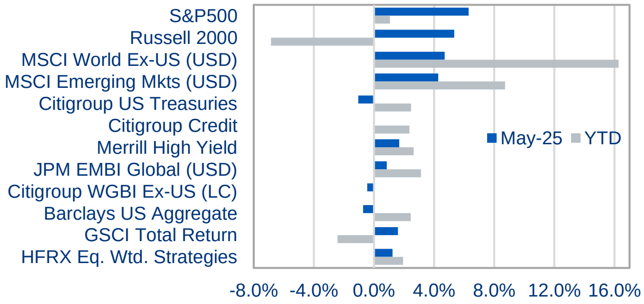
Global Market Review

After riding a roller coaster in April, U.S. equities rocketed higher in May, gaining over 6%. Wild swings in tariff policy remained the main driver of the ebb and flow of sentiment. Despite all the movement, U.S. equities are up only about 1% so far this year. Both advanced and emerging non-U.S. equity markets also enjoyed strong gains in May and have handily outperformed U.S. equities this year, helped in no small part by the depreciation of the U.S. dollar. With the Fed on hold in the face of an uncertain macroeconomic backdrop, the Treasury yield curve steepened in May as longer term rates rose. The move was modest, however, despite the downgrading by Moody's of the U.S. government's credit rating and pending legislation proposing a massive widening of the fiscal deficit. Credit spreads across the rating spectrum remained tight. The U.S. dollar depreciated further despite a widening yield differential over other currencies. Oil prices jumped in May but remain sharply lower so far this year.

Performance of Major Market Indices

Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.



U.S. equities extend their rally in May.

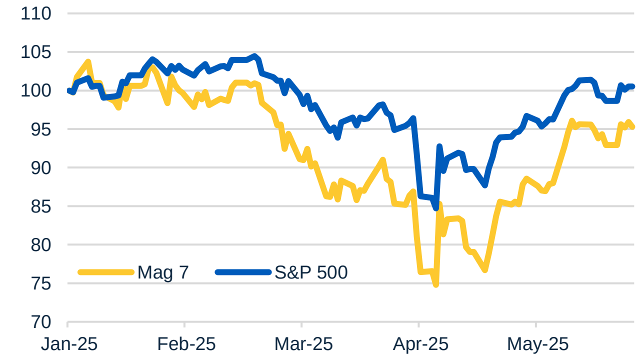
Massive May U.S. Equity Rally Recoups Earlier Losses

Tariff policy vacillations have made for a volatile equity market. High valuations, near-record market concentration, and the uncertain path for interest rates have all been secondary considerations in the face of tariff induced volatility. News that the Court of International Trade had ruled that many of the newly imposed tariffs were illegal constituted the latest catalyst for market gyrations.

The S&P 500 gained 6.3% in May, continuing a rally that began in early April. The index closed the month up 18.6% from its April trough but is up only 1.1% so far in 2025 (Exhibit 1). Buoyed by strong earnings, the Magnificent 7 band of mega-cap tech stocks regained its luster in May and led the market higher, rising 11.8%. They are up 27.4% from their April trough but remain down so far this year.

Exhibit 1. U.S. Equities' Wild Ride to Nowhere

Source: Bloomberg. Index January 1, 2025 = 100..



Growth stocks outperformed value in May, rising 8.7% versus value's gain of 3.5%. So far in 2025, however, growth stocks remain marginally lower, while value stocks are up 2%. Both large and small cap stocks enjoyed strong gains in May, rising 6.4% and 5.3%, respectively. Small cap stocks have lagged for most of the year, however, falling 6.8% through May versus a gain of 1% for large caps. Performance across sectors in May reflected the dominance of the Magnificent 7. Tech led all other sectors, gaining 10.8%. Consumer discretionary stocks, which include Tesla, followed closely with a gain of 9.5%. Both sectors remain down so far this year, however. Energy sector shares lagged in May, gaining only 0.4%. They remain down 5% in the five months through May.

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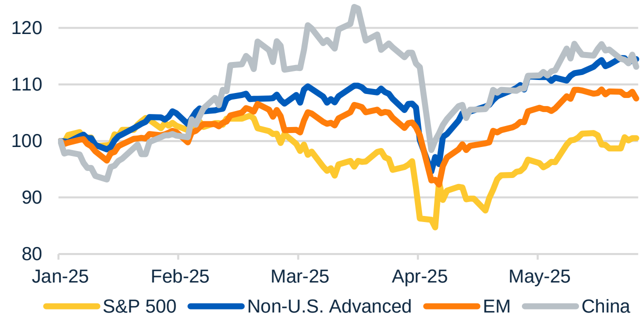
Non-U.S. Equity Markets Register Strong Gains

The MSCI World ex-U.S. index of advanced economy stocks rose 4.7% in May, bringing its gain so far this year to 16.3%, outpacing the U.S. market's gain of 1.1% by a wide margin (Exhibit 2). European markets continue to perform well. They are up 20.6% in the first five months of the year, with returns to U.S. investors buoyed by an appreciating euro. European equities have risen despite expectations that economic growth is likely to slow in the face of trade tensions. Hopes for more fiscal stimulus and continued ECB easing in the face of falling inflation are mitigating the impact of trade uncertainty.

Exhibit 2. U.S. Stocks Lag other Markets

Source: Bloomberg. Index January 1, 2025 = 100.



Emerging equities also generated strong gains in May, rising 4.3%. They are up 8.7% in the first five months of the year. Chinese equities have enjoyed strong gains so far this year, rising 13.1%, despite the imposition of punitive tariffs by the U.S. and the uncertainty created by trade tensions. The Chinese authorities have responded with renewed fiscal and monetary support to the economy, the equity market, and the manufacturing sector in particular, doubling down on the goal of self-sufficiency and export led growth.

Credit Downgrade and Fiscal Follies

The sustainability of U.S. fiscal deficits and debt have appeared shaky for some time. The U.S. is currently running a record peacetime, full-employment budget deficit. Government debt is set to accumulate rapidly, and the sustainability of its financing is dependent on a benign outlook for economic growth and interest rates. Interest payments on the debt are projected to pose an increasing burden and crowd out other expenditures. Citing these factors, Moody's downgraded the U.S. credit rating in May. Stabilizing the debt-to-GDP ratio at its current high level of 100% would require a significant, but manageable, tightening of fiscal policy. However, pending legislation would significantly increase the deficit and accelerate the accumulation of debt. Moreover, the prospect of tariff-induced stagflation increases the risk of unsustainable debt dynamics.

Against this backdrop, the U.S. Treasury yields have remained relatively stable. The yield curve did steepen in May with 30-year yields briefly rising above 5%. Despite this move, U.S. Treasury yields across most maturities were lower at end-May than at the beginning of the year.

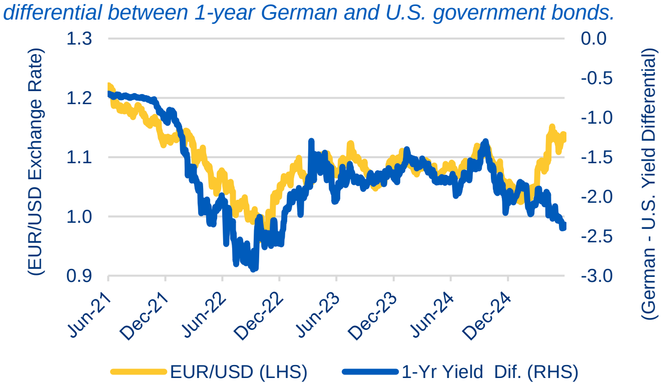
Credit spreads across the rating spectrum remain tight despite high levels of policy uncertainty. The high yield sector continues to outperform investment grade bonds. Like U.S. equities and Treasuries, the credit market remains relatively unperturbed by policy uncertainty, despite periodic bouts of volatility.

Yields, the Dollar, and Gold

Among U.S. assets, the U.S. dollar stands out as having been most affected by changing trade policies. Against expectations, the dollar fell following the announcement of tariffs on April 2. The dollar index has depreciated by 8.4% so far this year. This depreciation is unusual in light of the movement of the yield differential between the U.S. and other major countries. As highlighted in Exhibit 3, the euro/dollar exchange rate has in the past closely tracked the yield differential between 1-year German and U.S. government bonds. This relationship has broken down in recent weeks, leading some to speculate that policy uncertainty is undermining the safe haven status of the dollar.

Exhibit 3. Dollar and Yields Diverge

Source: Bloomberg. Euro/USD exchange rate (LHS) and yield differential between 1-year German and U.S. government bonds.



Gold, in contrast, has gained over 25% this year and briefly touched $3,500 per ounce. Gold's attractiveness is being driven in large part by policy and geopolitical uncertainty. Unlike U.S. Treasury bonds, gold is an asset that is no one's liability and therefore carries no default risk. Moreover, its supply is limited and the price of gold, while subject to fluctuation, cannot be debased by government action. These traits are increasing its attractiveness as a safe haven, despite its limited liquidity.

Performance of Major Market Indices through 05-31-2025

Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.

	1-Month	QTD	YTD	1-Year	3-Year	5-Year
S&P500	6.3%	5.6%	1.1%	1.1%	13.5%	14.4%
Russell 2000	5.3%	2.9%	-6.8%	-6.8%	1.2%	5.0%
MSCI World Ex-US (USD)	4.7%	9.5%	16.3%	16.3%	14.1%	11.1%
MSCI Emerging Mkts (USD)	4.3%	5.6%	8.7%	8.7%	13.0%	5.1%
Citigroup US Treasuries	-1.0%	-0.4%	2.5%	2.5%	5.0%	0.8%
Citigroup Credit	0.0%	0.0%	2.4%	2.4%	5.7%	2.8%
Merrill High Yield	1.7%	1.7%	2.6%	2.6%	9.3%	6.6%
JPM EMBI Global (USD)	0.9%	0.8%	3.1%	3.1%	7.8%	5.4%
Citigroup WGBI Ex-US (LC)	-0.4%	1.0%	-0.1%	-0.1%	3.2%	-0.4%
Barclays US Aggregate	-0.7%	-0.3%	2.4%	2.4%	5.5%	1.5%
GSCI Total Return	1.6%	-7.0%	-2.4%	-2.4%	-2.7%	-4.4%
HFRX Eq. Wtd. Strategies	1.2%	1.1%	1.9%	1.9%	4.8%	3.3%