MARKET INSIGHTS

from Ziegler Capital Management

Monthly Market Commentary: September 2022

WRITTEN: SEPTEMBER 1, 2022

Financial news headlines continue to be led by inflation running at multi-decade highs, recessionary fears, the Ukraine / Russia war, and the related economic sanctions, the pace and size of future increases in the Federal Funds rate and continued albeit improving supply chain disruptions. The narrowly divided Senate passed a package which raises roughly $740 billion in new revenue and spends $433 billion on climate and healthcare programs. The Democrats have tried and failed for much of the last year to pass this package. Democrats used a budget reconciliation process that allows a bill to advance in the Senate with a simple majority, rather than the 60-vote supermajority usually needed. Republicans opposed the package, saying it will damage the economy and further exacerbate inflation that is running at 40-year high levels. President Biden, through executive order, unveiled a student loan forgiveness plan that will provide up to $20,000 in federal student loan cancellation for up to 20 million borrowers subject to certain income thresholds. It is unclear if this executive order will survive expected legal challenges.

The S&P 500 returned -4.08% in August, turning negative during the last week of the month over economic fears. For the year-to-date period through August 31st, the S&P 500 has returned -16.14%. Small cap stocks, as measured by the Russell 2000, returned -2.05% in August and have returned -17.16% on a year-to-date basis as of August 31, 2022. This contrasts with the 14.82% return for calendar year 2021. Large Cap Value outperformed Growth in August, with the Russell 1000 Value returning -2.98% and the Russell 1000 Growth returning -4.66%. On a year-to-date basis as of August 31, 2022, Large Cap Value has significantly outperformed Large Cap Growth, with a return of

Returns by Sector (as of August 31, 2022)

	S&P 500		Russell 2000	
Sector	Aug 2022	YTD	Aug 2022	YTD
Communication Services	-4.19	-30.61	-4.04	-28.32
Consumer Discretionary	-4.57	-23.75	-2.55	-27.48
Consumer Staples	-1.75	-4.18	0.26	-6.53
Energy	2.83	48.75	5.68	47.33
Financials	-2.01	-14.62	-2.94	-13.67
Health Care	-5.78	-10.77	1.79	-22.27
Industrials	-2.81	-11.44	-3.50	-13.57
Information Technology	-6.12	-22.09	-4.94	-29.14
Materials	-3.47	-15.88	-0.06	-10.92
Real Estate	-5.61	-18.07	-7.11	-23.52
Utilities	0.51	5.45	-1.71	2.19
TOTAL RETURN	-4.08%	-16.14%	-2.05%	-17.16%

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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-9.85% versus -23.19%. In August, the Russell 2000 Value returned -3.16% and the Russell 2000 Growth returned -0.94%. On a year-to-date basis as of August 31, 2022, Small Cap Value outperformed Small Cap Growth, with a return of -12.17 for Small Cap Value versus Small Cap Growth at –22.29%.

Real gross domestic product (GDP) decreased at an annualized rate of 0.6%% in the first quarter of 2022 according to the "second" estimate released by the Bureau of Economic Analysis (BEA). This is an upward revision from the “advance” estimate which forecasted a decline of 0.9%. This reading follows a decrease of 1.6% in the first quarter. The update primarily reflects upward revisions to consumer spending and private inventory investment that were partly offset by a downward revision to residential fixed investment. The decrease in real GDP reflected decreases in private inventory investment, residential fixed investment, federal government spending, and state and local government spending, that were partly offset by increases in exports and consumer spending. Imports, which are a subtraction in the calculation of GDP, increased. The decrease in private inventory investment was led by a decrease in retail trade (mainly general merchandise stores). The decrease in residential fixed investment was led by a decrease in "other" structures (real estate brokers' commissions). The decrease in federal government spending reflected a decrease in non-defense spending that was partly offset by an increase in defense spending. The decrease in non-defense spending reflected the sale of crude oil from the Strategic Petroleum Reserve, which results in a corresponding decrease in consumption expenditures. Because the oil sold by the government enters private inventories, there is no direct net effect on GDP. The decrease in state and local government spending was led by a decrease in investment in structures. The increase in imports reflected an increase in services (led by travel). The increase in exports reflected increases in both goods (led by industrial supplies and materials) and services (led by travel). The increase in consumer spending reflected an increase in services (led by food services and accommodations as well as "other" services) that was partly offset by a decrease in goods (led by food and beverages).

The Institute for Supply Management’s (ISM) Purchasing Managers' Index (PMI) registered 52.8 in August, unchanged from July. This figure indicates expansion in the overall economy for the 27th month in a row after a contraction in April and May 2020, but is the lowest reading since June 2020 when it registered 52.4. A reading of over 50 is considered to be expansionary. According to the ISM, “The U.S. manufacturing sector continues expanding at rates similar to the prior two months. New order rates returned to expansion levels, supplier deliveries remain at appropriate tension levels and prices softened again, reflecting movement toward supply/demand balance. According to Business Survey Committee respondents’ comments, companies continued to hire at strong rates in August, with few indications of layoffs, hiring freezes or head-count reductions through attrition. Panelists reported lower rates of quits, a positive trend. Prices expansion eased dramatically in August, which — when coupled with lead times easing — should bring buyers back into the market, improving new order levels. Sentiment remained optimistic regarding demand, with five positive growth comments for every cautious comment. Panelists continue to express unease about a softening economy, with 18 percent of comments noting concern about order book contraction. Twelve percent of panelists’ comments reflect growing worries about total supply chain inventory.”

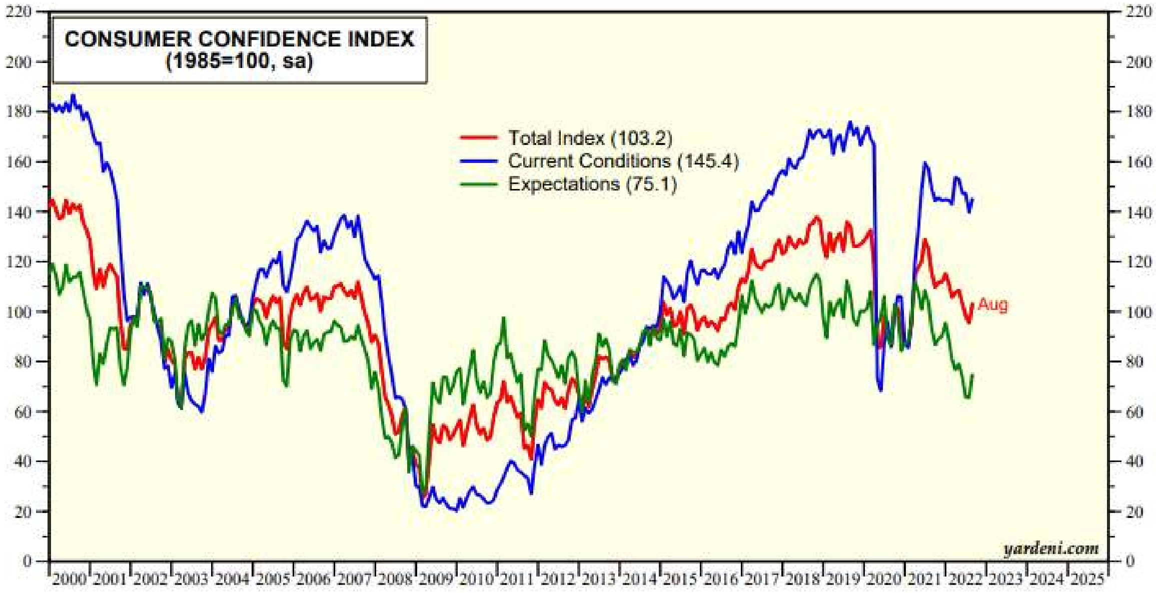
According to the U.S. Bureau of Labor Statistics (BLS), the unemployment rate was increased in July to 3.7% from 3.5%. The unemployment rate is calculated from the household survey which showed a meaningful increase in the civilian labor force of 798,000 in August. The larger number of participants led to a 344k increase in unemployed persons. As with prior months, job gains were widespread through various sectors with professional and business services (68k), manufacturing (45k), and retail trade (44k) leading the way. The number of unemployed increased by 344,000 to 6.0 million, largely due to the increased participation rate. Both measures 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 increased to 62.4% in July, equaling March 2022, which are the highest readings since February 2020.

The U.S. savings rate was 5.0% in July, unchanged from the June reading. The long-term average savings rate is approximately 9% after its stunning peak of 32.2% in April 2020. Personal income increased $47 billion in July (0.2%), according to the Bureau of Economic Analysis (BEA). The increase in personal income in July primarily reflected an increase in compensation that was partly offset by decreases in proprietors' income, personal current transfer receipts, and rental income of persons. The increase in compensation was led by private wages and salaries. The decrease in proprietors' income was mainly in nonfarm income. The decrease in personal current transfer receipts followed an increase in June that reflected a legal settlement from corporate business to persons. The $23.7 billion increase in current-dollar PCE in July reflected an increase of $33.3 billion in spending for services that was partly offset by a decrease of $9.6 billion in spending for goods. Within services, the largest contributors to the increase were spending for housing and utilities (mainly housing) and for "other" services (mainly international travel). Within goods, gasoline and other energy goods was the leading contributor to the decrease.

Federal Reserve Chairman Jerome Powell’s speech at the annual policy forum in Jackson Hole reiterated that the US central bank will keep raising interest rates and likely leave them elevated to combat 40-year high levels of inflation. Powell stated “While higher interest rates, slower growth, and softer labor market conditions will bring down inflation, they will also bring some pain to households and businesses. These are the unfortunate costs of reducing inflation. But a failure to restore price stability would mean far greater pain.” Powell cautioned that the Fed’s focus is more long-term oriented, and it will continue pushing ahead until inflation moves down closer to its 2% long-range target. “We are moving our policy stance purposefully to a level that will be sufficiently restrictive to return inflation to 2%,” Powell said. He added “restoring price stability will likely require maintaining a restrictive policy stance for some time. The historical record cautions strongly against prematurely loosening policy.”

Consumer Confidence increased in August to 103.2 from a slightly downward revised 95.3 in July. This increase follows three consecutive monthly declines. Consumer Confidence most recently reached a peak of 128.9 in June 2021. According to a statement from the Conference Board, “Consumer confidence increased in August after falling for three straight months. The Present Situation Index recorded a gain for the first time since March. The Expectations Index likewise improved from July’s 9-year low, but remains below a reading of 80, suggesting recession risks continue. Concerns about inflation continued their retreat but remained elevated. Meanwhile, purchasing intentions increased after a July pullback, and vacation intentions reached an 8-month high. Looking ahead, August's improvement in confidence may help support spending, but inflation and additional rate hikes still pose risks to economic growth in the short term." The Current Conditions Index (which is based on consumers' assessment of current business and labor market conditions) increased in August to 145.4 from a downward revised 139.7 in July. The Expectations Index (which is based on consumers' short-term outlook for income, business, and labor market conditions) increased to 75.6 in August from a revised 65.6 in July. According to information from the BEA, the consumer is responsible for approximately 70% of the U.S. economy.

Consumer Confidence (as of August 31, 2022)



Source: The Conference Board.

The Bloomberg U.S. Aggregate Bond Index returned -2.83% in August and has returned -10.75% on a year-to-date basis as of August 31st. This return is on the heels of a -1.54% return for calendar year 2021. The 10-Year U.S. Treasury ended August at 3.19% after ending July at 2.65% 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 August with a spread of negative 30 basis points (2-year: 3.49% and 10-year: 3.19%). This contrasts with figures from the beginning of the year with a spread of 78 basis points (2-Year: 0.73 % and 10-Year: 1.51%). Option Adjusted Spreads (as represented by the Bloomberg Corporate Index) ended August at 140 basis points, 4 basis points tighter than the July month end of 144 basis points. Spreads began 2022 with a reading of 92 basis points.

West Texas Intermediate (WTI) finished August at $88.85 per barrel, decreasing 9.9% from July at $98.62 per barrel. WTI has increased 18.1% 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 August at 25.87, increasing 21.3% from the July month-end reading of 21.33. The VIX has increased 50.2% 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, recessionary fears 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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22-02001
Printed Internally

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