ZCM Market Insights

Monthly Market Commentary: April 2023

WRITTEN: APRIL 4, 2023

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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March began much like the previous month, with news headlines dominated by improving but still high inflation rates, the likeliness of a recession, the ongoing Ukraine / Russia war, and continued interest rate increases. Then mid-month, Silicon Valley Bank began its collapse at unprecedented speed, becoming the largest bank failure in U.S. history. Capital markets focused on government regulators and the Federal Reserve to see how they would respond.

The S&P 500 returned 3.67% in March, following a -2.44% return in February. On a year-to-date basis as of March 31st, the S&P 500 has returned 7.50% following a -18.11% in 2022. As measured by the Russell 2000, Small Cap stocks returned -4.78% in March after returning -1.69% in February. On a year-to-date basis as of March 31st, the Russell 2000 has returned 2.74% following -18.11% in 2022. Large Cap Growth outperformed Large Cap Value in March, with the Russell 1000 Growth returning 6.84% and the Russell 1000 Value returning -0.46%. On a year-to-date basis as of March 31st, Large Cap Growth has outperformed Large Cap Value with returns of 14.37% and 1.01%, respectively. In March, the Russell 2000 Growth returned -2.47%, and the Russell 2000 Value returned -7.17%. On a year-to-date basis as of March 31st, Small Cap Growth outperformed Small Cap Value with returns of 6.07% and -0.66%, respectively.

Returns by Sector (as of March 31, 2022)

	S&P 500		Russell 2000	
Sector	Mar. 2023	YTD	Mar. 2023	YTD
Communication Services	10.38	20.50	-5.72	6.44
Consumer Discretionary	3.12	16.13	-2.49	11.73
Consumer Staples	4.23	0.83	0.83	5.92
Energy	-0.17	-4.67	-7.03	-5.33
Financials	-9.55	-5.56	-13.81	-8.76
Health Care	2.22	-4.31	-4.91	-1.94
Industrials	0.66	3.47	-3.70	7.71
Information Technology	10.93	21.82	1.70	13.39
Materials	-1.04	4.29	-3.14	8.24
Real Estate	-1.40	1.95	-4.41	0.56
Utilities	4.92	-3.24	1.29	1.45
TOTAL RETURN	3.67%	7.50%	-4.78%	2.74%

Source: Bloomberg

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Real gross domestic product (GDP) increased at an annual rate of 2.6% in the fourth quarter of 2022, according to the “third” estimate released by the Bureau of Economic Analysis. In the third quarter, real GDP increased 3.2%. The recently released GDP estimate is based on more complete source data than were available for the “second” estimate issued last month. In the second estimate, the increase in real GDP was 2.7 percent. The revision primarily reflected downward revisions to exports and consumer spending (refer to “Updates to GDP”). Imports, a subtraction in the calculation of GDP, were revised down.

The increase in real GDP primarily 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) and mining, utilities, and construction (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, housing, and utilities. Within goods, the leading contributor to the decrease was “other” durable goods (mainly jewelry). Within nonresidential fixed investment, increases in structures and intellectual property products (primarily software) were partly offset by a decrease in equipment. The increase in federal government spending was led by nondefense spending. The increase in state and local government spending primarily reflected an increase in the compensation of state and local government employees.

The leading contributors to the decrease in residential fixed investment 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, both goods (led by durable consumer goods) and services (led by transport) decreased.

The Institute for Supply Management's (ISM) Purchasing Managers' Index (PMI) registered 46.3 in March, a slight decrease from the 47.4 reading in February. Regarding the overall economy, this figure indicates a fourth month of contraction after a 30-month period of expansion. The Manufacturing PMI® is at its lowest level since May 2020, when it registered 43.5 percent. The New Orders Index remained in contraction territory at 44.3 percent, 2.7 percentage points lower than the figure of 47 percent recorded in February. The Production Index reading of 47.8 percent is a 0.5-percentage point increase compared to February’s figure of 47.3 percent. The Prices Index registered 49.2 percent, down 2.1 percentage points compared to the February figure of 51.3 percent. The Backlog of Orders Index registered 43.9%, 1.2 percentage points lower than the February reading of 45.1%. The Employment Index continued in contraction territory, registering 46.9%, down 2.2 percentage points from February’s reading of 49.1%. The Supplier Deliveries Index figure of 44.8% is 0.4 percentage point lower than the 45.2% recorded in February; this is the index’s lowest reading since March 2009 (43.%). The Inventories Index dropped into contraction at 47.5%, 2.6 percentage points lower than the February reading of 50.1%. The New Export Orders Index reading of 47.6% is 2.3 percentage points lower than

February's figure of 49.9%. The Imports Index continued in contraction territory at 47.9%, 2 percentage points below the 49.9% reported in February.

According to the U.S. Bureau of Labor Statistics (BLS), the unemployment rate increased from 3.4% in January to 3.6% in February. The economy added 311K jobs, a decline from last January's revised 504K jobs gain, but ahead of expectations of 225K. Private payrolls increased by 265K, also better than expectations, but down from last month. Last month's private payroll gain of 443K was revised down to 386K. The household survey that produces the unemployment rate showed 177K jobs were added in February. However, the labor force increased by a larger 419K, causing the unemployment rate to rise. The increase in the labor force was a positive sign for the economy. Wage gains increased from 4.4% to 4.6% YOY. Earnings remain solid but, as in the past, still below inflation as workers are falling further behind in real spending power. The February report was a slowdown from the very strong January report. It was still a solid report, although there are patches of weakness that may be showing that the Fed's rate hikes are starting to cool the hot labor market. This mixed jobs report corroborates weakness in leading economic indicators, such as manufacturing surveys and consumer sentiment indicators. Lacking though is a follow-through to the harder economic data. Before stopping the rate hikes, the Fed will likely need to see more weakness in the jobs reports and softness in core inflation data.

The U.S. personal savings rate was 4.6% in February, up slightly from the January reading of 4.4%. Personal income increased $72.9 billion in February (0.3%), according to the Bureau of Economic Analysis (BEA). The increase in current-dollar personal income in February was led by an increase in compensation, mainly from wages and salaries. Private wages and salaries for services-producing industries and government wages and salaries increased.

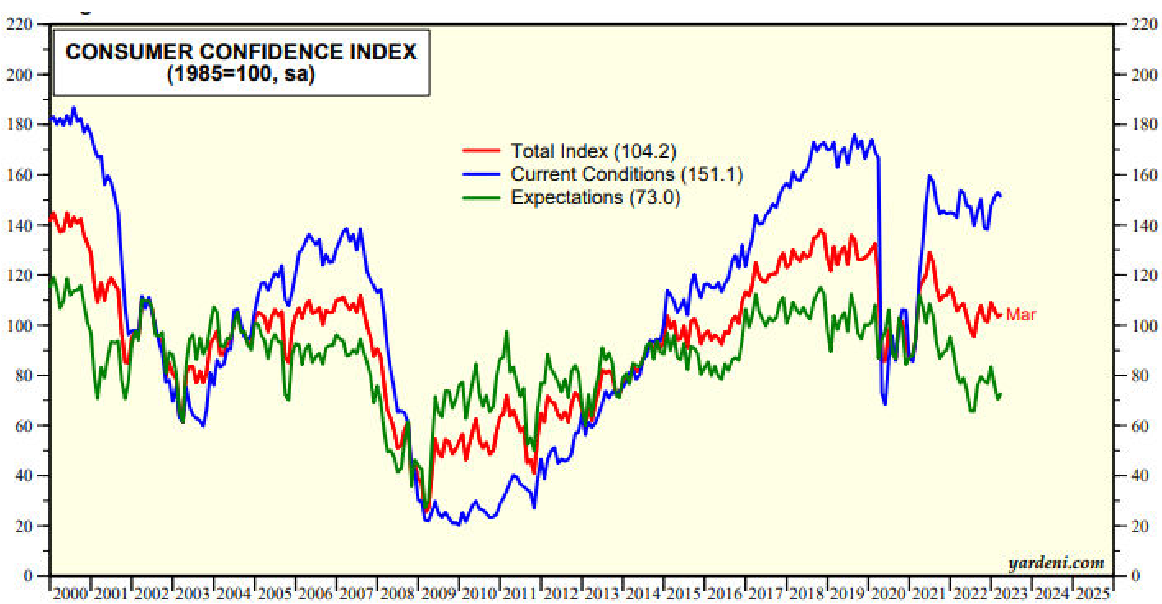
The $27.9 billion increase in current-dollar PCE in February reflected an increase of $25.8 billion in spending for services and an increase of $2.0 billion in spending for goods (table 3). Within services, increases in housing and health care were partly offset by a decrease in food services and accommodations. Within goods, increases in gasoline and other energy goods, "other" nondurable goods (led by pharmaceuticals), and food and beverages were partly offset by a decrease in motor vehicles and parts (mainly new and used light trucks).

March was plagued by volatility in financial markets. Persistent inflation and resilient economic activity saw investors ratchet up their expectations for the Fed's terminal rate. This was validated by Chair Powell at his semi-annual congressional testimony where he said, "we would be prepared to increase the pace of rate hikes", opening the door for a return to a 50bp increase. The Fed's expected terminal rate stood at a new cycle high of 5.69%. This all changed when Silicon Valley Bank collapsed and system-wide contagion became a possibility. Credit Suisse came under scrutiny and was purchased by UBS and worry of additional regional bank failures emerged. Investors dramatically repriced Fed policy expectations ahead of the March meeting. The Fed though moved ahead with a 25bp rate hike lifting the lower bound to 4.75%, emphasizing that "Job gains have picked up in recent months and are running at robust pace, the unemployment rate has remained low" and "Inflation remains elevated". They commented "The banking system is sound and resilient" but acknowledged "Recent developments are likely to result in tighter credit conditions for households and businesses and to weigh on economic activity, hiring and inflation. The extent of these effects is uncertain." The Fed is in a difficult position. A policy decision at their next meeting on May 3rd is highly uncertain, but the expectation is a 25bp hike followed by a pause. The market has priced a total of 50bps of cuts before year-end but we believe this is premature.

Consumer Confidence increased slightly in March to 104.2 up from 103.4 in February. Consumer Confidence most recently reached a peak of 128.9 in June 2021. According to a statement from the Conference Board, "Driven by an uptick in expectations, consumer confidence improved somewhat in March, but remains below the average level seen in 2022 (104.5). The gain reflects an improved outlook for consumers under 55 years of age and for households earning $50,000 and over. While consumers feel a bit more confident about what is ahead, they are slightly less optimistic about the current landscape. The share of consumers saying jobs are 'plentiful' fell, while the share of those saying jobs are 'not so plentiful' rose. The latest results also reveal that their expectations of inflation over the next 12 months remains elevated—at 6.3 percent. Overall purchasing plans for appliances continued to soften while automobile purchases slightly increased."

The Present Situation Index (based on consumers' assessment of current business and labor market conditions) decreased to 151.1 in March from 153.0 in February. The Expectations Index (based on consumers' short-term outlook for income, business, and labor market conditions) ticked up 73.0 in March from 70.4 in February (a slight upward revision). However, for 12 of the last 13 months—since February 2022—the Expectations Index has been below 80, the level which often signals a recession within the next year. According to information from the BEA, the consumer is responsible for approximately 70% of the U.S. economy.

Consumer Confidence (as of March 31, 2023)



Source: The Conference Board.

The Bloomberg U.S. Aggregate Bond Index returned +2.54% in March after returning -2.59% in February. It has returned +2.96% on a year-to-date basis as of March 31st. This return is on the heels of a -13.01% return for the calendar year 2022. The 10-Year U.S. Treasury ended March at 3.47% after ending February at 3.92%. 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 March with a spread of negative 56 basis points (2-year: 4.03% and 10-year: 3.47%). 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 March at 138 basis points, 14 basis points wider than the February month end of 124 basis points. Spreads began 2023 with a reading of 130 basis points.

West Texas Intermediate (WTI) finished March at $75.67 per barrel, decreasing 2.5% since ending February at $77.05 per barrel. WTI has decreased 6.14% 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 March at 18.70, increasing 6.7% since the January month-end reading of 20.70. The VIX has decreased 12.23% 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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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.