MARKET INSIGHTS

from Ziegler Capital Management

Monthly Market Commentary: October 2022

WRITTEN: OCTOBER 3, 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, as well as the upcoming mid-term elections. Consumers and businesses are beginning to feel the impact of higher interest rates with slowing home sales and higher levels of inflation. The Federal Reserve has continued to increase interest rates that are now at their highest level since early 2008 with more rate increases expected. This the most aggressive Fed tightening since it started using overnight funds as its principal policy tool in 1990. The November mid-term elections are coming into focus with all 435 House of Representative and thirty-five of the one hundred Senate seats up for election. This is in addition to thirty-nine state and territory gubernatorial elections. This is the first election following the redistricting from the 2020 census.

The S&P 500 returned -9.21% in September, its six month of negative returns so far in 2022. For the year-to-date period through September 30th, the S&P 500 has returned -23.87%. Small cap stocks, as measured by the Russell 2000, returned -9.57% in September and have returned -25.08% on a year-to-date basis as of September 30th. This contrasts with the 14.82% return for calendar year 2021. Large Cap Value outperformed Growth in September, with the Russell 1000 Value returning -8.77% and the Russell 1000 Growth returning -9.72%. On a year-to-date basis as of September 30th, Large Cap Value has significantly outperformed Large Cap Growth, with a return of -17.75% versus -30.66%. In September, the Russell 2000 Value returned -10.19% and the Russell 2000 Growth returned -9.00%. On a year-to-date basis as of September 30th,

Returns by Sector (as of September 30, 2022)

Sector	S&P 500 Sept. 2022	S&P 500 YTD	Russell 2000 Sept. 2022	Russell 2000 YTD
Communication Services	-12.15	-39.04	-12.97	-41.30
Consumer Discretionary	-8.06	-29.89	-11.02	-35.72
Consumer Staples	-7.99	-11.83	-11.21	-17.57
Energy	-9.28	34.94	-12.26	30.48
Financials	-7.76	-21.25	-7.63	-20.28
Health Care	-2.60	-13.08	-4.97	-26.26
Industrials	-10.48	-20.72	-11.16	-24.44
Information Technology	-12.01	-31.44	-9.80	-37.36
Materials	-9.35	-23.74	-12.51	-23.10
Real Estate	-13.15	-28.85	-13.54	-34.01
Utilities	-11.34	-6.51	-10.31	-8.62
TOTAL RETURN	-9.21%	-23.87%	-9.57%	-25.08%

Source: Bloomberg

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

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Small Cap Value outperformed Small Cap Growth, with a return of -21.12 for Small Cap Value versus Small Cap Growth at –29.28%.

Real gross domestic product (GDP) decreased at an annualized rate of 0.6%% in the first quarter of 2022 according to the "third" estimate released by the Bureau of Economic Analysis (BEA). This is the same reading as the “second” estimate. This reading follows a decrease of 1.6% in the first quarter. The update primarily reflected an upward revision to consumer spending that was offset by a downward revision to exports. Imports, which are a subtraction in the calculation of GDP, were revised down. 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 “other” general merchandise stores). The decrease in residential fixed investment was led by a decrease in "other" structures (specifically real estate brokers' commissions). The decrease in federal government spending reflected a decrease in nondefense spending that was partly offset by an increase in defense spending. The decrease in nondefense 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 50.9 in September, a decline from the August reading of 52.8. This figure indicates expansion in the overall economy for the 28th 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, “Manufacturing expanded for the 28th straight month. Panelists' companies slowed hiring activity; month-over-month supplier delivery performance was the best since December 2019; prices growth slowed notably (with the index at 60 percent or lower) for the third consecutive month; and lead times continue to ease for capital equipment and production materials. Markedly absent from panelists’ comments was any large-scale mentioning of layoffs; this indicates companies are confident of near-term demand, so primary goals are managing medium-term head counts and supply chain inventories.” The ISM further added, “Of the six biggest manufacturing industries, four — Machinery; Transportation Equipment; Food, Beverage & Tobacco Products; and Computer & Electronic Products — registered moderate-to-strong growth in September. Nine manufacturing industries reported growth in September, in the following order: Nonmetallic Mineral Products; Machinery; Plastics & Rubber Products; Miscellaneous Manufacturing; Apparel, Leather & Allied Products; Transportation Equipment; Food, Beverage & Tobacco Products; Computer & Electronic Products; and Electrical Equipment, Appliances & Components. The seven industries reporting contraction in September compared to August, in the following order are: Furniture & Related Products; Textile Mills; Wood Products; Printing & Related Support Activities; Paper Products; Chemical Products; and Fabricated Metal Products.

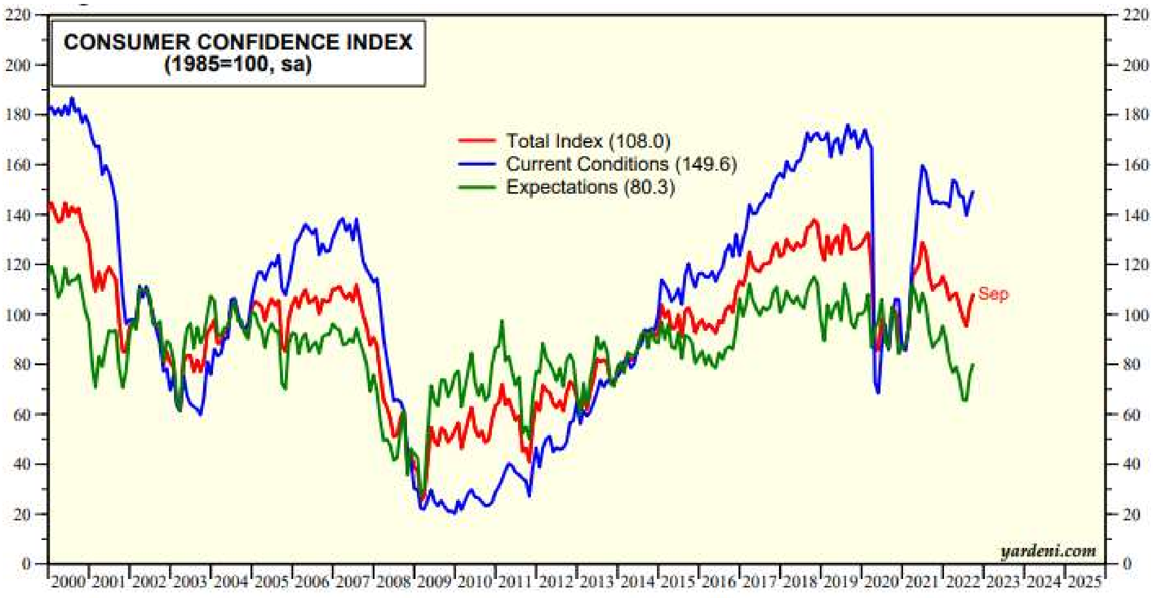
According to the U.S. Bureau of Labor Statistics (BLS), the unemployment rate increased in August to 3.7% from 3.5% in July. The unemployment rate is calculated from the household survey which showed a meaningful increase in the civilian labor force of 798,000 in August. September figures will be released on October 7th. 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, 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 August, equaling March 2022, which are the highest readings since February 2020.

The U.S. savings rate was 3.5% in August, unchanged from the July reading. The long-term average savings rate is approximately 9% after its stunning peak of 32.2% in April 2020. Personal income increased $71.6 billion in August (0.3%), according to the Bureau of Economic Analysis (BEA). The increase in current-dollar personal income in August primarily reflected increases in compensation, proprietors' income, and government social benefits that were partly offset by a decrease in personal interest income. The increase in compensation was led by private wages and salaries. Within private wages and salaries, an increase in services-producing industries was offset by a decrease in goods-producing industries. The increase in proprietors' income reflected an increase in nonfarm income. The increase in government social benefits was in Medicare. The $67.5 billion increase in current-dollar PCE in August reflected an increase of $96.9 billion in spending for services that was offset by a decrease of $29.4 billion in spending for goods. Within services, the largest contributors to the increase were spending for housing and utilities, transportation, and health care. Within goods, spending for gasoline and other energy goods was the leading contributor to the decrease.

At the Federal Reserve's September meeting, it raised its benchmark interest rate by seventy-five basis points to a range of 3.00 to 3.25% and will continue its ongoing reduction of Treasury and Agency debt, as well as Agency Mortgage-Backed securities. The Fed stated, "Recent indicators point to modest growth in spending and production. Job gains have been robust in recent months, and the unemployment rate has remained low. Inflation remains elevated, reflecting supply and demand imbalances related to the pandemic, higher food and energy prices, and broader price pressures. Russia's war against Ukraine is causing tremendous human and economic hardship. The war and related events are creating additional upward pressure on inflation and are weighing on global economic activity. The Committee is highly attentive to inflation risks." Regarding future monetary policy, it added "The Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on public health, labor market conditions, inflation pressures and inflation expectations, and financial and international developments.”

Consumer Confidence increased in September for the second consecutive month to 108.0 from an upward revised 103.6 in August. Consumer Confidence most recently reached a peak of 128.9 in June 2021. According to a statement from the Conference Board, “Consumer confidence improved in September for the second consecutive month supported in particular by jobs, wages, and declining gas prices. The Present Situation Index rose again, after declining from April through July. The Expectations Index also improved from summer lows, but recession risks nonetheless persist. Concerns about inflation dissipated further in September—prompted largely by declining prices at the gas pump—and are now at their lowest level since the start of the year. Meanwhile, purchasing intentions were mixed, with intentions to buy automobiles and big-ticket appliances up, while home purchasing intentions fell. The latter no doubt reflects rising mortgage rates and a cooling housing market. Looking ahead, the improvement in confidence may bode well for consumer spending in the final months of 2022, but inflation and interest-rate hikes remain strong headwinds to growth in the short term.” The Current Conditions Index (which is based on consumers’ assessment of current business and labor market conditions) increased in September to 149.6 from a slightly revised 145.3 in August. The Expectations Index (which is based on consumers’ short-term outlook for income, business, and labor market conditions) increased to 80.3 in September from a revised 75.8 in August. According to information from the BEA, the consumer is responsible for approximately 70% of the U.S. economy.

Consumer Confidence (as of September 30, 2022)



Source: The Conference Board.

The Bloomberg U.S. Aggregate Bond Index returned -4.32% in September and has returned -14.61% on a year-to-date basis as of September 30. This return is on the heels of a -1.54% return for calendar year 2021. The 10-Year U.S. Treasury ended September at 3.83% after ending August at 3.19% 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 September with a spread of negative forty-five basis points (2-year: 4.28% and 10-year: 3.83%). This contrasts with figures from the beginning of the year with a spread of seventy-eight basis points (2-Year: 0.73 % and 10-Year: 1.51%). Option Adjusted Spreads (as represented by the Bloomberg Corporate Index) ended September at 159 basis points, nineteen basis points wider than the August month end of 140 basis points. Spreads began 2022 with a reading of ninety-two basis points.

West Texas Intermediate (WTI) finished September at $79.74 per barrel, decreasing 10.3% from August at $88.85 per barrel. WTI has increased 6.0% 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 September at 31.62, increasing 22.2% from the August month-end reading of 25.87. The VIX has increased 83.6% after beginning 2022 with a reading of 17.22. Movement in the VIX has 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 twenty.

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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S&P 500: is an unmanaged index of 500 common stocks primarily traded on the New York Stock Exchange, weighted by market capitalization. Index performance includes the reinvestment of dividends and capital gains.
Russell 2000: The Russell 2000 Index is a small-cap stock market index that makes up the smallest 2,000 stocks in the Russell 3000 Index.
Russell 1000: The Russell 1000 Index is a stock market index that tracks the highest-ranking 1,000 stocks in the Russell 3000 Index.
VIX: The VIX Index is a popular measure of the stock market's expectation of volatility based on S&P 500 index options.
Bloomberg US Aggregate Bond Index: The Bloomberg US Aggregate Bond Index, or the Agg, is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States.