MARKET INSIGHTS

from Ziegler Capital Management

Monthly Market Commentary: June 2022

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Financial news headlines continue to be led by the invasion of Ukraine by Russia and the related economic sanctions, the pace of future increases in the Federal Funds rate and their size, inflation running at multi-decade highs, and continued supply chain disruptions that are having a broader effect on U.S. companies and their consumers. While COVID-19 cases increased in May, they remain far below levels seen in late December and January. Hospitalizations are continuing to fall dramatically across the country. The number of people who have received at least one dose of a COVID-19 vaccine continues to increase. According to the Centers for Disease Control (CDC), 75.1% of the United States population over 12 years old is fully vaccinated against COVID-19, with 87.5% of the population having received at least one dose as of May 31st.

The S&P 500 was roughly flat in May with a return of 0.18%. For the year-to-date period through May 31st, the S&P 500 has returned -12.76%. Small cap stocks, as measured by the Russell 2000, returned 0.15% in May and have returned -16.57% on a year-to-date basis as of May 31, 2022. This contrasts with the 14.82% return for calendar year 2021. Like January, February and April, Large Cap Value outperformed Growth in May, with the Russell 1000 Value returning 1.92% and the Russell 1000 Growth returning -1.89%. On a year-to-date basis as of May 31, 2022, Large Cap Value has outperformed Large Cap Growth, with a return of -4.52% versus -21.88%. In May, the Russell 2000 Value returned 1.92% and the Russell 2000 Growth returned -1.89%. On a year-to-date basis as of May 31, 2022, Small Cap Value outperformed Small Cap Growth, with a return of -8.25% for Small Cap Value versus Small Cap Growth at -24.79%.

Returns by Sector

	S&P 500		Russell 2000	
Sector	May 2022	YTD	May 2022	YTD
Communication Services	1.79	-24.35	-2.94	-24.50
Consumer Discretionary	-4.85	-24.69	-3.61	-25.48
Consumer Staples	-4.61	-3.16	-2.04	-10.67
Energy	15.77	58.47	13.88	56.56
Financials	2.73	-8.78	3.64	-12.20
Health Care	1.44	-5.83	-4.06	-32.02
Industrials	-0.48	-10.14	0.49	-13.28
Information Technology	-0.85	-19.39	-2.08	-25.66
Materials	1.14	-4.70	2.82	-6.70
Real Estate	-5.02	-14.10	-3.79	-15.27
Utilities	4.32	4.65	5.77	2.09
TOTAL RETURN	0.18%	-12.76%	0.15%	-16.57%

Source: Bloomberg

ABOUT ZCM MARKET INSIGHTS

A series that provides a glimpse of our internal thought process through current topics affecting our clients and colleagues.

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The “Build Back Better” bill appears to be dead, although there are reports it may be broken into smaller bills in hopes of securing passage of parts of the larger bill prior to the November mid-term elections. Some of the opposition to the larger bill was due to a lack of permanent, full financing for some provisions. Several of President Biden’s campaign promises have been abandoned, such as providing free community college and clean electricity standards. Programs such as the expanded Child Tax Credit and expanded Medicaid that were initially going to be permanent will instead expire in a year or two in the current framework. To pay for his plans, President Biden’s proposals include raising the top income tax and capital gains rates, increasing corporate taxes, and expanding the Internal Revenue Service’s collections.

Real gross domestic product (GDP) decreased at an annualized rate of 1.5% in the first quarter of 2022 according to the "second" estimate released by the Bureau of Economic Analysis (BEA), a decrease from the first estimate of -1.4%. The update reflects downward revisions to private inventory investment and residential investment that were partly offset by an upward revision to consumer spending. The decrease in GDP reflected decreases in private inventory investment, exports, federal government spending, and state and local government spending, while imports, which are a subtraction in the calculation of GDP, increased. Personal consumption expenditures (PCE), nonresidential fixed investment, and residential fixed investment increased. The decrease in private inventory investment was led by decreases in wholesale trade (mainly motor vehicles) as well as mining, utilities, and construction (utilities). Within exports, widespread decreases in nondurable goods were partly offset by an increase in "other" business services such as financial services. The decrease in federal government spending primarily reflected a decrease in defense spending on intermediate goods and services. The increase in imports was led by increases in durable goods (non-food and non-automotive consumer goods). The increase in PCE reflected widespread increases in services (led by housing and utilities). Within goods, an increase in durable goods (led by motor vehicles and parts) was offset by a decrease in nondurable goods (led by gasoline and other energy goods). The increase in nonresidential fixed investment reflected increases in equipment and intellectual property products.

The Institute for Supply Management’s (ISM) Purchasing Managers' Index (PMI) registered 56.1 in May, an increase from the April reading of 55.4. A reading of over 50 is considered to be expansionary. This figure indicates expansion in the overall economy for the 24th month in a row after a contraction in April and May 2020. According to the ISM, “The U.S. manufacturing sector remains in a demand-driven, supply chain-constrained environment. Despite the Employment Index contracting in May, companies improved their progress on addressing moderate-term labor shortages at all tiers of the supply chain, according to Business Survey Committee respondents’ comments. Panelists reported slightly lower rates of quits compared to April. May was a second straight month of slight easing of prices expansion, but instability in global energy markets continues. Surcharge increase activity appears to be stabilizing across all industry sectors. Sentiment remained strongly optimistic regarding demand, with five positive growth comments for every cautious comment. Panelists continue to note supply chain and pricing issues as their biggest concerns.”

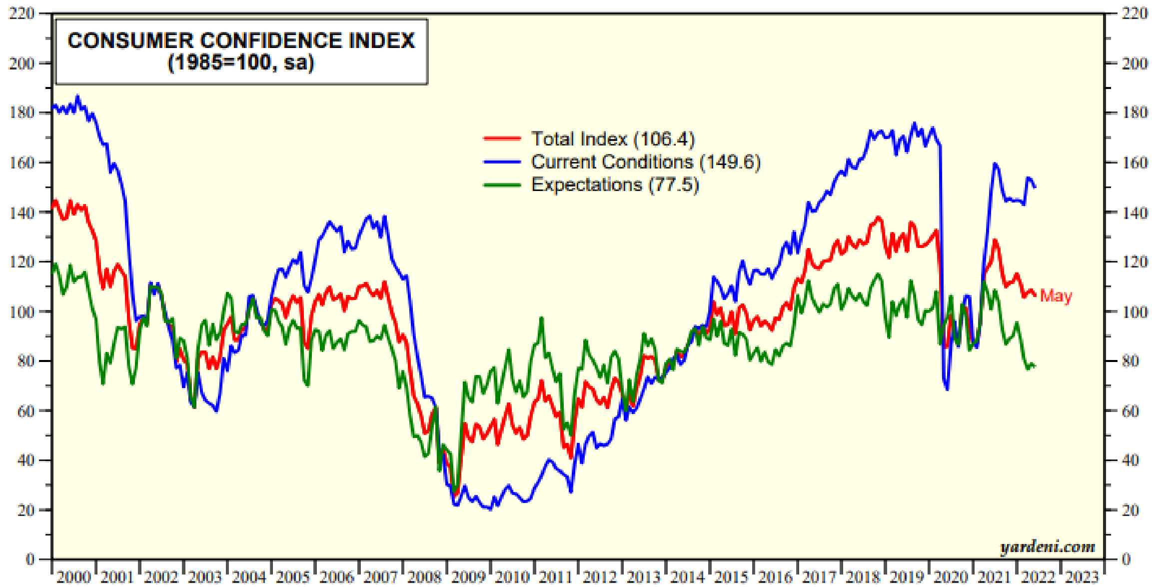
According to the U.S. Bureau of Labor Statistics (BLS), the unemployment rate was unchanged in April, at 3.6%, from the March reading. Total non-farm payroll employment rose by 428,000 in April. Job growth was widespread during the month and was led by gains in leisure and hospitality, manufacturing, and transportation and warehousing. The number of unemployed was essentially unchanged at 5.9 million. Both measures continue to fall and are significantly lower than their April 2020 highs and are now roughly in line with their February 2020 pre-pandemic levels of 3.5% and 5.7 million people. The labor force participation rate was 62.2% in April, little changed from March and February. It has remained in a narrow range since June 2020, with the last four readings the highest rate in that period.

The U.S. savings rate was 4.4% in April, a sharp decrease from 6.4% in March. The long-term average savings rate is approximately 9% after its stunning peak of 32.2% in April 2020. Personal income increased $89.3 billion (0.4%) in April, according to the Bureau of Economic Analysis (BEA). The increase in personal income in April primarily reflected an increase in compensation and personal income receipts on assets that were partly offset by a decrease in proprietors' income. Within compensation, the increase reflected increases in both private and government wages and salaries. The increase in personal income receipts on assets was led by personal dividend income. The decrease in proprietors' income was led by nonfarm income. The $152.3 billion increase in personal consumption expenditures in April reflected an increase of $48.6 billion in spending for goods and a $103.7 billion increase in spending for services. Within goods, increases were widespread across all components except for gasoline and other energy goods; spending for motor vehicles and parts was the leading contributor to the increase. Within services, increases were also widespread across all components, led by food service, accommodations, housing, and utilities.

In the minutes released from the Fed's May meeting, showed "all participants concurred that the U.S. economy was very strong, the labor market was extremely tight, and inflation was very high." They discussed the need to raise interest rates quickly and possibly more than markets anticipate tackling rising inflation. "Most participants judged that 50 basis point increases in the target range would likely be appropriate at the next couple of meetings," the minutes stated. The committee further added "a restrictive stance of policy may well become appropriate depending on the evolving economic outlook and the risks to the outlook." The Fed raised interest rates by 50 basis points at the meeting and laid out a plan to reduce its $9 trillion balance sheet. This was the first 50 basis point increase in 22 years and inflation is running at a 40-year high. The minutes mentioned "inflation" sixty times. "All participants reaffirmed their strong commitment and determination to take the measures necessary to restore price stability," the minutes further stated. There are expectations of two additional 50 basis point increases followed by a series of 25 basis point increases by the end of the year. The market pricing in rates between 2.50% and 2.75% by the end of 2022.

Consumer Confidence decreased slightly in May to 106.4, down from an upward revised 108.6 in April. Consumer Confidence recently reached a peak of 128.9 in June 2021. According to a statement from the Conference Board, "Consumer confidence dipped slightly in May, after rising modestly in April. The decline in the Present Situation Index was driven solely by a perceived softening in labor market conditions. By contrast, views of current business conditions—which tend to move ahead of trends in jobs—improved. Overall, the Present Situation Index remains at strong levels, suggesting growth did not contract further in Q2. That said, with the Expectations Index weakening further, consumers also do not foresee the economy picking up steam in the months ahead. They do expect labor market conditions to remain relatively strong, which should continue to support confidence in the short run. Meanwhile, purchasing intentions for cars, homes, major appliances, and more all cooled—likely a reflection of rising interest rates and consumers pivoting from big-ticket items to spending on services. Vacation plans have also softened due to rising prices. Indeed, inflation remains top of mind for consumers, with their inflation expectations in May virtually unchanged from April's elevated levels. Looking ahead, expect surging prices and additional interest rate hikes to pose continued downside risks to consumer spending this year." The Current Conditions Index (which is based on consumers' assessment of current business and labor market conditions) declined to 149.6 from an upward revised 152.9 in May. The Expectations Index (which is based on consumers' short-term outlook for income, business, and labor market conditions) decreased to 7.5 in May from an upward revised 79.0 in April. According to information from the BEA, the consumer is responsible for approximately 70% of the U.S. economy.

Consumer Confidence



Source: The Conference Board.

The Bloomberg U.S. Aggregate Bond Index returned +0.64% in May and has returned –8.92% on a year-to-date basis as of May 31st. This is on the heels of a -1.54% return for calendar year 2021. The 10-Year U.S. Treasury ended May at 2.85% after ending April at 2.94% and beginning the year at 1.51%. It has increased dramatically since hitting an all-time low of 0.54% in July 2020. The 2-Year U.S. Treasury and 10-Year Treasury spread ended May with a spread of 29 basis points (2-year: 2.56% and 10-year: 2.85%). This contrasts with figures from the beginning of the year with a spread of 78 basis points and the 2-Year at 0.73 % and the 10-Year at 1.51%. Option Adjusted Spreads (as represented by the Bloomberg Corporate Index) ended May at 130 basis points, 5 basis points tighter than the April month end of 135 basis points. Spreads began 2022 with a reading of 92 basis points.

West Texas Intermediate (WTI) finished May at $115.48 per barrel, increasing 11.0% from April at $104.00 per barrel. WTI has increased 58.2% since beginning 2022 at $75.21 per barrel. This is on the heels of a 58.9% increase in 2021. Turmoil from the invasion of Ukraine by Russia, the related sanctions and increasing demand have been a significant factor in the increases so far in 2022. WTI is significantly higher than April 2020's close at $18.84 per barrel during the Saudi/Russia price war.

The Volatility Index (VIX) ended May at 26.19, decreasing 21.5% from the April month-end reading of 33.35. The VIX has increased 52.1% after beginning 2022 with a reading of 17.22. Movement in the VIX has largely been driven by market turbulence over inflation, increasing interest rates and the war between Russia and Ukraine. It remains lower than the March 16, 2020, COVID-19 pandemic peak of 82.69. The long-term average of the VIX is approximately 20.

We actively monitor the capital markets and are prepared to respond accordingly. As we have stated in the past, we continue to advise our clients to adhere to their long-term plans and objectives.

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