MARKET INSIGHTS

from Ziegler Capital Management

Monthly Market Commentary: November 2022

WRITTEN: NOVENBER 1, 2022

As has been the case for most of 2022, news headlines continue to be led by multi-decade high inflation rates, the fear of a recession, the on-going Ukraine / Russia war, continued interest rate hikes and the November 8th mid-term election. Consumers and businesses are feeling the impact of higher interest rates with slowing home sales and adjustments in spending behavior. The Federal Reserve increased interest rates at its last meeting and is expected to do so again in early November. The November 8th mid-term election has all 435 House of Representative and 35 of 100 Senate seats on the ballot as well 39 state and territory gubernatorial elections. This is the first election following the redistricting from the 2020 census.

The S&P 500 returned 8.10% in October following a -9.21% returns in September. For the year-to-date period through October 31st, the S&P 500 has returned -17.70%. Small cap stocks, as measured by the Russell 2000, returned 10.98% in October and have returned -16.87% on a year-to-date basis as of October 31st. This contrasts with the 14.82% return for calendar year 2021. Large Cap Value outperformed Growth in October, with the Russell 1000 Value returning 10.25% and the Russell 1000 Growth returning 5.84%. On a year-to-date basis as of October 31st, Large Cap Value has significantly outperformed Large Cap Growth with a return of -9.32% versus -26.61%. In October, the Russell 2000 Value returned 12.59% and the Russell 2000 Growth returned 9.49%. On a year-to-date basis as of October 31st, Small Cap Value outperformed Small Cap Growth, with a return of -11.19% for Small Cap Value versus Small Cap Growth at –22.57%.

Returns by Sector (as of October 31, 2022)

	S&P 500		Russell 2000	
Sector	Oct. 2022	YTD	Oct. 2022	YTD
Communication Services	0.14	-38.96	11.04	-30.72
Consumer Discretionary	0.23	-29.73	12.63	-27.26
Consumer Staples	9.04	-3.86	11.57	-7.42
Energy	24.96	68.62	25.63	61.44
Financials	11.99	-11.81	12.38	-10.28
Health Care	9.71	-4.64	2.92	-24.13
Industrials	13.92	-9.68	13.50	-13.17
Information Technology	7.82	-26.08	9.58	-29.49
Materials	9.00	-16.88	14.37	-10.50
Real Estate	2.05	-27.39	11.14	-26.70
Utilities	2.05	-4.59	7.24	-1.63
TOTAL RETURN	8.10%	-17.70%	10.98%	-16.87%

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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Real gross domestic product (GDP) decreased at an annualized rate of 2.6%% in the third quarter of 2022 according to the "advanced" estimate released by the Bureau of Economic Analysis (BEA). This reading follows decreases of 1.6% in the first quarter and 0.6% in the second quarter. The upturn primarily reflected a smaller decrease in private inventory investment, an acceleration in nonresidential fixed investment, and an upturn in federal government spending that were partly offset by a larger decrease in residential fixed investment and a deceleration in consumer spending. Imports turned down. The increase in real GDP reflected increases in exports, consumer spending, nonresidential fixed investment, federal government spending, and state and local government spending, that were partly offset by decreases in residential fixed investment and private inventory investment. Imports, which are a subtraction in the calculation of GDP, decreased. The increase in exports reflected increases in both goods and services. Within exports of goods, the leading contributors to the increase were industrial supplies and materials (notably petroleum and products as well as other nondurable goods), and nonautomotive capital goods. Within exports of services, the increase was led by travel and "other" business services (mainly financial services). Within consumer spending, an increase in services (led by health care and "other" services) was partly offset by a decrease in goods (led by motor vehicles and parts as well as food and beverages). Within nonresidential fixed investment, increases in equipment and intellectual property products were partly offset by a decrease in structures. The increase in federal government spending was led by defense spending. The increase in state and local government spending primarily reflected an increase in compensation of state and local government employees. Within residential fixed investment, the leading contributors to the decrease were new single-family construction and brokers' commissions. The decrease in private inventory investment primarily reflected a decrease in retail trade (led by "other" retailers). Within imports, a decrease in imports of goods (notably consumer goods) was partly offset by an increase in imports of services (mainly travel).

The Institute for Supply Management’s (ISM) Purchasing Managers' Index (PMI) registered 50.2 in October, a decline from the September reading of 50.9. This figure indicates expansion in the overall economy for the 29th month in a row after a contraction in April and May 2020. A reading of over 50 is considered to be expansionary. This is the lowest reading since May 2020 when it registered 43.5. According to the ISM, “The U.S. manufacturing sector continues to expand, but at the lowest rate since the coronavirus pandemic recovery began. With panelists reporting softening new order rates over the previous five months, the October index reading reflects companies’ preparing for potential future lower demand. In the meantime, demand eased, with the (1) New Orders Index remaining in contraction territory, (2) New Export Orders Index below 50 percent for a third consecutive month and at a faster rate of contraction, (3) Customers’ Inventories Index remaining at a low level, with the same reading as in September and (4) Backlog of Orders Index slipping into contraction. Output/Consumption (measured by the Production and Employment indexes) improved month over month, with a combined positive 3-percentage point impact on the Manufacturing PMI® calculation. The Employment Index shifted from contraction to a reading of 50 percent (unchanged), and the Production Index increased by 1.7 percentage points, staying in modest growth territory. Business Survey Committee panelists’ companies are continuing to manage head counts through hiring freezes and attrition to lower levels, with medium- and long-term demand still uncertain. Inputs — defined as supplier deliveries, inventories, prices and imports — mostly accommodated growth. The Supplier Deliveries Index indicated faster deliveries and the Inventories Index dropped 3 percentage points as panelists' companies continued to manage the total supply chain inventory. The Prices Index decreased for a seventh straight month and fell into contraction territory, which should encourage buyers. Of the six biggest manufacturing industries, three — Machinery; Petroleum & Coal Products; and Transportation Equipment — registered moderate-to-strong growth in October."

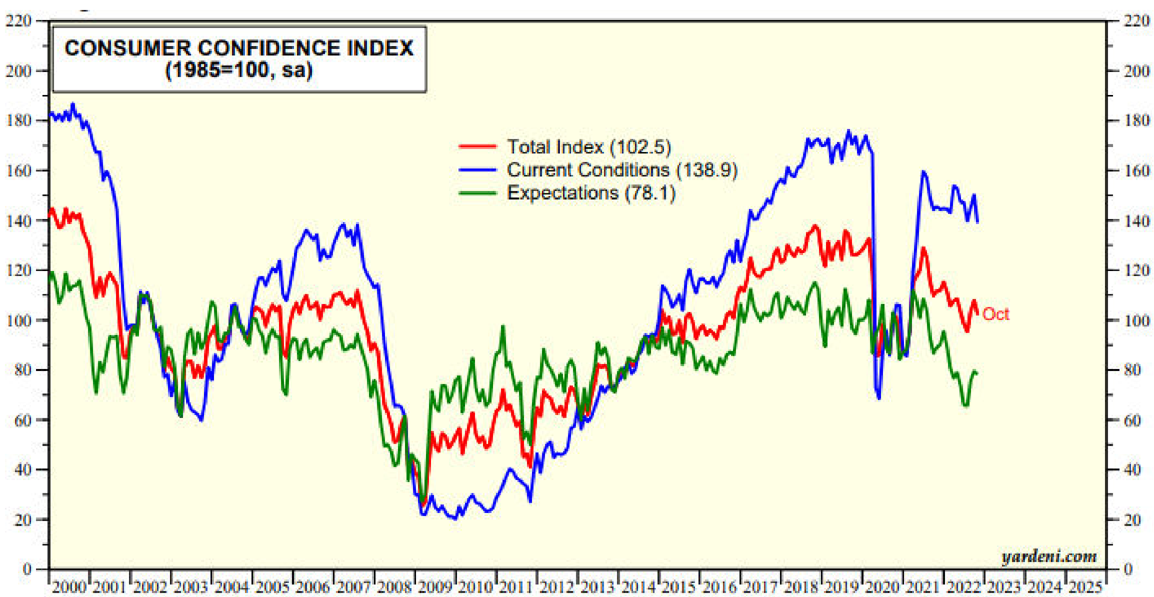
According to the U.S. Bureau of Labor Statistics (BLS), the unemployment rate decreased in September to 3.5% from 3.7% in August. Total nonfarm payroll employment increased by 263,000 in September. Monthly job growth has averaged 420,000 thus far in 2022, compared with 562,000 per month in 2021. October figures will be released on November 4th. Job gains occurred in leisure and hospitality and in health care. The number of unemployed decreased slightly to 5.8 million. 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 was little changed at 62.3% in September, falling slightly from 62.4% in August. These are the highest readings since February 2020.

The U.S. savings rate was 3.1% in September, down from the August reading of 3.4%. The long-term average savings rate is approximately 9% after its stunning peak of 32.2% in April 2020. Personal income increased $78.9 billion in September (0.4%), according to the Bureau of Economic Analysis (BEA). The increase in current-dollar personal income in September primarily reflected increases in compensation and personal income receipts on assets. The increase in compensation was led by private wages and salaries. Within private wages and salaries, both services-producing industries and goods-producing industries increased. The increase in personal income receipts on assets reflected increases in both interest and dividend income. The $113.0 billion increase in current-dollar PCE in September reflected an increase of $94.7 billion in spending for services and an increase of $18.3 in spending for goods. Within services, the leading contributors were housing and utilities (housing), "other" services (international travel), and transportation services (air transportation). Within goods, increases in "other" nondurable goods (prescription drugs) and motor vehicles and parts (new motor vehicles) were partly offset by a decrease in gasoline and other energy goods.

In the minutes released from the Federal Reserve's September meeting, it expects higher interest rates to remain in place until prices come down and are surprised at continued inflation rates. "Participants observed that inflation remained unacceptably high and well above the Committee's longer-run goal of 2 percent," the minutes said. "Participants commented that recent inflation data generally had come in above expectations and that, correspondingly, inflation was declining more slowly than they had previously been anticipating. Participants judged that the Committee needed to move to, and then maintain, a more restrictive policy stance in order to meet the Committee's legislative mandate to promote maximum employment and price stability," the meeting summary stated. Economic projections have been lowered with GDP expected to grow at a 0.2% annualized pace in 2022 and 1.2% in 2023. This contrasts with 2021 which saw the strongest gains since 1984 as the capital markets recovered from the COVID-19 pandemic. The Fed approved its third consecutive 75 basis point increase to a range of 3%-3.25% with an additional 75 basis point rise expected to be approved at the November meeting. It noted that it "would become appropriate at some point to slow the pace of policy rate increases while assessing the effects of cumulative policy adjustments on economic activity and inflation." It added that after the fed funds rate "reached a sufficiently restrictive level," that "it likely would be appropriate to maintain that level for some time until there was compelling evidence that inflation was on course to return to the 2% objective. "

Consumer Confidence decreased in October to 102.5 from a downward revised 107.8 in September, snapping a two-month previous streak of gains. Consumer Confidence most recently reached a peak of 128.9 in June 2021. According to a statement from the Conference Board, "Consumer confidence retreated in October, after advancing in August and September. The Present Situation Index fell sharply, suggesting economic growth slowed to start Q4. Consumers' expectations regarding the short-term outlook remained dismal. The Expectations Index is still lingering below a reading of 80—a level associated with recession—suggesting recession risks appear to be rising. Notably, concerns about inflation—which had been receding since July—picked up again, with both gas and food prices serving as main drivers. Vacation intentions cooled; however, intentions to purchase homes, automobiles, and big-ticket appliances all rose. Looking ahead, inflationary pressures will continue to pose strong headwinds to consumer confidence and spending, which could result in a challenging holiday season for retailers. And, given inventories are already in place, if demand falls short, it may result in steep discounting which would reduce retailers' profit margins." The Current Conditions Index (which is based on consumers' assessment of current business and labor market conditions) declined sharply to 138.9 in October from an upward revised 150.2 in September. The Expectations Index (which is based on consumers' short-term outlook for income, business, and labor market conditions) decreased to 78.1 in September from a downward revised 79.5 in September. According to information from the BEA, the consumer is responsible for approximately 70% of the U.S. economy.

Consumer Confidence (as of October 31, 2022)



Source: The Conference Board.

The Bloomberg U.S. Aggregate Bond Index returned -1.30% in October and has returned -15.72% on a year-to-date basis as of October 31. This return is on the heels of a -1.54% return for calendar year 2021. The 10-Year U.S. Treasury ended October at 4.05% after ending September at 3.83% 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 October with a spread of negative 43 basis points (2-year: 4.48% and 10-year: 4.05%). This contrasts with figures from the beginning of the year with a positive 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 October at 158 basis points, 1 basis points tighter than the September month end of 159 basis points. Spreads began 2022 with a reading of ninety-two basis points.

West Texas Intermediate (WTI) finished October at $86.43 per barrel, increasing 8.4% from September at $79.74 per barrel. WTI has increased 14.9% 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 October at 25.88, decreasing 5.7% from the September month-end reading of 31.62. The VIX has increased 50.3% 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.