ZCM Market Insights

Monthly Market Commentary: February 2023

WRITTEN: FEBRUARY 1, 2022

Headlines are dominated by stories on the improving but still high inflation rates, the likeliness of a recession, the on-going Ukraine / Russia war, and continued interest rate increases. Capital markets remain focused on the Federal Reserve. The Fed increased interest rates at its January meeting by 25 basis points, a reduction from 50 basis points at the December meeting and past increases of 75 basis points at the previous four meetings prior to December.

The S&P 500 returned 6.28% in January following an -5.76% return in December. For calender year 2022, the S&P 500 returned -18.11%. Small cap stocks, as measured by the Russell 2000, returned 9.75% in January after returning -6.49% in December and returned -20.45% for calendar year 2022. Large Cap Growth outperformed Large Cap Value in January, with the Russell 1000 Growth returning 8.33% and the Russell 1000 Value returning 5.18%. For calendar year 2022, Large Cap Value significantly outperformed Large Cap Growth with a return of -7.54% versus -29.14%. In January, the Russell 2000 Growth returned 9.95% and the Russell 2000 Value returned 9.54%. 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 January 31, 2022)

	S&P 500		Russell 2000	
Sector	Jan. 2023	CY 2022	Jan. 2023	CY 2022
Communication Services	14.50	-34.77	17.76	-36.99
Consumer Discretionary	15.02	-29.04	16.77	-29.81
Consumer Staples	-0.89	2.26	5.05	-8.98
Energy	2.81	70.74	5.90	51.17
Financials	6.86	-5.59	5.68	-15.15
Health Care	-1.87	-0.04	7.68	-29.03
Industrials	3.66	-2.59	11.35	-15.13
Information Technology	9.32	-21.63	11.44	-32.45
Materials	9.00	-7.10	13.11	-11.86
Real Estate	9.92	-22.38	12.02	-29.19
Utilities	-2.00	2.11	2.92	-1.24
TOTAL RETURN	6.28%	-18.11%	9.75%	-20.45%

Source: Bloomberg

Real gross domestic product (GDP) increased at an annualized rate of 2.9% in the fourth quarter of 2022 according to the "advance" estimate released by the Bureau of Economic Analysis (BEA). This reading follows an increase of 3.2% in the third quarter.

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The increase in real GDP reflected increases in private inventory investment, consumer spending, federal government spending, state and local government spending, and nonresidential fixed investment that were partly offset by decreases in residential fixed investment and exports. Imports, which are a subtraction in the calculation of GDP, decreased. The increase in private inventory investment was led by manufacturing (mainly petroleum and coal products as well as chemicals) as well as mining, utilities, and construction industries (led by utilities). The increase in consumer spending reflected increases in both services and goods. Within services, the increase was led by health care, housing and utilities, and "other" services (notably, personal care services). Within goods, the leading contributor was motor vehicles and parts. Within federal government spending, the increase was led by nondefense spending. The increase in state and local government spending primarily reflected an increase in compensation of state and local government employees. Within nonresidential fixed investment, an increase in intellectual property products was partly offset by a decrease in equipment. Within residential fixed investment, the leading contributors to the decrease were new single-family construction as well as brokers' commissions. Within exports, a decrease in goods (led by nondurable goods excluding petroleum) was partly offset by an increase in services (led by travel as well as transport). Within imports, the decrease primarily reflected a decrease in goods (led by durable consumer goods).Compared to the third quarter, the deceleration in real GDP in the fourth quarter primarily reflected a downturn in exports and decelerations in nonresidential fixed investment, state and local government spending, and consumer spending. These movements were partly offset by an upturn in private inventory investment, an acceleration in federal government spending, and a smaller decrease in residential fixed investment. Imports decreased less in the fourth quarter than in the third quarter.

The Institute for Supply Management’s (ISM) Purchasing Managers' Index (PMI) registered 47.4 in January, a decline of 1.0 from the November reading of 48.4. This figure is the third monthly 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 again contracted, 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 nine months, the January composite index reading reflects companies slowing outputs to better match demand in the first half of 2023 and prepare for growth in the second half of the year. Demand eased, with the (1) New Orders Index contracting strongly, (2) New Export Orders Index still below 50 percent but improving, (3) Customers’ Inventories Index contracting slightly, a positive for future production and (4) Backlog of Orders Index recovering for a second month, but still in strong contraction. Output/Consumption (measured by the Production and Employment indexes) was negative, with a combined 0.8-percentage point downward impact on the Manufacturing PMI calculation. The Employment Index remained just above 50 percent and the Production Index logged a second month in contraction territory. Panelists’ companies are indicating that they are not going to substantially reduce head counts as they are positive about the second half of the year. Inputs — defined as supplier deliveries, inventories, prices and imports — continue to accommodate future demand growth. The Supplier Deliveries Index indicated faster deliveries, and the Inventories Index expanded at a slower rate as panelists' companies manage the total supply chain inventory. The Prices Index contracted for the fourth consecutive month, but at a slower rate.Of the six biggest manufacturing industries, one — Transportation Equipment — registered growth in January. New order rates remain depressed due to buyer and supplier disagreements regarding price levels and delivery lead times; these should be resolved by the second quarter. In the meantime, panelists' companies are attempting to maintain head-count levels during the anticipated slow first half in preparation for a strong performance in the second half of 2023. Eighty-six percent of manufacturing gross domestic product (GDP) is contracting, up from 85 percent in December. However, 26 percent of sector industries had a composite PMI calculation of below 45 percent in January (a stronger indication of industry sluggishness), down from 35 percent the previous month."

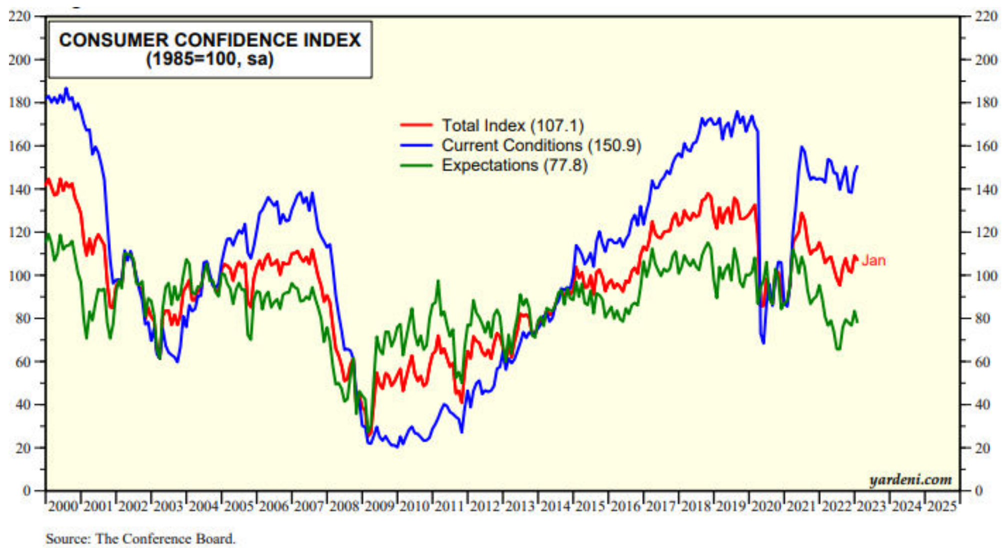
According to the U.S. Bureau of Labor Statistics (BLS), the unemployment rate dropped to 3.5% in December from 3.7% November. The unemployment rate has been in a narrow range of 3.5 percent to 3.7 percent since March 2022.Total nonfarm payroll employment increased by 223,000 in December. Notable job gains occurred in leisure and hospitality, health care, construction, and social assistance. Monthly job growth has averaged 392,000 thus far in 2022, compared with 562,000 per month in 2021. The number of unemployed people fell to 5.7 million in December from 6.0 million in November. 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 December, increasing slightly from 62.1% in November.

The U.S. savings rate was 3.4% in December, up significantly from the November reading of 2.4%. The long-term average savings rate is approximately 9% after its stunning peak of 32.2% in April 2020. Personal income increased $49.5 billion in December (0.2%), according to the Bureau of Economic Analysis (BEA). The increase in current-dollar personal income in December primarily reflected increases in compensation and proprietors' income. The increase in compensation reflected increases in private wages and salaries in both services-producing industries and goods-producing industries. The increase in proprietors' income reflected an increase in nonfarm income that was partly offset by a decrease in farm income. The $41.6 billion decrease in current-dollar PCE in December reflected a decrease of $95.0 billion in spending for goods and a $53.4 billion increase in spending for services. Within goods, decreases were widespread and led by gasoline as well as motor vehicles and parts. Within services, the largest contributors to the increase were spending for housing, transportation (mainly air transportation), and health care.

The Federal Reserve approved a 25-basis point interest rate hike at its January 31st / February 1st meeting, slowing the pace of its increases in a sign that the central bank is seeing progress in its fierce battle with inflation. This follows a 50-basis point increase in December after 4 prior increases of 75 basis points each. In its statement following the meeting, the Fed stated, "inflation has eased somewhat but remains elevated." The Fed's rate increases are attempting to slow the economy and tame inflation. Recent data on wage growth and inflation have been encouraging and economic growth signals have become concerning. The prices of some goods have started to fall with consumer demand shifting to services. Energy costs have also dropped, and the housing market has slowed. The Fed further stated, "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." The extent future increases will depend on several economic and financial factors. Powell added "If we do see inflation coming down much more quickly, that will play into our policy setting, of course." In the post meeting press conference, Fed Chair Jerome Powell Jerome Powell said he does not expect the Fed to cut rates this year, stating "Given our outlook, I don't see us cutting rates this year, if our outlook comes true."

Consumer Confidence decreased in January to 107.1, from an upward revised 109.0 in December to 108.3. Consumer Confidence most recently reached a peak of 128.9 in June 2021. According to a statement from the Conference Board, "Consumer confidence declined in January, but it remains above the level seen last July, lowest in 2022. Consumer confidence fell the most for households earning less than $15,000 and for households aged under 35. Consumers' assessment of present economic and labor market conditions improved at the start of 2023. However, the Expectations Index retreated in January reflecting their concerns about the economy over the next six months. Consumers were less upbeat about the short-term outlook for jobs. They also expect business conditions to worsen in the near term. Despite that, consumers expect their incomes to remain relatively stable in the months ahead. Meanwhile, purchasing plans for autos and appliances held steady, but fewer consumers are planning to buy a home—new or existing. Consumers' expectations for inflation ticked up slightly from 6.6 percent to 6.8 percent over the next 12 months, but inflation expectations are still down from its peak of 7.9 percent last seen in June." The Current Conditions Index (which is based on consumers' assessment of current business and labor market conditions) increased to 150.9 in December from an upward revised 147.4 in December. The Expectations Index (which is based on consumers' short-term outlook for income, business, and labor market conditions) decreased to 77.8 in January from an upward revised 83.4 in December. 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 January 31, 2022)



The Bloomberg U.S. Aggregate Bond Index returned 3.08% in January. This return is on the heels of a -13.01% return for calendar year 2022. The 10-Year U.S. Treasury ended January at 3.51% after ending December at 3.88%. 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 January with a spread of negative 69 basis points (2-year: 4.20% and 10-year: 3.51%). This contrasts with figures from the beginning of the year with a negative spread of 55 basis points (2-Year: 4.43% and 10-Year: 3.88%). Option Adjusted Spreads (as represented by the Bloomberg Corporate Index) ended January at 117 basis points, 13 basis points tighter than the December month end of 130 basis points. Spreads began 2022 with a reading of ninety-two basis points.

West Texas Intermediate (WTI) finished January at $79.02 per barrel falling slightly since the 2022-year end price of $80.26 per barrel. WTI increased 6.7% in 2022 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 and so far in 2023.

The Volatility Index (VIX) ended January at 19.40, decreasing 10.5% from the 2022 year-end reading of 21.67. 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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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.