ZCM Market Insights

Monthly Market Commentary: March 2023

Like last month, news headlines are dominated include 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 -2.44% in Febraury, following a 6.28% return in January. On a year-to-date basis as of February 28th, the S&P 500 has returned 3.69% following a -18.11% in 2022. Small cap stocks, as measured by the Russell 2000, returned -1.69% in February after returning 9.75% in January. On a year-to-date basis as of February 28th, the Russell 2000 has returned 7.89% following a -18.11% in 2022. Large Cap Growth outperformed Large Cap Value in February, with the Russell 1000 Growth returning -1.19% and the Russell 1000 Value returning -3.53%. On a year-to-date basis as of February 28th, Large Cap Growth has outperfomed Large Cap Value with returns of 7.05% and 1.47%, respectively. In February, the Russell 2000 Growth returned -1.08% and the Russell 2000 Value returned -2.31%. On a year-to-date basis as of February 28th, Small Cap Growth outperformed Small Cap Value with returns of 8.76% and 7.02%, repsectively.

Returns by Sector (as of February 28, 2022)

	S&P 500		Russell 2000	
Sector	Feb. 2023	YTD	Feb. 2023	YTD
Communication Services	-4.66	9.16	-4.13	12.90
Consumer Discretionary	-2.09	12.62	-1.73	14.76
Consumer Staples	-2.40	-3.27	0.00	5.05
Energy	-7.12	-4.51	-3.84	1.84
Financials	-2.30	4.41	0.13	5.81
Health Care	-4.61	-6.39	-4.23	3.12
Industrials	-0.89	2.79	0.67	12.12
Information Technology	0.45	9.81	-0.37	11.02
Materials	-3.30	5.38	-1.20	11.75
Real Estate	-5.92	3.39	-6.05	5.20
Utilities	-5.90	-7.78	-2.68	0.16
TOTAL RETURN	-2.44%	3.69%	-1.69%	7.89%

Source: Bloomberg

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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 2.7% in the fourth quarter of 2022 according to the "second" estimate released by the Bureau of Economic Analysis (BEA). This is a reduction from the “advance” estimate of 2.9% This reading follows an increase of 3.2% in the third quarter. The updated estimates primarily reflected a downward revision to consumer spending that was partly offset by an upward revision to nonresidential fixed investmen. Imports, which are a subtraction in the calculation of GDP, were revised up. The increase in real GDP in the fourth quarter reflected increases in private inventory investment, 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 exports. Imports decreased. The increase in private inventory investment was led by manufacturing (mainly petroleum and coal products) as well as mining, utilities, and construction industries (led by utilities). The increase in consumer spending reflected an increase in services that was partly offset by a decrease in goods. Within services, the increase was led by health care as well as housing and utilities. Within goods, the leading contributor to the decrease was "other" durable goods (mainly jewelry). Within nonresidential fixed investment, increases in intellectual property products (mainly software) and structures were partly offset by a decrease in equipment. 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 residential fixed investment, the leading contributors to the decrease were new single-family construction and 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, a decrease in goods (led by durable consumer goods) was partly offset by an increase in services (led by travel). Compared to the third quarter, the deceleration in real GDP in the fourth quarter primarily reflected a downturn in exports and decelerations in consumer spending, nonresidential fixed investment, and state and local government spending. These movements were partly offset by an upturn in private inventory investment, a smaller decrease in residential fixed investment, and an acceleration in federal government spending. Imports decreased less in the fourth quarter than in the third quarter.

The Institute for Supply Management’s (ISM) Purchasing Managers' Index (PMI) registered 47.7 in February, a slight increase from the 47.4 reading in January. This figure is the fourth 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. According to the ISM, “The U.S. manufacturing sector again contracted, with the Manufacturing PMI improving marginally over the previous month. With Business Survey Committee panelists reporting softening new order rates over the previous nine months, the February composite index reading reflects companies continuing to slow outputs to better match demand for 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 at a slower rate, (2) New Export Orders Index still below 50 percent but continuing to improve, (3) Customers’ Inventories Index remaining at ‘too low’ levels, a positive for future production and (4) Backlog of Orders Index recovering for a third month but still in moderate contraction. Output/Consumption (measured by the Production and Employment indexes) was negative, with a combined 2.2-percentage point downward impact on the Manufacturing PMI® calculation. The Employment Index returned to

contraction after two months of expansion, and the Production Index logged a third month in contraction territory. Panelists' companies continue to indicate that they will not substantially reduce head counts, as sentiment is positive about the second half of the year, though slightly less so compared to January. 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 their total supply chain inventories. The Prices Index jumped back into 'increasing' territory after four consecutive months below 50 percent, supporting agreement between buyers and sellers to place orders in the near term. Of the six biggest manufacturing industries, two — Transportation Equipment; and Petroleum & Coal Products — registered growth in February. New order rates remain sluggish due to buyer and supplier disagreements regarding price levels and delivery lead times; the index increase suggests progress in February. Panelists' companies continue to attempt to maintain head-count levels through the projected slow first half of the year in preparation for a stronger performance in the second half. Eighty-two percent of manufacturing gross domestic product (GDP) is contracting, down from 86 percent in January. In February, fewer industries contracted strongly: The share of sector industries with a composite PMI calculation at or below 45 percent — a good barometer of overall manufacturing sluggishness — was 10 percent, an improvement compared to 26 percent in January."

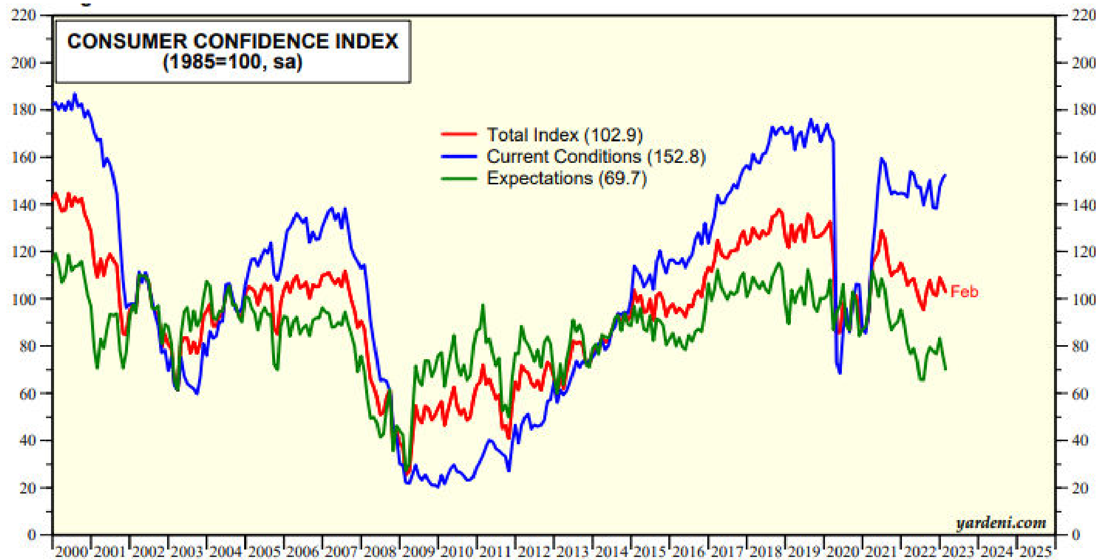
According to the U.S. Bureau of Labor Statistics (BLS), the unemployment rate dropped to 3.4% in January from 3.5% December. The unemployment rate has been in a narrow range of 3.4% to 3.7% since March 2022.Total nonfarm payroll employment increased by 517,000 in January after increasing 223,000 in December. The number of unemployed people remained 5.7 in January, the same as the December reading. Job growth was widespread, led by gains in leisure and hospitality, professional and business services, and health care. Employment also increased in government, partially reflecting the return of workers from a strike. In January, the labor force participation rate was 62.4 % essentially unchanged after removing the effects of the annual adjustments to the population controls. These measures have shown little net change since early 2022 and remain below the pre-pandemic February 2020 levels of 63.3%.

The U.S. savings rate was 4.7% in January , up significantly from the December 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 $131.1 billion in January (0.6%), according to the Bureau of Economic Analysis (BEA). The increase in current-dollar personal income in January was led by an increase in compensation, reflecting private wages and salaries in both services-producing industries and goods-producing industries. Government social benefits decreased in January, reflecting a decrease in "other" benefits that was partly offset by an 8.7% cost-of living increase in Social Security. The decrease in "other" benefits primarily reflected the expiration of the extended child tax credit (from the American Rescue Plan) as well as a decline in one-time refundable tax credits issued by states. The $312.5 billion increase in current-dollar PCE in January reflected increases of $162.2 billion in spending for goods and $150.2 billion in spending for services. Within goods, the increase was widespread and led by motor vehicles and parts as well as "other" nondurable goods (led by pharmaceuticals). Within services, the largest contributor to the increase was spending for food services.

Meeting minutes from the Federal Reserve's January 31st / February 1st meeting noted that inflation remained "well above" the central bank's 2% target, adding that the labor market is still "very tight, contributing to continuing upward pressures on wages and prices." The Fed officials added that "inflation data received over the past three months showed a welcome reduction in the monthly pace of price increases but stressed that substantially more evidence of progress across a broader range of prices would be required to be confident that inflation was on a sustained downward path." The Fed raised rates by 25 basis points, pausing the pattern of previous larger increases that included a 50-basis point increase in December after 4 prior increases of 75 basis points each. In its original 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." The Federal Open Market Committee meets again on March 21st and 22nd.

Consumer Confidence decreased in February to 102.9, from a downward revised January reading of 106.0. Consumer Confidence most recently reached a peak of 128.9 in June 2021. According to a statement from the Conference Board, "Consumer confidence declined again in February. The decrease reflected large drops in confidence for households aged 35 to 54 and for households earning $35,000 or more. While consumers' view of current business conditions worsened in February, the Present Situation Index still ticked up slightly based on a more favorable view of the availability of jobs. In fact, the proportion of consumers saying jobs are 'plentiful' climbed to 52.0 percent—back to levels seen in the spring of last year. However, the outlook appears considerably more pessimistic when looking ahead. Expectations for where jobs, incomes, and business conditions are headed over the next six months all fell sharply in February. And, while 12-month inflation expectations improved—falling to 6.3 percent from 6.7 percent last month—consumers may be showing early signs of pulling back spending in the face of high prices and rising interest rates. Fewer consumers are planning to purchase homes or autos and they also appear to be scaling back plans to buy major appliances. Vacation intentions also declined in February." The Current Conditions Index (which is based on consumers' assessment of current business and labor market conditions) increased to 152.8 in February from an upward revised 151.1 in January. The Expectations Index (which is based on consumers' short-term outlook for income, business, and labor market conditions) decreased to 69.7 in February from a downward 76.0 in January. Expectations around 80 are often a level associated with a recession where it been in 11 of the last 12 months. According to information from the BEA, the consumer is responsible for approximately 70% of the U.S. economy.

Consumer Confidence (as of February 28, 2022)



The Bloomberg U.S. Aggregate Bond Index returned -2.59% in February after returning 3.08% in January. It has returned +0.41% on a year-to-date basis as of February 28th. This return is on the heels of a -13.01% return for calendar year 2022. The 10-Year U.S. Treasury ended February at 3.92% after ending January at 3.51%. 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 February with a spread of negative 90 basis points (2-year: 4.82% and 10-year: 3.92%). 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 February at 124 basis points, 7 basis points wider than the January month end of 117 basis points. Spreads began 2023 with a reading of 130 basis points.

West Texas Intermediate (WTI) finished February at $77.05 per barrel, decreasing 2.5% since ending January at $79.02 per barrel. WTI has decreased 4.0% since the 2022-year end price of $80.26 per barrel. WTI increased 6.7% in 2022 following 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 February at 20.70, increasing 6.7% since the January month-end reading of 19.40. The VIX has decreased 4.5% since beginning 2023 at 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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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.