MAY: STOCKS & BONDS REBOUND
U.S. PUBLIC & PRIVATE DEBT OVERVIEW

Figure 1: 5/31/2024 Returns (source: Bloomberg)
Conditional formatting: green (high) to red (low) for each time period

Bonds	ETF	Month	YTD	1YR	vs. 52-wk High	vs. 52-wk Low
US Aggregate Fixed Income	AGG	1.7%	-1.6%	1.3%	-3.3%	5.3%
Investment Grade Corp Bonds	LQD	2.2%	-2.0%	3.7%	-4.1%	8.7%
U.S. Treasury Bonds	GOVT	1.4%	-1.8%	-0.3%	-3.3%	3.7%
U.S. 20+ YR Treasuries	TLT	2.9%	-7.3%	-8.9%	-12.8%	10.0%
Muni Bonds	MUB	-0.3%	-1.5%	2.2%	-3.0%	4.8%
US High Yield	HYG	1.6%	1.8%	10.6%	-1.5%	7.3%
Non-US Corp Bonds	IBND	1.9%	-2.5%	5.8%	-4.5%	8.4%
Emerging Markets Bond LC	EMLC	2.3%	-2.4%	3.2%	-7.6%	4.3%
Global Equity						
ACWI Global Equity	ACWI	4.6%	9.1%	23.7%	-0.9%	26.3%
ACWI Global Equity ex US	ACWX	4.0%	6.1%	16.8%	-1.3%	21.4%
International Developed	EFA	5.1%	7.7%	18.5%	-0.6%	24.0%
Emerging Markets	EEM	2.0%	3.9%	12.4%	-3.4%	16.5%
Global Equity by Region						
United States	VTI	4.8%	10.2%	27.6%	-1.0%	29.1%
Europe	IEUR	6.3%	9.1%	20.2%	-0.5%	27.5%
Asia ex-Japan	AAXJ	2.9%	5.4%	10.8%	-3.2%	17.0%
China	MCHI	4.7%	7.6%	4.9%	-11.4%	24.4%
Japan	BBJP	2.5%	8.1%	19.6%	-3.4%	19.7%
Latin America	ILF	-1.2%	-6.9%	15.2%	-10.6%	12.5%
US Equity						
US S&P 500	IVV	5.1%	11.3%	28.3%	-0.8%	29.3%
NASDAQ 100 QQQ	QQQ	6.2%	10.2%	30.4%	-1.3%	32.9%
US Large Growth	IWF	6.0%	13.1%	33.4%	-1.1%	34.6%
US Large Value	IWD	3.3%	7.7%	21.7%	-1.5%	23.4%
US Eqwt S&P 500	RSP	2.8%	5.5%	20.7%	-2.3%	24.4%
US Mid Cap	IJH	4.5%	8.0%	26.1%	-1.8%	29.5%
US Small Cap	VTWO	5.1%	2.8%	20.3%	-2.2%	28.1%

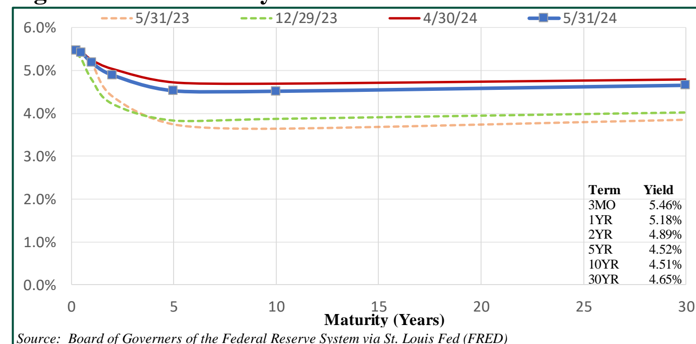
Stocks and bonds rebounded in May as soft economic data (GDP growth, job creation and inflation) revived investors' hopes for interest rate cuts sooner rather than later. Performance highlights for the month and year-to-date (YTD) are summarized below.

- Bonds: The US Aggregate index (AGG) rose 1.7% this month (-1.6% YTD) as yields declined. Long-term Treasuries (TLT) are highly sensitive to interest rates, rising 2.9% (-7.3% YTD). Corporate bonds (LQD) gained 2.2% (-2.0% YTD), and high yield (HYG) rose 1.6% (+1.8% YTD). Non-US bonds logged similar gains as the US dollar was relatively stable.
- Global equity (ACWI): +4.6% in May (+9.1% YTD).
- US Equity: The broad market (VTI) rose 4.8% (+10.2% YTD), and the S&P 500 (IVV) gained 5.1% (+11.3% YTD). Small (VTWO) and mid cap stocks (IJH) logged similar gains but have under-performed YTD as large tech stocks (QQQ and IWF) continue to account for an outsized proportion of market gains. Ten of the eleven sectors rose this month; energy stocks (XLE) lost ground as oil prices declined. Utilities were surprisingly strong (XLU +9.0%), followed closely by Technology (XLK +7.1%) and Communications stocks (XLC +6.9%).
- Non-US Equity: Developed markets (EFA) rose 5.1% in May (+7.7% YTD), with strength across Europe (IEUR +6.3%, +9.1% YTD). Emerging market stocks (EEM) gained 2.0% (+3.9% YTD) as China equities (MCHI) rose 4.7% (+7.6% YTD); Latin American stocks (ILF) were down 1.2% (-6.9% YTD), led lower by Brazil (EWZ). Stocks in India (INDA) logged marginal gains and are up 27.4% over the past year.

Interest Rates and the Economy

The yield curve (Figure 2) plots the interest rates (vertical axis) for various US Treasury maturities (horizontal axis). After rising sharply for the last several months, yields declined modestly in May as recent data pointed to slowing economic growth (Q1 real GDP +1.3% annualized), job growth (May +175k jobs), and stabilizing inflation (April CPI +3.4%), reigniting hopes for Fed rate cuts in the near future. The inverted yield curve (short-term > long-term yields) signals economic slowdown or recession ahead. The benchmark 10-year US Treasury now yields 4.51%.

Figure 2: US Treasury Yield Curve

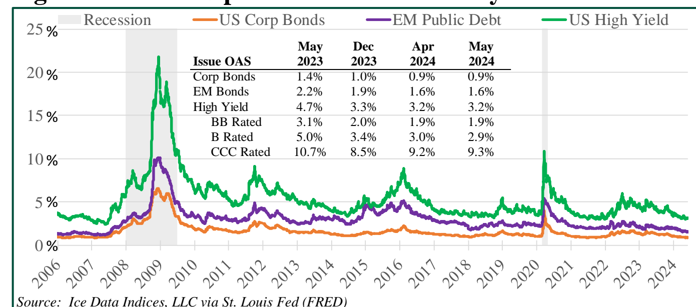


Source: Board of Governers of the Federal Reserve System via St. Louis Fed (FRED)

For bonds other than US Treasuries, we track the option-adjusted spread (OAS) between their yields and Treasuries of comparable maturities (Figure 3). Low or narrowing spreads signal optimism, while high or widening spreads signal fear. Spreads were stable in May but remain very low by historical standards.

- Investment grade corporate bond spreads were unchanged at +0.9% this month, well below year-ago spreads of +1.4%.
- High yield (non-investment grade) spreads stabilized at +3.2% but are still down from +4.7% in the last year. Spreads of the riskiest bonds (rated CCC & below) widened to +9.3% over Treasuries but are still below the +10.7% spreads one year ago.
- Emerging market spreads were unchanged at +1.6% and have tightened steadily versus +2.2% a year ago, indicating that investors see relatively low risk in emerging market debt.

Figure 3: Credit Spreads vs. U.S. Treasury Yields



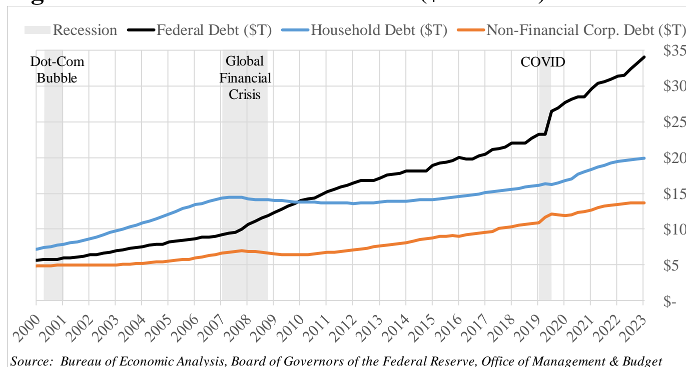
Source: Ice Data Indices, LLC via St. Louis Fed (FRED)

US Public & Private Debt

The stock and bond markets continue to be hyper-focused on the future path of interest rates, with investors parsing each new economic data point (real GDP growth, employment, inflation, etc.) to gauge when the Federal Reserve (the Fed) might begin cutting rates and by how much. In general, low or falling interest rates tend to be good for the economy (as well as for stock and bond prices), making it easier and less costly for borrowers to secure funding for their businesses, households and public works. Conversely, high or rising interest rates impede spending and growth.

The most tangible impact of interest rates is the cost of servicing existing debt. Much attention is paid to the staggering $34 trillion national debt, but that is only half of the story. Figure 4 plots the growth of public and private debt in the US since 2000.

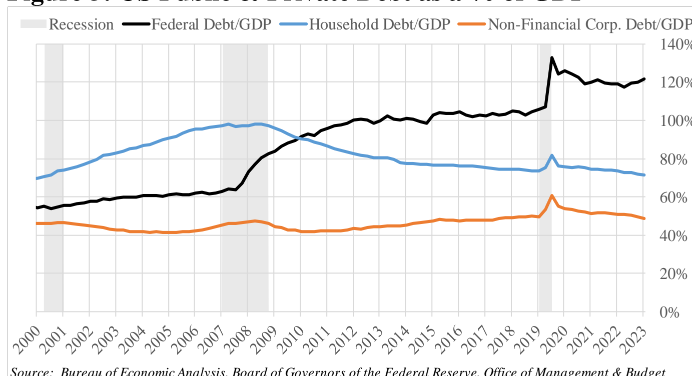
Figure 4: US Public & Private Debt ($Trillions)



Source: Bureau of Economic Analysis, Board of Governors of the Federal Reserve, Office of Management & Budget

US national debt has grown consistently over decades, spiking incrementally higher during crisis periods like the global financial crisis (GFC) or the pandemic. Corporations carry another $14 trillion in debt, and households owe $22 trillion (mortgage, HELOC, auto loans, student loans, credit cards, etc.). It is important to analyze these amounts relative to the size of the US economy. Figure 5 restates the dollar amounts as a percentage of the US Gross Domestic Product (GDP – the value of all final goods and services produced annually, currently $28 trillion).

Figure 5: US Public & Private Debt as a % of GDP

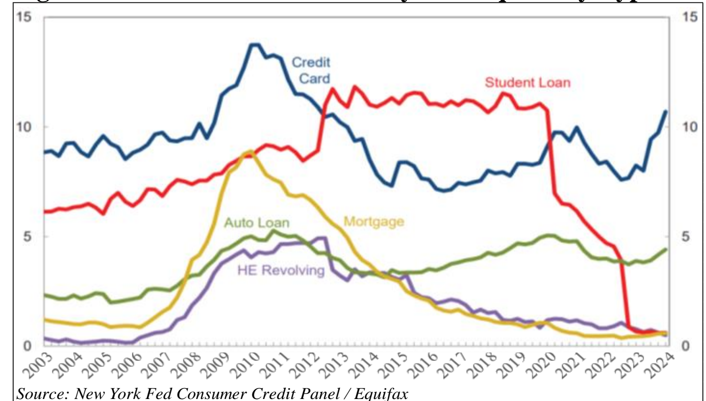


Source: Bureau of Economic Analysis, Board of Governors of the Federal Reserve, Office of Management & Budget

Despite the continuous increase in federal debt over many years, the size of that debt relative to the size of the US economy has shifted only episodically in the wake of crisis periods requiring massive fiscal response (government spending). During and after the GFC, the national debt spiked from 60% of GDP to over 100%, where it stayed for nearly a decade. The fiscal response to COVID pushed the debt to more than 120% of GDP. Interestingly, corporate and household debt show different trends. Corporate debt has remained relatively stable at 40-50% of GDP, but household debt has actually declined relative to the size of the economy, even though the dollar total has increased. This makes sense given the banking system reforms implemented in the wake of the subprime mortgage meltdown, and possibly lessons learned, during the GFC. According to Fed data, the portion of disposable household income required to service debt (principal and interest payments) is under 10%, below pre-pandemic levels.

Given that two-thirds of US economic activity (GDP) is driven by personal consumption expenditures, the financial health of the consumer is critical to the health of the economy. Household balance sheets appear to be in good shape, but it is important to be alert for changes that can affect consumer spending. Higher interest rates on mortgages, car loans, student loans and credit cards impact consumers' appetite for debt as well as their ability to service that debt. Rising delinquency rates on consumer loans can be an early warning sign regarding consumer spending and the economy. Figure 6 plots the percentage of various types of household debt balances that are more than 90 days past due.

Figure 6: % Loan Balance 90+ Days Delinquent by Type



Source: New York Fed Consumer Credit Panel / Equifax

Delinquency rates on mortgages, home equity and student loans are very low by historical standards, but auto and credit card delinquencies have begun to rise noticeably and are now at or above pre-pandemic levels. Consumers are feeling pain at the margin.

Bottom Line

Investors remain focused on interest rates, analyzing each new economic data point to assess when the Fed will begin cutting interest rates and by how much. Stocks and bonds lost value in April as stronger-than-expected employment and inflation data pushed expectations for Fed rate cuts further out into the future. Softer economic data in May renewed investors' hope for Fed rate cuts this year, causing stock and bond prices to rebound. Investors will continue to adjust expectations with every new economic data release (including the May jobs report this week and the next CPI report due June 12); market volatility will continue.

The US national debt has risen to $34 trillion and now stands at 122% of our annual GDP. Given the rapid growth of the economy, the current debt load is serviceable, but the trajectory is not sustainable, as noted by the Fed. Corporate debt has grown to $14 trillion but remained stable relative to the size of the US economy. Interestingly, while household debt has increased to $22 trillion, it has actually shrunk in proportion to GDP since the GFC. We note that auto loan and credit card delinquencies are rising, potentially an early warning regarding the health of the consumer and the economy. Diversification continues to be critical to provide a cushion to offset equity market volatility.

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