

ECONOMIC OUTLOOK

Summary

The Bureau of Economic Analysis reported first quarter GDP growth of 2.0% annualized on April 30, slightly below estimates of 2.3% but a meaningful rebound from the 0.5% recorded during the fourth quarter defined by the government shutdown. The headline number invited cautious optimism, but the details beneath it revealed a narrower expansion than the headline implied.

Three subcomponents accounted for more than 75% of all the growth in the first quarter. The first two, computing hardware and software, contributed 1.09 percentage points of the 2.0% headline, reflecting the continued buildout of data centers and other AI technology across the private sector. The investment in this technology is real and contributed meaningfully to growth, but it was concentrated within a narrow slice of the economy. The third subcomponent, non-defense federal government spending, was less a sign of strength and more a reversal, as federal employees who missed paychecks during the fourth-quarter shutdown returned to work and their compensation flowed back through the economy. Excluding those three components, underlying growth in the broader economy was 0.5%, matching the fourth-quarter's pace. The economy grew, but the foundation beneath the headline is narrower than the number implies.

That uneven foundation gives the inflation data released in April added significance. An expansion with broader footing is likely to absorb an energy shock more comfortably. March headline CPI rose by 0.9% to 3.3% year-over-year, its highest reading since May 2024. The increase was mostly attributable to a 21.2% monthly surge in gasoline prices, the largest single-month increase since records began in 1967. The energy shock, however, may not tell the full story. Core Personal Consumption Expenditures (PCE), which excludes food and energy prices, accelerated from 3.0% to 3.2% year-over-year, a sign that some inflation pressure predates the

energy move and will require monitoring regardless of how the war in Iran resolves.

The Strait of Hormuz remains effectively closed, with the ceasefire between the United States and Iran fragile and actively contested. Energy prices have not retreated and the ripple effects across the broader economy are still unfolding. The economy entered the second quarter with genuine momentum in select areas and some unevenness beneath the surface. Whether a durable resolution to recent geopolitical events emerges and how far energy prices can retreat will shape both the inflation outlook and the durability of the economic expansion in the months ahead.

Positives

Initial Jobless Claims hit its lowest level in more than 50 years (189k)

Durable goods orders turned positive for the first time since November (0.8%)

ISM manufacturing has remained in expansion territory for four months (52.7)

Negatives

Core PCE year-over-year (the Fed's preferred inflation metric) moved higher by 0.2% to 3.2%

Consumer spending contributed the least amount to GDP in four quarters

The personal savings rate dropped to the lowest level since Oct '22

EQUITY OUTLOOK

Summary

After weeks of tension and uncertainty dragging the stock market lower, equities rebounded considerably in April. The S&P 500 Index rose 10.5% during the month, recovering all the losses from the first quarter. The S&P is now up 5.7% year to date. The equity rally was broad in terms of style, size and regional geography. The Russell 1000 Growth Index and Russell 1000 Value Index were higher by 11.9% and 8.2%, respectively. The small-cap Russell 2000 Index climbed 12.3%. And the developed international MSCI EAFE Index added 7.5% while the MSCI Emerging Markets Index soared 14.7%.

The recovery in equity markets was partly driven by peace talks in the Middle East and hopes shipping through the Strait of Hormuz could normalize in the near future. Corporate earnings and guidance have generally been strong and have helped create a tailwind for stocks. Still uncertainty remains elevated, and peace talks and cease fires have been fragile at best.

Equity markets seem to want to shrug off near-term uncertainty and favor looking ahead to the positive advancement that will drive productivity and profitability. There is an argument to be made that the market is not accurately reflecting the current level of risk and that valuations are historically stretched. Still, it is hard to fight the stock market's positive momentum, especially when companies are delivering strong financial results.

Kevin Warsh is expected to be seated as the new chair of the Federal Reserve later this month. While the decisions at the Fed are still dictated by a committee, the new chair is expected to lean towards dovish policy which should be accommodative to risk assets. Equity markets have had positive momentum and those forces have proven hard to deter in spite of heightened uncertainties. We do expect higher volatility as we advance through the rest of the year.

Positives

Corporate earnings growth and profitability

Solid economic backdrop

Negatives

Elevated geopolitical tensions

Midterm election and uncertainty

Unknowns

Path of inflation

FIXED INCOME OUTLOOK

Summary

The 10-year Treasury note yield traded in a relatively narrow closing level range of 18 basis points (bps) for the entire month of April. Despite ongoing concern about the budget deficit and fears the Iran war might drive foreign investors away from U.S. assets, yields offered little confirmation of an exodus. The monthly average closing yield was approximately 20 bps above the prolonged range the 10-year occupied late last year. The U.S. dollar, another barometer of foreign confidence, likewise showed no meaningful flight from American assets.

Elevated oil prices pushed yields modestly higher on a month-over-month basis. The 2-year Treasury rose 8 bps to close at 3.87%, a level similar to last summer despite the overnight rate having fallen 75 bps since then. The 10-year and 30-year bonds each rose 6 bps, ending the month at 4.37% and 4.97%, respectively. Overall, the Treasury market delivered a slightly negative total return of -0.07%, though intermediate maturities edged into positive territory at 0.08%.

Investment-grade corporate bond issuance continued at a historic pace. Driven heavily by technology companies raising capital for AI infrastructure, \$185 billion of new bonds came to market in April, nearly double the average of the prior four Aprils. Year-to-date supply now runs 29% ahead of last year's pace and is on track to surpass the record set during the Covid-era surge of 2020, according to JP Morgan research. Despite the volume, investor demand remained strong: credit spreads tightened 11 bps from their conflict-elevated wides and intermediate corporate bonds outperformed comparable Treasuries with a return of 0.47%.

At its late April meeting, the Federal Open Market Committee (FOMC) voted to hold the overnight rate steady, as expected. The meeting was notable, however, because of an unusual level of internal discord. Four committee members dissented - the most in over 30 years. One member favored an additional 25 bps rate cut, while three others sought to remove the easing bias language from the post-meeting statement, the first such dissent over statement language since December 2014. The meeting

also coincided with Kevin Warsh clearing a key Senate committee hurdle on his path to becoming the next Fed chair. The ongoing war in Iran and its inflationary impact will continue to pull the Fed's two mandates, price stability and maximum employment, in opposing directions. We have removed our expectation for a rate cut this year and are not anticipating a rate hike either.

Looking ahead, the bond market remains hostage to developments in the Middle East. The Strait of Hormuz closure continues to support oil prices and, in turn, keeps pressure on longer-maturity yields. A durable resolution and the resumption of normal oil flows could bring yields down sharply. In the meantime, we continue to find the front end of the curve attractive as the 2-year Treasury is priced for tightening that, in our view, is unlikely to materialize. We continue to maintain a neutral duration policy as well as an overweight to corporate bonds.

Positives

Yields remain elevated due to the Iran war and its impact on oil prices

Markets are now expecting a Fed rate hike which is unlikely

If the war is resolved, oil prices and inflation concerns should ease

Negatives

Previously expected Fed rate cuts may be on hold

GDP remains resilient with technology spending leading growth

Corporate bond issuance continues to be heavy

Unknowns

Outcome of Iran war and direction of oil prices