investors appear to minimize the risk of "*default*" as major equity indices are higher in both April and May. Through 5/19/23, the widely followed large-company S&P 500 equity index gained 0.6% in May (price return, not including dividends), following April's 1.5% price gain, and was up 9.2% in 2023 year-to-date. We italicize the word "*default*" to emphasize that the precise immediate impact of the government running out of funding is highly uncertain. Technically, U.S. debt issuance hit its approved limit of $31.4 trillion in late January, preventing the Treasury from issuing new bonds to fund ongoing deficits. Since the limit was reached, the Treasury has used incoming tax receipts as well as accounting maneuvers to continue all government spending. Urgency was added to Congressional debt ceiling negotiations after Treasury Secretary Janet Yellen said those measures would be exhausted by the first day of June. President Biden and Senate Democrats want a clean increase in the debt ceiling, while House Republicans passed a Bill to raise the debt ceiling, but with spending caps added. Once funding mechanisms expire, some suggest that interest on existing bonds could be halted, but the government would likely prioritize those payments (along with social security and Medicare), and maturing bonds could be refinanced as that would only replace existing debt. This places other government spending programs at risk (at least temporarily) and could lead to Federal furloughs and/or suspended paychecks. A prolonged government shutdown could weigh on economic growth, and lower investor confidence could lead to higher interest costs if future U.S. bond issuance requires higher interest rates. This may explain the recent increase in U.S. interest rates, as the yield on the 2-year U.S. Treasury yield moved to 4.24% on 5/19/23 from 3.98% one week earlier, while the U.S. 10-year Treasury yield moved to 3.65% from 3.36% over the same period. While debt negotiations stalled over the weekend, talks are expected to resume on Monday, and we are hopeful that progress is made. Typically, we say that investors like divided government (legislative and executive control spilt between the two political parties) as large policy changes become less likely, but in this case the divided government creates angst as spending obligations become due. Risks remain and this should come to a head over the next ten days.

S&P 500 earnings reports exceed expectations but are negative for the second consecutive quarter. With 95% of S&P 500 constituents having reported first quarter (1Q23) financial results as of 5/19/23, earnings were down 2.1%, compared to a down 6.6% estimate on 3/31/23. Following a 4Q22 earnings decline of 4.6%, the 1Q23 reflects incremental improvement and suggests that current estimates for year-over-year earnings growth to resume in 3Q23 remains possible. The wildcard remains the extent of the economic slowdown ahead as earnings weakness is likely to remain modest in a "soft landing," while larger economic slowdown or "hard landing," is likely not fully anticipated by investors.

As earnings season winds down, investor focus shifts to economic data and investor conferences. On 5/26/23, the Bureau of Economic Analysis will report Personal Income and Spending for April. Income exceeded expectation in January through March, creating solid support for consumer spending. In addition, several Wall Street firms are set to hold investor conferences this week, giving companies an opportunity to update business trends with 2Q23 now past the halfway point.

James D. Ragan, CFA
Director of WM Research
(206) 389-4070
jragan@dadco.com

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