MARKET INSIGHTS

from Ziegler Capital Management

Monthly Market Commentary: January 2023

WRITTEN: JANUARY 3, 2022

News headlines are dominated on the outcome of the November election which saw Republicans gain a majority in the United States House and Democrats remaining in control of the Senate. Additional headlines include high inflation rates, the likeliness of a recession, the on-going Ukraine / Russia war, and continued interest rate increases. Home sales continue to slow across the country with increasing rates. The Federal Reserve increased interest rates at its December meeting by 50 basis points instead of the past increases of 75 basis points at the previous four meetings.

The S&P 500 returned -5.76% in December following an 5.59% return in November. For calender year 2022, the S&P 500 returned -18.11%. Small cap stocks, as measured by the Russell 2000, returned -6.49% in December and returned -20.45% for calendar year 2022. This contrasts with the 14.82% return for calendar year 2021. Large Cap Value outperformed Growth again in December, with the Russell 1000 Value returning -4.03% and the Russell 1000 Growth returning -7.66%. For calendar year 2022, Large Cap Value has significantly outperformed Large Cap Growth with a return of -7.54% versus -29.14%. In December, the Russell 2000 Value returned -6.56% and the Russell 2000 Growth returned -6.42%. For calendar year 2022, Small Cap Value outperformed Small Cap Growth, with a return of -14.48% for Small Cap Value versus Small Cap Growth at –26.36%.

Returns by Sector (as of December 31, 2022)

	S&P 500		Russell 2000	
Sector	Dec. 2022	YTD	Dec. 2022	YTD
Communication Services	-39.89	-34.77	-9.04	-36.99
Consumer Discretionary	-37.03	-29.04	-8.07	-29.81
Consumer Staples	-0.62	2.26	-6.64	-8.98
Energy	65.72	70.74	-7.02	51.17
Financials	-10.53	-5.59	-7.57	-15.15
Health Care	-1.95	-0.04	-4.62	-29.03
Industrials	-5.48	-2.59	-5.93	-15.13
Information Technology	-28.19	-21.63	-6.15	-32.45
Materials	-12.27	-7.10	-7.17	-11.86
Real Estate	-26.13	-22.38	-6.81	-29.19
Utilities	1.57	2.11	-4.35	-1.24
TOTAL RETURN	-5.76%	-18.11%	-6.49%	-20.45%

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) increased at an annualized rate of 3.2%% in the third quarter of 2022 according to the "third" estimate released by the Bureau of Economic Analysis (BEA). This is a revision from the “advance” estimate of 2.9%. This reading follows a decrease of 0.6% in the second quarter. The updated estimates primarily reflected upward revisions to consumer spending and nonresidential fixed investment that were partly offset by a downward revision to private inventory investment. The increase in real GDP for the third quarter reflected increases in exports, consumer spending, nonresidential fixed investment, state and local government spending, and federal government spending, that were partly offset by decreases in residential fixed investment and private inventory investment. Imports 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 nondurable goods), "other" exports of goods, and nonautomotive capital goods. Within exports of services, the increase was led by "other" business services and travel. 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 state and local government spending was led by increases in investment in structures and in compensation of state and local government employees. The increase in federal government spending was led by defense spending. The decrease in residential fixed investment was led by new single-family construction and brokers' commissions. Within private inventory investment, the decrease was led by retail trade (mainly other general merchandise stores). Within imports, the decrease primarily reflected a decrease in imports of goods (notably consumer goods).

The Institute for Supply Management’s (ISM) Purchasing Managers' Index (PMI) registered 49.0 in November, a decline of 1.2 from the October reading of 50.2. This figure is the first contraction in the overall manufacturing economy after 29 consecutive monthly gains dating back to contractions 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 dipped into contraction, with the Manufacturing PMI at its lowest level since the coronavirus pandemic recovery began. With Business Survey Committee panelists reporting softening new order rates over the previous six months, the November composite index reading reflects companies’ preparing for future lower output. Demand eased, with the (1) New Orders Index remaining in contraction territory, (2) New Export Orders Index below 50 percent for a fourth consecutive month, (3) Customers’ Inventories Index effectively in ‘just right’ territory, climbing 7.1 percentage points, and (4) Backlog of Orders Index moving deeper into contraction. Output/Consumption (measured by the Production and Employment indexes) declined month over month, with a combined negative 2.4-percentage point impact on the Manufacturing PMI calculation. The Employment Index moved back into contraction, and the Production Index decreased but still remained in modest growth territory. Panelists’ companies confirm that they are continuing to manage head counts through a combination of hiring freezes, employee attrition, and now layoffs. Inputs — defined as supplier deliveries, inventories, prices and imports — mostly accommodated future demand growth. The Supplier Deliveries Index indicated faster deliveries, and the Inventories Index expanded at a slower rate as panelists’ companies continued to manage the total supply chain inventory. The Prices Index decreased for the ninth consecutive month, falling deeper into contraction territory. Of the six biggest manufacturing industries, two — Petroleum & Coal Products; and Transportation Equipment — registered weak-to-moderate growth in November".

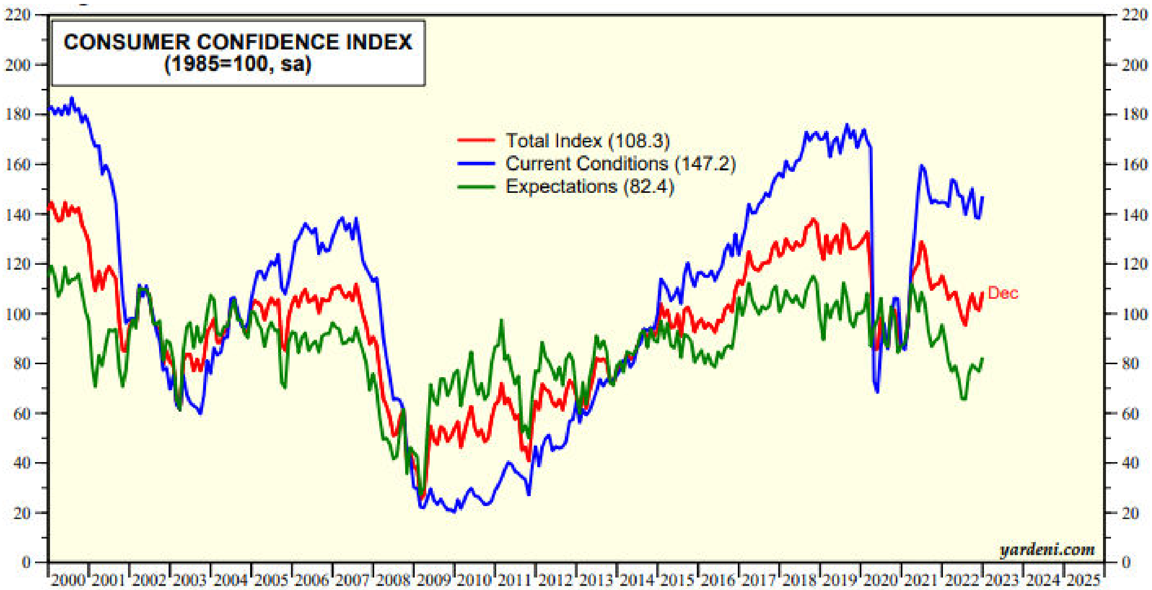
According to the U.S. Bureau of Labor Statistics (BLS), the unemployment rate was unchanged in November from 3.7% in October. Total nonfarm payroll employment increased by 263,000 in November. Notable job gains occurred in leisure and hospitality, health care, and government. Employment declined in retail trade and in transportation and warehousing. Monthly job growth has averaged 392,000 thus far in 2022, compared with 562,000 per month in 2021. In November, the number of unemployed people was essentially unchanged at 6.0 million. The unemployment rate has been in a narrow range of 3.5 percent to 3.7 percent since March. 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 62.1% in November, falling slightly from 62.2% in October. These are the highest readings since February 2020.

The U.S. savings rate was 2.4% in November, up slightly from the October reading of 2.2%. The long-term average savings rate is approximately 9% after its stunning peak of 32.2% in April 2020. Personal income increased $80.4 billion in November (0.4%), according to the Bureau of Economic Analysis (BEA). The increase in current-dollar personal income in November primarily reflected increases in compensation and personal income receipts on assets. The increase in compensation reflected increases in private wages and salaries in both services-producing industries and goods-producing industries. The $19.8 billion increase in current-dollar PCE in November reflected an increase of $79.2 billion in spending for services that was partly offset by a $59.5 billion decrease in spending for goods. Within services, the largest contributor to the increase was spending on housing. Within goods, spending on new motor vehicles (mainly new light trucks) was the leading contributor to the decrease.

In the statement following the Federal Reserve's December meeting, it stated "The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. In support of these goals, the Committee decided to raise the target range for the federal funds rate to 4-1/4 to 4-1/2 percent. The Committee anticipates that ongoing increases in the target range will be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time. In determining the pace of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet that were issued in May. The Committee is strongly committed to returning inflation to its 2 percent objective. In assessing the appropriate stance of monetary policy, 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". The 50-basis point increase in the benchmark Fed Funds rate follows four consecutive increases of 75 basis points. This is part of an part of an aggressive campaign to try and bring down the highest inflation since the early 1980s. "Inflation data received so far for October and November show a welcome reduction in the monthly pace of price increases," Fed Chairman Powell said at his post-meeting news conference. "But it will take substantially more evidence to have confidence that inflation is on a sustained downward path."

Consumer Confidence increased in December to 108.3, up sharply from a revised 101.4 in November. Consumer Confidence most recently reached a peak of 128.9 in June 2021. According to a statement from the Conference Board, "Consumer confidence bounced back in December, reversing consecutive declines in October and November to reach its highest level since April 2022. The Present Situation and Expectations Indexes improved due to consumers' more favorable view regarding the economy and jobs. Inflation expectations retreated in December to their lowest level since September 2021, with recent declines in gas prices a major impetus. Vacation intentions improved but plans to purchase homes and big-ticket appliances cooled further. This shift in consumers' preference from big-ticket items to services will continue in 2023, as will headwinds from inflation and interest rate hikes." The Current Conditions Index (which is based on consumers' assessment of current business and labor market conditions) increased to 147.2 in December from a downward revised 138.3 in November. The Expectations Index (which is based on consumers' short-term outlook for income, business, and labor market conditions) increased to 82.4 in December from a downward revised 76.7 in November. Expectations around 80 are often a level associated with a recession. According to information from the BEA, the consumer is responsible for approximately 70% of the U.S. economy.

Consumer Confidence (as of December 31, 2022)



Source: The Conference Board.

The Bloomberg U.S. Aggregate Bond Index returned -0.45% in December and returned -13.01% for calendar year 2022. This return is on the heels of a -1.54% return for calendar year 2021. The 10-Year U.S. Treasury ended December at 3.88% after ending November at 3.61% 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 November with a spread of negative 55 basis points (2-year: 4.43% and 10-year: 3.88%). 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 December at 130 basis points, 3 basis points tighter than the November month end of 133 basis points. Spreads began 2022 with a reading of ninety-two basis points.

West Texas Intermediate (WTI) finished December at $80.26 per barrel, essentially flat from November at $80.40 per barrel. WTI has increased 6.7% since beginning 2022 at $75.21 per barrel and after a 58.9% increase in 2021. WTI peaked at over $129 per barrel in March 2022, retreated, and spiked to over $123 per barrel in July 2022. Turmoil from the invasion of Ukraine by Russia, the related sanctions and increasing demand have been a significant factor in market volatility in 2022.

The Volatility Index (VIX) ended December at 21.67, increasing 5.3% from the November month-end reading of 20.58. The VIX has increased 25.8% after beginning 2022 with a reading of 17.22. The VIX's 2022 peak was 35.15 on March 7th. Movement in the VIX has been driven by market turbulence over inflation, increasing interest rates, recessionary fears and the war between Russia and Ukraine. 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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22-02001
Printed Internally

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.