# Third Quarter 2023 Market Summary

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# Third Quarter 2023 Market Summary

During the third quarter, financial markets were driven by shifting interest rate expectations. Returns were negative across asset classes during the quarter. September, historically one of the worst returning months, was particularly weak. Despite the market pullback, most asset classes have managed to maintain positive returns year-to-date.

Amidst the market volatility, many positive economic data points remain as the U.S. economy continues exceeding the market's expectations. The labor market remains stable with low unemployment and nominal initial claims, even though early signs of weakening have emerged. Corporate earnings have been solid, inflationary pressures have been receding, and the consumer has been resilient thus far.

This economic backdrop has led the Federal Reserve to adjust its forecasts and reiterate its expectation that rates will remain "higher for longer". The Federal Open Market Committee (FOMC) raised the federal funds rate 25bps in July to a target of 5.25%-5.50% but opted to pause in September. Notably, while the Fed is near the end of its rate cycle, it revised its expectations for 2024 year-end rates in its most recent announcement. Previously, the Fed and the market were expecting 100bps of rate cuts in 2024. Now, the Fed is indicating it expects only 50bps of rate cuts as the economy has been stronger than expected, the labor market has held up, and there is the potential for more persistent inflation.

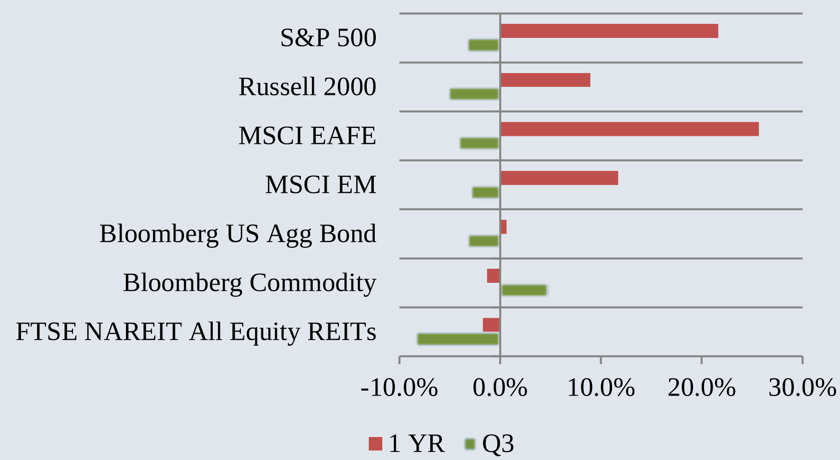
Despite these positive factors, competing narratives persist regarding the current stage of the economic cycle. Concerns have arisen due to tighter financial conditions, increased federal borrowing costs, and various factors that could slow consumer spending. These issues include the restart of student loan payments, higher oil prices, and higher interest rates. Signs of consumer stress have emerged, including higher delinquency rates, rising credit card balances, and diminished savings.

As shown in the chart below, U.S. large company stocks (i.e. S&P 500 Index) were down 3.3%, during the third quarter, and U.S. small company stocks (i.e. Russell 2000 Index) were down 5.1%. Over recent months, there has been a noticeable shift in sentiment towards caution, with waning enthusiasm for AI (Artificial Intelligence). The Energy sector saw positive returns during the quarter with higher oil prices. If we exclude a handful of large company technology stocks, the U.S. market would be essentially flat for the year.

International stocks, represented by the MSCI ACWI ex US Index, were down 3.8% during the third quarter. This performance was roughly in line with U.S. equities despite the recent rally in the U.S. dollar. There are questions about economic growth in Europe and China, but there is currently low sentiment, low expectations, and low valuations, which may lead to more favorable outcomes.

The Bloomberg Barclays U.S. Aggregate Bond Index, representing a broad basket of bonds, was down 3.2% during the third quarter. The bond market has been more volatile than usual this year. While the first four months of the year witnessed a strong rally in bonds, since then yields have been rising, eroding the earlier gains. As the Fed has adjusted its guidance over the past few months, rates on the intermediate to long part of the Treasury curve have experienced upward pressure, resulting in the 10-year Treasury reaching levels last seen in 2007. Higher yields should ultimately lead to better forward returns in fixed income.

**Broad Market Index Returns**
**Third Quarter 2023**



## Third Quarter 2023 Market Summary (continued)

As we enter the fourth quarter, the most noticeable shift in recent months has been in sentiment and how investors perceive the economic landscape rather than the data itself. Questions are increasingly centered around what could potentially go wrong rather than the optimism of what could go right. The prospect of an impending recession has lingered in the minds of some investors for the past three years, yet a broad based recession has yet to occur. However, we have witnessed a "rolling recession" impacting various industries at different times. If this trend persists, it could eventually culminate into a broader recession.

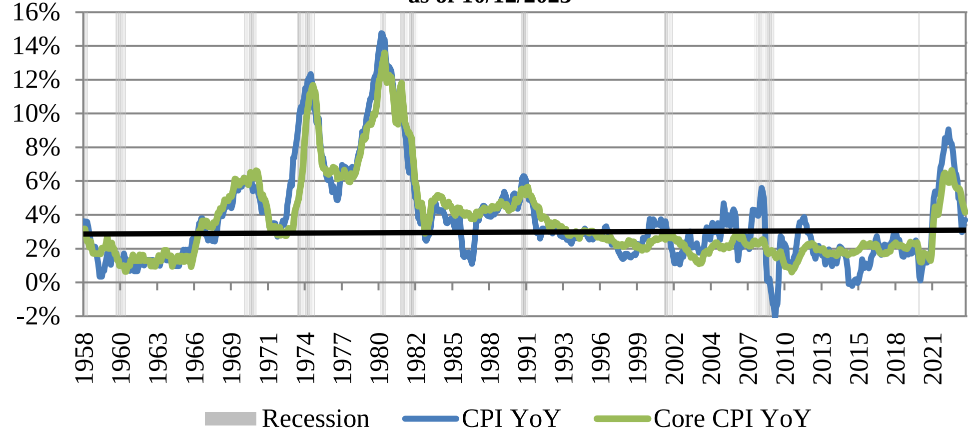
It’s crucial to remember market corrections are common, and an integral aspect of the investment landscape. These periodic adjustments, though at times disconcerting, can trigger impulsive responses from investors. However, it’s also worth noting market corrections can create opportunities to acquire assets at more attractive valuations. Therefore, even during periods of short-term volatility, it’s important not to lose sight of your long-term financial goals and objectives.

The market is currently shifting as it adjusts to a world where cash and bonds offer real income, prompting a reevaluation of asset allocation strategies. Historically, low interest rates have pushed investors toward riskier assets in search of higher returns. However, the changing landscape now presents opportunities for a more balanced and diversified investment approach. As cash and bonds regain attractiveness, investors are reconsidering their portfolios to strike a balance between risk and income generation. This shift in perspective underscores the importance of staying agile and adaptable in the face of evolving market conditions.

## MACROECONOMICS

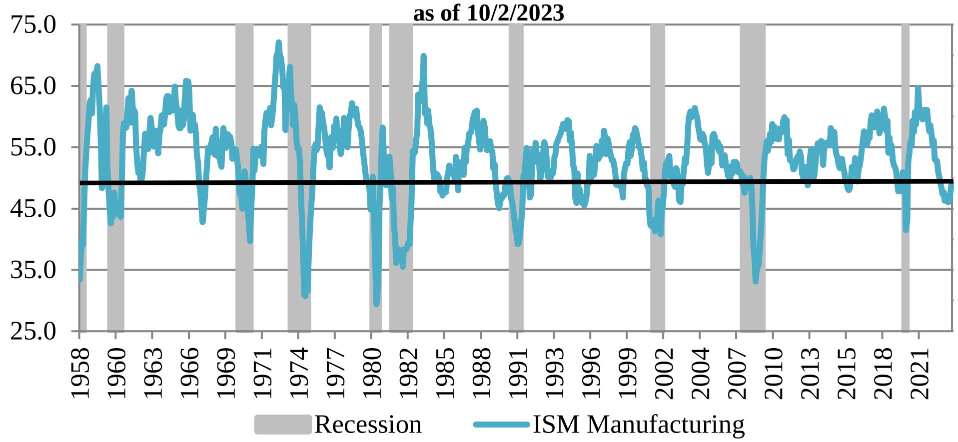
- The Bureau of Economic Analysis released the advanced estimate of third quarter 2023 real GDP, an annual rate increase of 4.9% from the preceding quarter.
- Inflation's downward trend persists, albeit at a slower pace. In Sept., headline CPI increased 3.7% year-over-year. Core CPI, which excludes food and energy, had a 4.1% increase.

**Inflation - CPI**
**as of 10/12/2023**



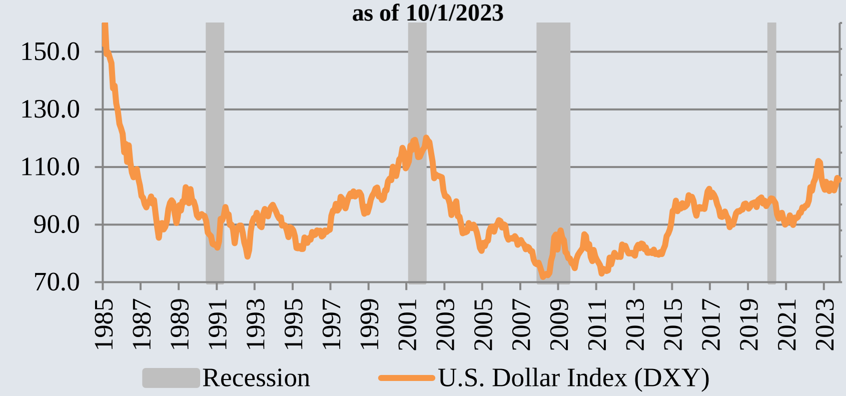

- The ISM Manufacturing Index increased during the quarter, finishing at 49.0 versus 46.0 in June. Typically, when the ISM Index is above 55 it is bullish and when it is below 45 it is bearish. The ISM Non-Manufacturing Index was roughly flat during the quarter and finished at 53.6 in September.

**ISM Manufacturing Index**
**as of 10/2/2023**




- In September, the Conference Board Leading Economic Index decreased 0.7% month-over-month to 104.6. The index, which is a composite of leading employment, housing, manufacturing, and market indicators, has declined significantly over the past year.
- The U.S. dollar appreciated over the past quarter.

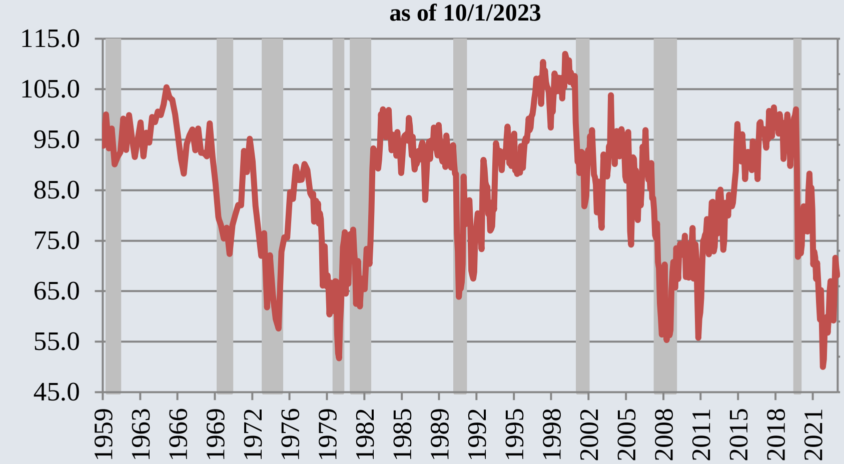
**U.S. Dollar Index (DXY)**
**as of 10/1/2023**




## CONFIDENCE METRICS

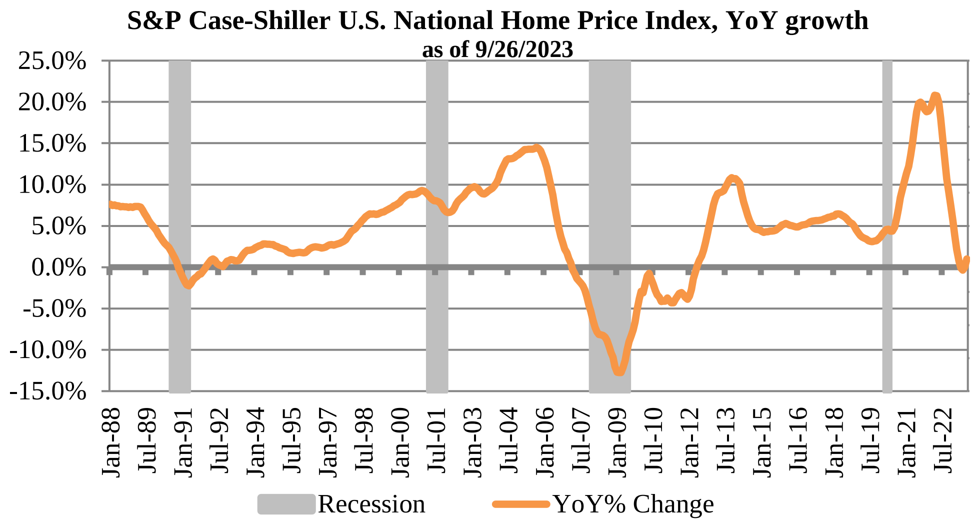
- The Conference Board's Consumer Confidence Index September reading was 103.0, down from 110.1 in June as economic data has been slightly weaker over the past quarter.
- The University of Michigan Consumer Sentiment Index final reading for September was 68.1, up from the lows in June of 2022.

**University of Michigan Consumer Sentiment Index**
**as of 10/1/2023**

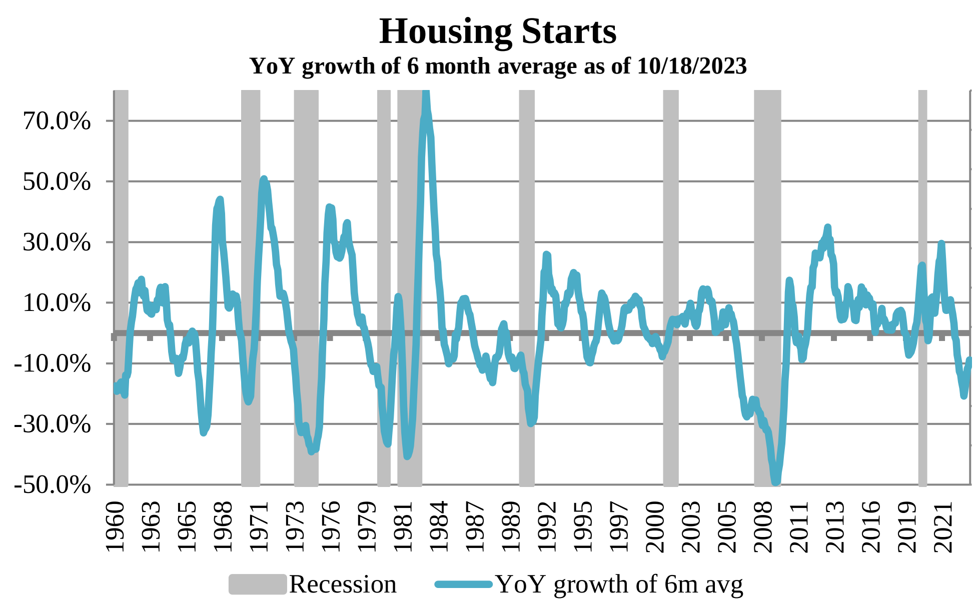


## HOUSING

- S&P Case-Shiller U.S. National Home Price Index (seasonally adjusted) showed home prices increased 1.0% year/year in July. Price growth has slowed since mid-2022.

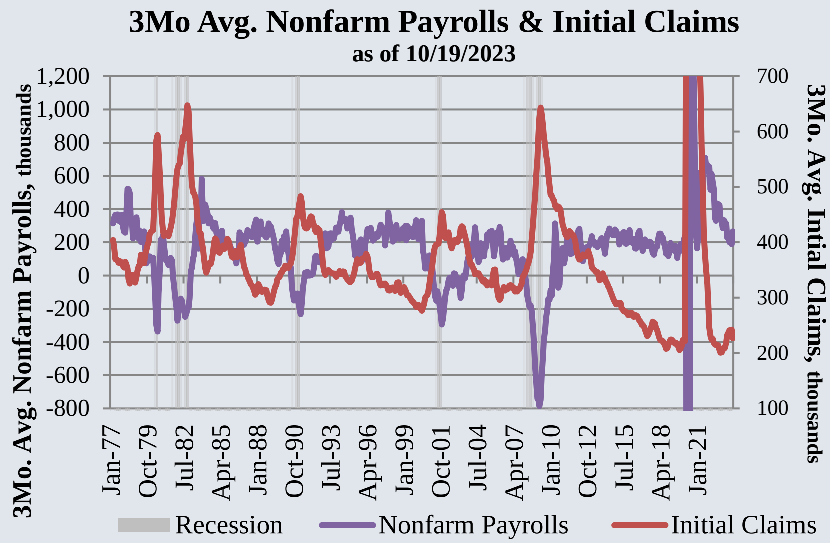



- Housing starts have declined over the past few quarters, in part, due to higher financing costs. The housing market remains in a supply-challenged environment.

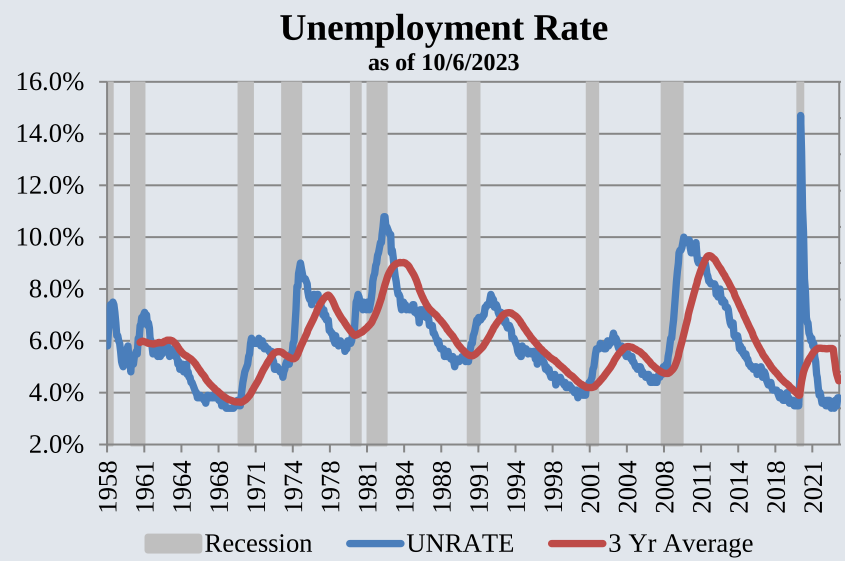



## EMPLOYMENT

- During the quarter, nonfarm payrolls averaged 266,000 jobs added per month, while initial claims remain low.



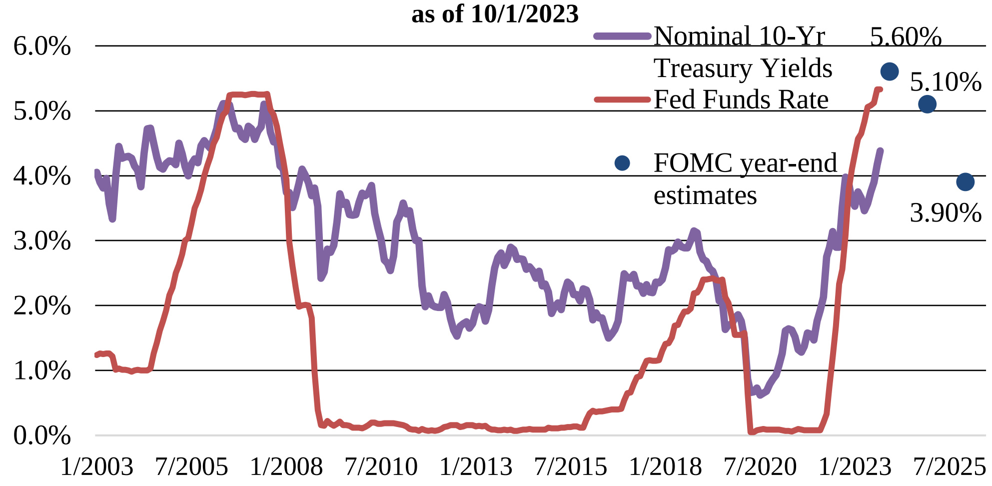

- The unemployment rate rose slightly during the quarter to 3.8%.



## FED POLICY

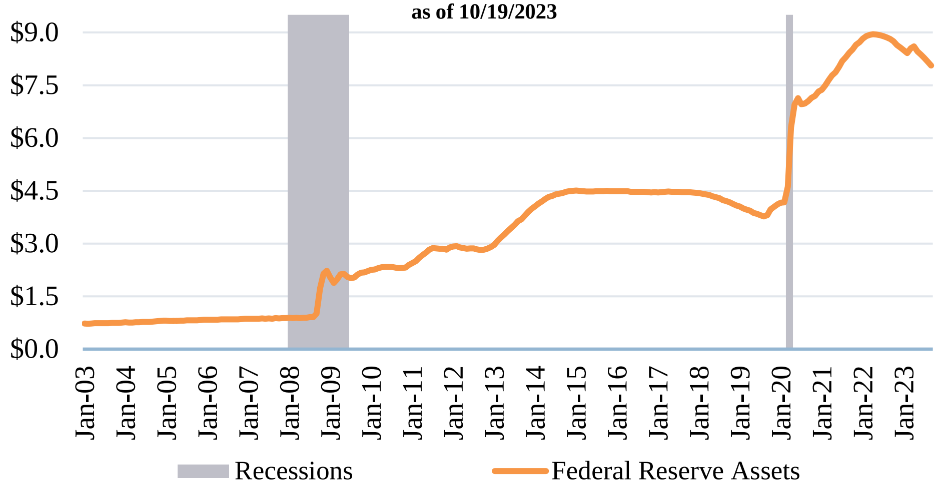
- The Federal Open Market Committee (FOMC) raised the federal funds rate 0.25% in July but paused in September. The Fed revised its expectations for 2024 year-end rates higher, as the economy continues to be stronger than expected.

**U.S. 10-Year Treasury Yield vs. Fed Funds Rate**
**as of 10/1/2023**




- In 2022, the Fed started to reduce its holdings of Treasuries and agency MBS. Other central banks have been reducing their balance sheets as well.

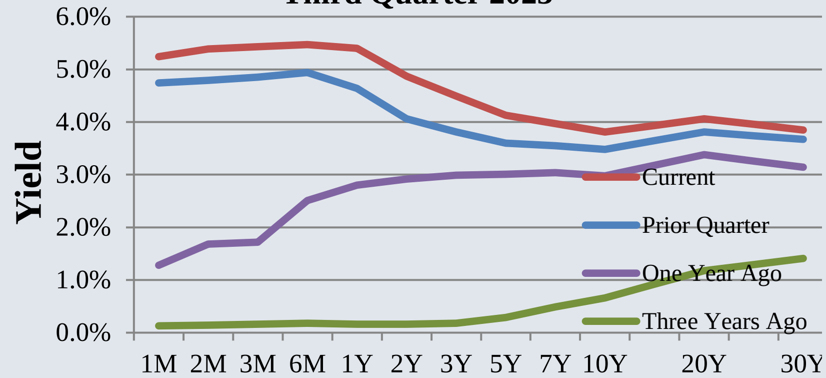
**Federal Reserve Balance Sheet, assets in trillions $**
**as of 10/19/2023**




## FIXED INCOME

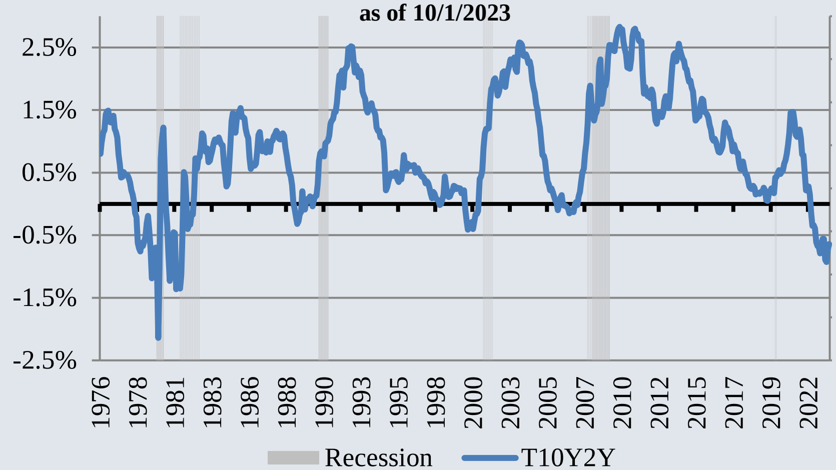
- Yields across the U.S. Treasury curve increased during the quarter. In particular, the intermediate-term rates rose. Short-term interest rates are controlled or heavily influenced by central banks, whereas long-term interest rates are affected by market forces and economic growth.

**U.S. Treasuries Yield Curve**
**Third Quarter 2023**




- The spread between short and intermediate-term Treasuries has remained inverted since July 2022, and finished at negative 64bps in September. Historically, the 10-year to 2-year Treasury curve has "inverted" 6-20 months before recessions.

**U.S. Treasury Spread 10-year vs. 2-year**
**as of 10/1/2023**



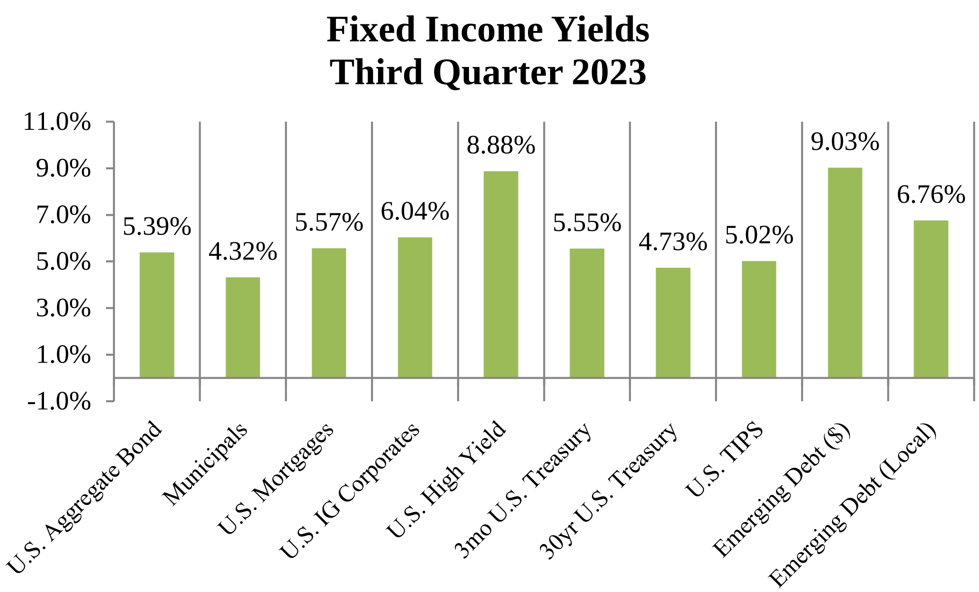
## FIXED INCOME (continued)

- During the quarter, the Bloomberg Barclays U.S. Aggregate was down 3.23%. Bonds with less interest rate risk, generally, performed better.

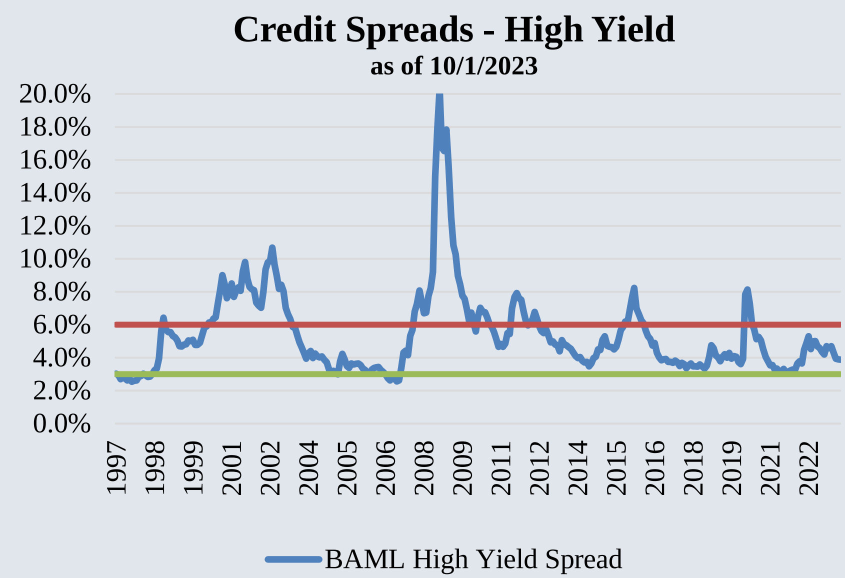
| | 3Q 23 Return | 1-Yr Return | 5-Yr Return | 10-Yr Return |
|---|---|---|---|---|
| **U.S. Aggregate Bond** | -3.23% | 0.64% | 0.10% | 1.13% |
| **Municipals** | -3.95% | 2.66% | 1.05% | 2.29% |
| **U.S. Mortgages** | -4.05% | -0.17% | -0.77% | 0.61% |
| **U.S IG Corporates** | -3.09% | 3.65% | 0.93% | 2.23% |
| **U.S. High Yield** | 0.46% | 10.28% | 2.96% | 4.24% |
| **3mo U.S. Treasury** | 1.33% | 4.65% | 1.76% | 1.14% |
| **30yr U.S. Treasury** | -12.72% | -12.05% | -3.73% | 0.28% |
| **U.S. TIPS** | -2.60% | 1.25% | 2.12% | 1.74% |
| **Emerging Debt ($)** | -2.70% | 9.50% | -0.50% | 2.30% |
| **Emerging Debt (LCL)** | -3.60% | 11.80% | -0.20% | -1.00% |

Bloomberg and JPMorgan Indices

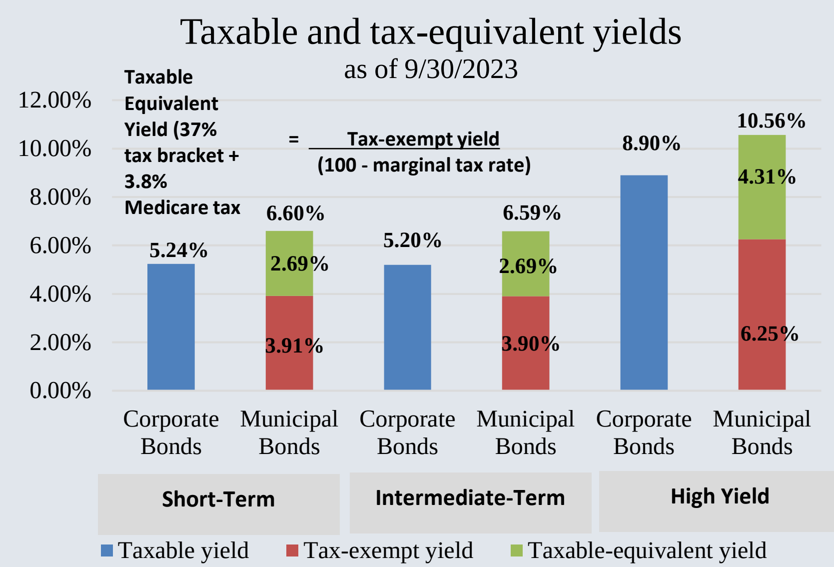
- Yields increased during the third quarter and remain at attractive levels.




- Credit spreads remained near historical averages during the quarter.




- Municipals are currently more attractive relative to taxable bonds on an after-tax basis for investors in the highest marginal tax bracket.



## DOMESTIC EQUITIES

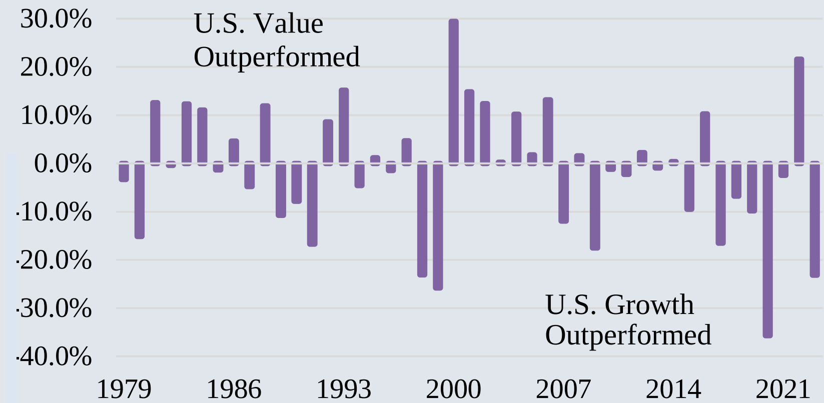
| Third Quarter 2023 Returns | | | |
|---|---|---|---|
| | Value | Core | Growth |
| **Mega Cap** | | -2.8% | |
| **Large Cap** | -3.2% | -3.2% | -3.1% |
| **Mid Cap** | -4.5% | -4.7% | -5.2% |
| **Small Cap** | -3.0% | -5.1% | -7.3% |
| **Micro Cap** | -5.6% | -7.9% | -12.0% |

- The Russell 1000 Index, comprised of large and mid-capitalization stocks, posted a negative total return of 3.2% during the third quarter. On a year-over-year basis, the Russell 1000 Index has increased 21.2%.
- Small capitalization stocks, as represented by the Russell 2000 Index, decreased 5.1% during the third quarter. On a year-over-year basis, the index has increased 8.9%.

| | S&P 500 Weight | Russell 1000 Value Weight | Russell 1000 Growth Weight | 3Q 23 Return | 1-Yr Return | 10-Yr Return |
|---|---|---|---|---|---|---|
| **Energy** | 4.7% | 9.1% | 0.6% | 12.2% | 30.2% | 5.1% |
| **Materials** | 2.4% | 4.8% | 0.7% | -4.8% | 18.0% | 8.7% |
| **Financials** | 12.8% | 20.6% | 6.6% | -1.1% | 11.7% | 9.7% |
| **Industrials** | 8.3% | 13.2% | 6.0% | -5.2% | 24.6% | 10.0% |
| **Cons. Disc.** | 10.7% | 5.0% | 16.0% | -4.8% | 13.8% | 11.5% |
| **Technology** | 27.5% | 9.1% | 42.1% | -5.6% | 41.1% | 20.4% |
| **Comm. Services** | 8.9% | 5.0% | 11.6% | 3.1% | 38.5% | 7.3% |
| **Real Estate** | 2.4% | 4.7% | 0.9% | -8.9% | -1.8% | 7.0% |
| **Health Care** | 13.4% | 15.3% | 11.3% | -2.7% | 8.2% | 11.7% |
| **Cons. Staples** | 6.6% | 8.3% | 4.3% | -6.0% | 7.3% | 8.9% |
| **Utilities** | 2.4% | 4.9% | 0.0% | -9.2% | -7.0% | 8.3% |
| **S&P 500 Index** | 100.0% | 100.0% | 100.0% | -3.3% | 21.6% | 11.9% |

- During the quarter, only Energy and Communication Services had positive returns. There continues to be wide dispersion of returns among sectors.

### U.S. Value vs. Growth Relative Equity Performance (as of 9/30/23)



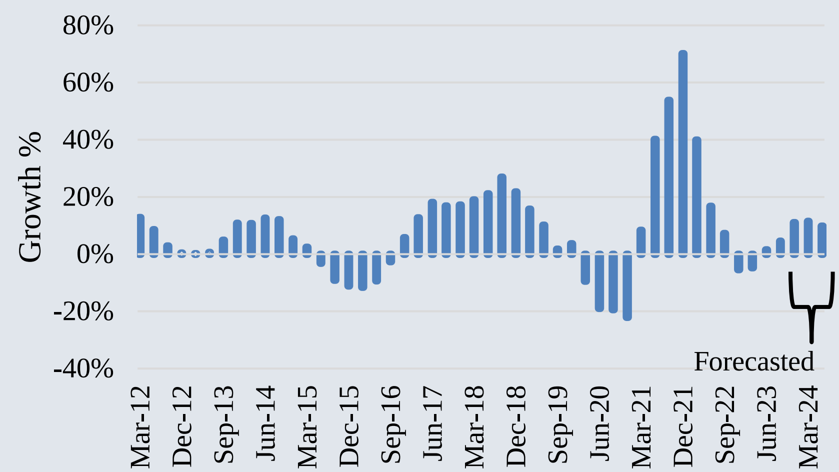

Russell 1000 Value TR vs. Russell 1000 Growth TR

- Growth trailed Value during the quarter but has significantly outperformed YTD. Growth has outperformed for eleven out of the past sixteen years, during which interest rates and inflation were generally low.

### S&P 500 Earnings Growth

**Trailing 12-Month Operating Earnings Growth YoY**

**(as of 10/18/2023)**




- Corporate earnings growth has slowed over the past year, but earnings are expected to rebound over the next year.

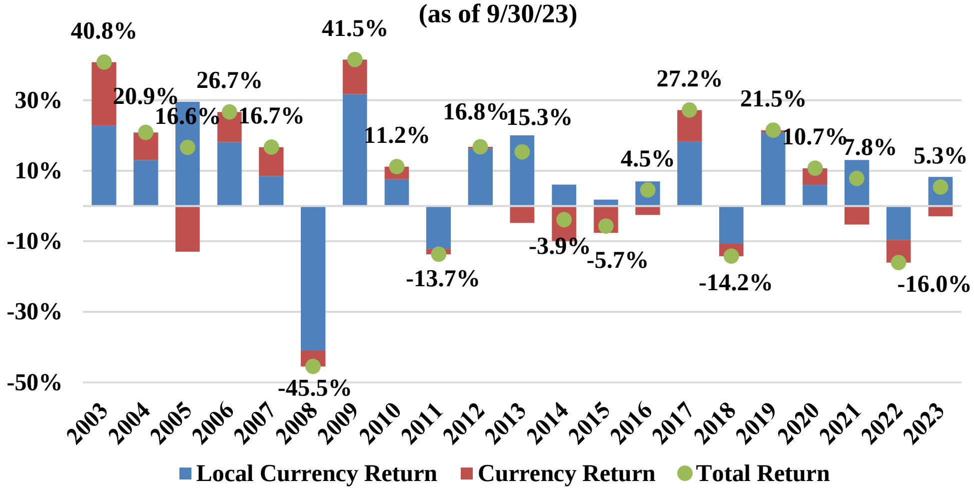
## INTERNATIONAL EQUITIES

- Developed international stocks, as represented by the MSCI EAFE, were down 4.1% during the quarter, but are up 25.6% on a year-over-year basis.
- Emerging market stocks outperformed developed markets during the third quarter as the MSCI Emerging Markets Index was down 2.9%. On a year-over-year basis, emerging market stocks are trailing developed markets with a return of 11.7%.

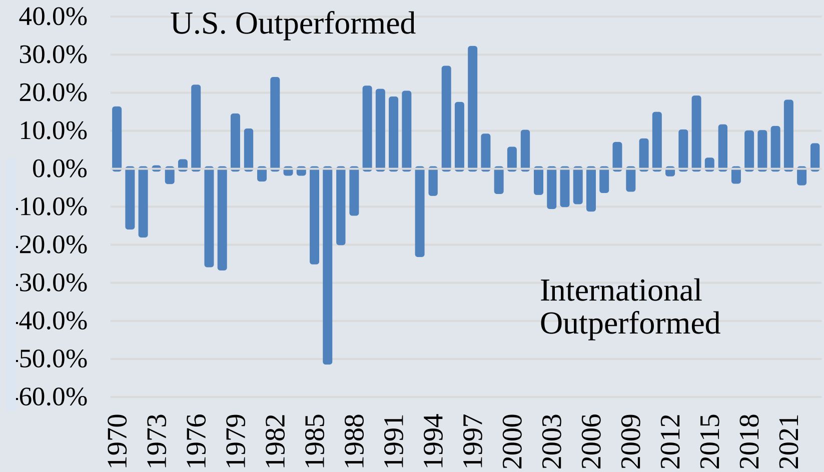
| | 3Q 23 Return | 1-Yr Return | 5-Yr Return | 10-Yr Return |
|---|---|---|---|---|
| **World** | -3.4% | 20.8% | 6.5% | 7.6% |
| **World Ex-US** | -3.8% | 20.4% | 2.6% | 3.3% |
| **EAFE** | -4.1% | 25.6% | 3.2% | 3.8% |
| **Europe** | -5.0% | 28.8% | 4.0% | 3.8% |
| **Japan** | -1.6% | 25.9% | 2.1% | 4.4% |
| **Pacific Ex-Japan** | -4.8% | 10.6% | 1.8% | 2.8% |
| **Emerging Markets** | -2.9% | 11.7% | 0.6% | 2.1% |
| **EM (Asia)** | -2.9% | 11.9% | 1.0% | 3.8% |
| **EM (Latin America)** | -4.7% | 19.4% | 2.8% | 0.2% |
| **EM (Eastern Europe)** | -8.5% | 57.8% | -23.4% | -12.5% |

- Currency has been a slight drag to international equity returns. The U.S. dollar has been very strong the past ten years, but currency trends tend to be cyclical.

**MSCI ACWI ex US Index, total return and currency impact (as of 9/30/23)**



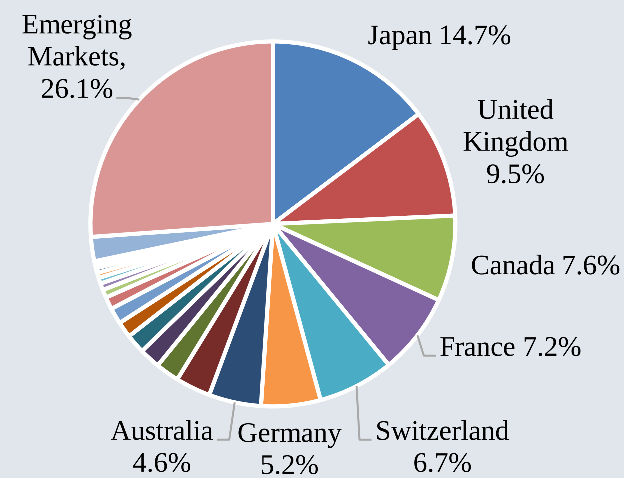

## U.S. vs. International Equity Performance (as of 9/30/23)

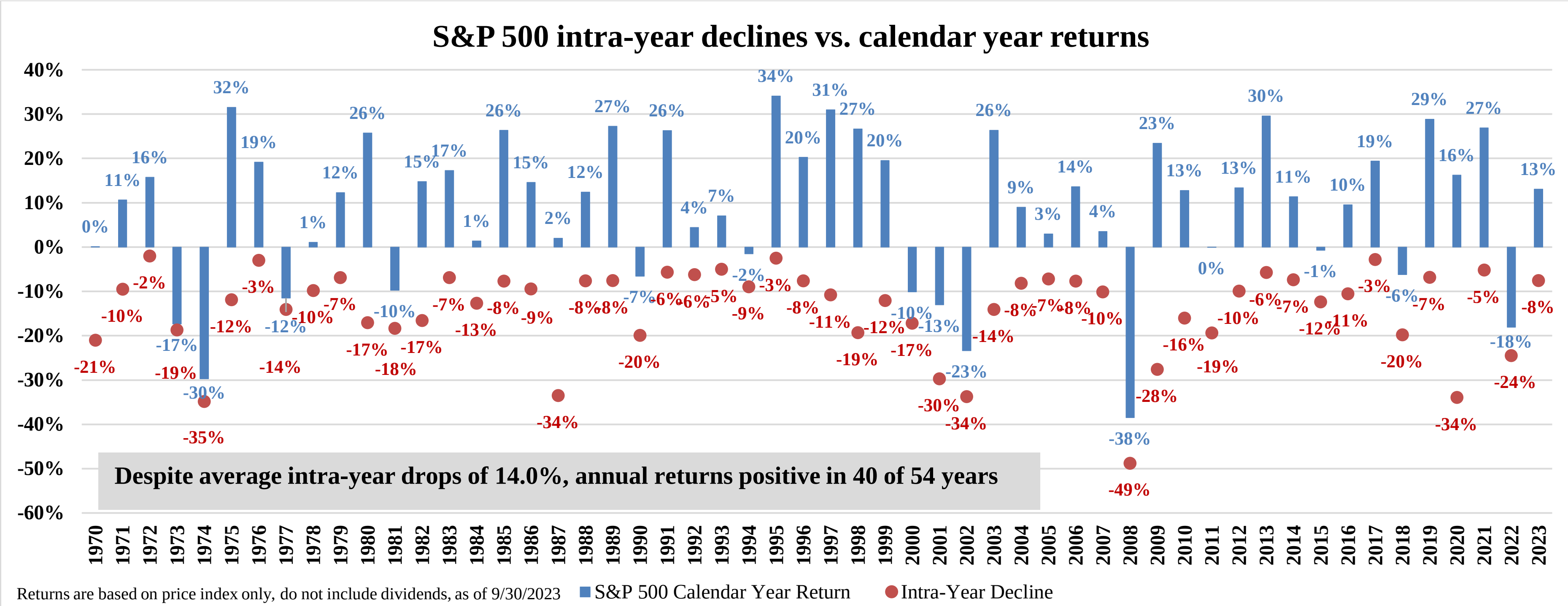


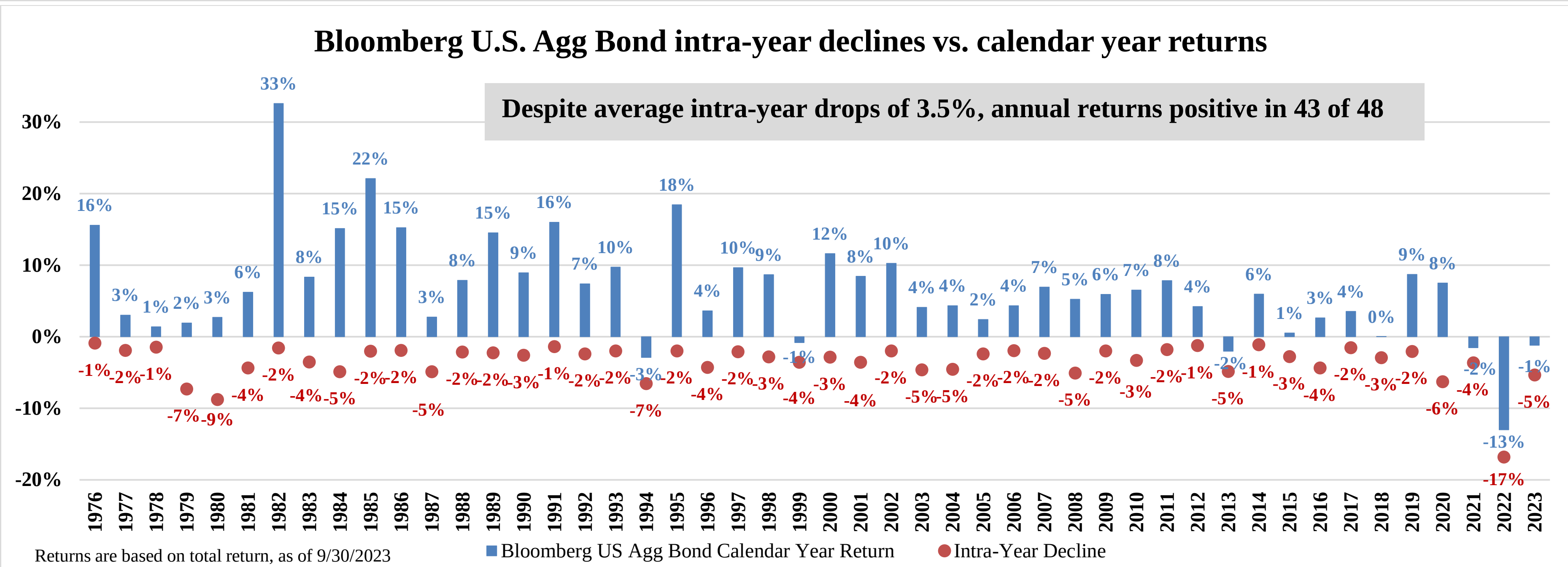

S&P 500 TR vs. MSCI EAFE NR

- International equities performed worse than U.S. equities during the quarter; however, international equities have outperformed since November 2022. International equities have underperformed U.S. equities in ten out of the last thirteen years. Performance is cyclical as shown in the chart above.

## Country Weighting in MSCI ACWI ex US (as of 9/30/2023)




S&P 500 intra-year declines vs. calendar year returns
Despite average intra-year drops of 14.0%, annual returns positive in 40 of 54 years
Returns are based on price index only, do not include dividends, as of 9/30/2023
S&P 500 Calendar Year Return
Intra-Year Decline


Bloomberg U.S. Agg Bond intra-year declines vs. calendar year returns
Despite average intra-year drops of 3.5%, annual returns positive in 43 of 48
Returns are based on total return, as of 9/30/2023
Bloomberg US Agg Bond Calendar Year Return
Intra-Year Decline

# Market leadership changes. Focus on asset allocation and diversification.

Asset Class Performance (Best → Worst)

| 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 YTD | 10-yrs '13-'22 Return | 10-yrs '13-'22 Volatility |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Real Estate 19.7% | Small Cap 38.8% | Real Estate 28.0% | Real Estate 2.8% | Small Cap 21.3% | Emerging Markets 37.8% | Cash 1.8% | Large Cap 31.5% | Small Cap 20.0% | Real Estate 41.3% | Commodities 16.1% | Large Cap 13.1% | Large Cap 12.6% | Small Cap 19.3% |
| High Yield 19.6% | Large Cap 32.4% | Large Cap 13.7% | Large Cap 1.4% | High Yield 14.3% | International 25.6% | Fixed Income 0.0% | Real Estate 28.7% | Emerging Markets 18.7% | Large Cap 28.7% | Cash 1.5% | International 7.6% | Small Cap 9.0% | Emerging Markets 16.7% |
| Emerging Markets 18.6% | International 23.3% | Fixed Income 6.0% | Fixed Income 0.6% | Large Cap 12.0% | Large Cap 21.83% | Real Estate -4.0% | Small Cap 25.5% | Large Cap 18.4% | Commodities 27.1% | High Yield -12.7% | High Yield 5.1% | Real Estate 7.1% | Real Estate 16.5% |
| International 17.9% | Asset Allocation 14.9% | Asset Allocation 5.3% | Cash 0.0% | Commodities 11.8% | Small Cap 14.7% | High Yield -4.1% | International 22.7% | Asset Allocation 10.5% | Small Cap 14.8% | Fixed Income -13.0% | Asset Allocation 4.6% | Asset Allocation 6.0% | International 14.8% |
| Small Cap 16.3% | High Yield 7.3% | Small Cap 4.9% | International -0.4% | Emerging Markets 11.6% | Asset Allocation 14.5% | Large Cap -4.4% | Asset Allocation 19.4% | International 8.3% | Asset Allocation 13.5% | Asset Allocation -13.9% | Cash 3.7% | International 5.2% | Large Cap 14.8% |
| Large Cap 16.0% | Real Estate 2.9% | Cash 0.0% | Asset Allocation -2.0% | Real Estate 8.6% | High Yield 10.4% | Asset Allocation -5.8% | Emerging Markets 18.9% | Fixed Income 7.5% | International 11.8% | International -14.0% | Small Cap 2.5% | High Yield 3.0% | Commodities 14.1% |
| Asset Allocation 12.1% | Cash 0.0% | High Yield 0.0% | High Yield -2.7% | Asset Allocation 8.3% | Real Estate 8.7% | Small Cap -11.0% | High Yield 12.6% | High Yield 7.0% | High Yield 1.0% | Large Cap -18.1% | Emerging Markets 2.2% | Emerging Markets 1.8% | Asset Allocation 9.3% |
| Fixed Income 4.2% | Fixed Income -2.0% | Emerging Markets -1.8% | Small Cap -4.4% | Fixed Income 2.7% | Fixed Income 3.5% | Commodities -11.3% | Fixed Income 8.7% | Cash 0.5% | Cash 0.0% | Emerging Markets -19.7% | Fixed Income -1.2% | Fixed Income 1.1% | High Yield 8.4% |
| Cash 0.1% | Emerging Markets -2.3% | International -4.5% | Emerging Markets -14.6% | International 1.5% | Commodities 1.7% | International -13.4% | Commodities 7.7% | Commodities -3.1% | Fixed Income -1.5% | Small Cap -20.4% | Commodities -3.4% | Cash 0.7% | Fixed Income 4.1% |
| Commodities -1.1% | Commodities -9.5% | Commodities -17.0% | Commodities -24.7% | Cash 0.3% | Cash 0.8% | Emerging Markets -14.3% | Cash 2.2% | Real Estate -5.1% | Emerging Markets -2.2% | Real Estate -25.0% | Real Estate -5.6% | Commodities -1.3% | Cash 0.3% |

Performance of all sited indices is calculated on a total return basis and includes dividend reimbursement. Indices are not available for direct investment. Past performance is not indicative of future results. It is important to remember that there are risks inherent in any investment and there is no assurance that any asset class or index will provide positive performance over time.

* Large Cap – S&P 500 Index
* Small Cap – Russell 2000 Index
* International – MSCI EAFE GR Index
* Emerging Markets – MSCI EM GR Index
* Fixed Income – Barclays Capital Aggregate Bond Index
* Real Estate – FTSE NAREIT All Equity REIT Index
* Commodities – Bloomberg Commodity Index
* High Yield – Barclays Global High Yield Index
*Cash – Barclays 1-3m Treasury Index

The "Asset Allocation" portfolio assumes the following weights: 25% S&P 500, 10% Russell 2000, 15% MSCI EAFE, 5% MSCI EM, 25% Barclays Agg, 5% Barclays 1-3m Treasury, 5% Barclays Global High Yield Index, 5% Bloomberg Commodity Index, 5% FTSE NAREIT All Equity REIT Index

Source: Morningstar, through 9/30/2023

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