MARKET INSIGHTS

from Ziegler Capital Management

Monthly Market Commentary: December 2022

News headlines are dominated on the outcome of the November election which saw Republicans gain a majority in the United States House, but with the Democrats remaining in control of the Senate with the Georgia race going to a runoff election on December 6th. 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 last meeting and is expected to do so again in mid-December albeit at a 50-basis point level instead of the past increases of 75 basis points.

The S&P 500 returned 5.59% in November following an 8.10% return in October. For the year-to-date period through November 30th, the S&P 500 has returned -13.10%. Small cap stocks, as measured by the Russell 2000, returned 2.34% in November and have returned -14.93% on a year-to-date basis as of November 30th. This contrasts with the 14.82% return for calendar year 2021. Large Cap Value outperformed Growth again in November, with the Russell 1000 Value returning 6.25% and the Russell 1000 Growth returning 4.56%. On a year-to-date basis as of November 30th, Large Cap Value has significantly outperformed Large Cap Growth with a return of -3.65% versus -23.26%. In November, the Russell 2000 Value returned 3.06% and the Russell 2000 Growth returned 1.63%. On a year-to-date basis as of November 30th, Small Cap Value outperformed Small Cap Growth, with a return of -8.48% for Small Cap Value versus Small Cap Growth at –21.31%.

Returns by Sector (as of November 30, 2022)

	S&P 500		Russell 2000	
Sector	Nov. 2022	YTD	Nov. 2022	YTD
Communication Services	6.85	-34.77	-0.22	-30.80
Consumer Discretionary	0.99	-29.04	5.23	-23.58
Consumer Staples	6.37	2.26	5.30	-2.52
Energy	1.26	70.74	1.10	63.22
Financials	7.04	-5.59	2.14	-8.42
Health Care	4.82	-0.04	-1.92	-25.58
Industrials	7.85	-2.59	3.57	-10.08
Information Technology	6.03	-21.63	1.96	-28.01
Materials	11.76	-7.10	6.09	-5.05
Real Estate	6.90	-22.38	3.74	-23.95
Utilities	7.02	2.11	5.47	3.63
TOTAL RETURN	5.59%	-13.10%	2.34%	-14.93%

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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CAPITAL MANAGEMENT, LLC

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Real gross domestic product (GDP) decreased at an annualized rate of 2.9%% in the third quarter of 2022 according to the "second" estimate released by the Bureau of Economic Analysis (BEA). This is a revision from the “advance” estimate of 2.6%. This reading follows a decrease of 0.6% in the second quarter. The second estimate primarily reflected upward revisions to consumer spending and nonresidential fixed investment that were partly offset by a downward revision to private inventory investment. Imports, which are a subtraction in the calculation of GDP, decreased more than previously estimated. The increase in real GDP 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 travel and "other" business services (mainly financial services). 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 compensation of state and local government employees and investment in structures. 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 clothing and accessory stores as well as "other" retailers). Within imports, a decrease in imports of goods (notably consumer goods) was partly offset by an increase in imports of services (mainly travel).

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".

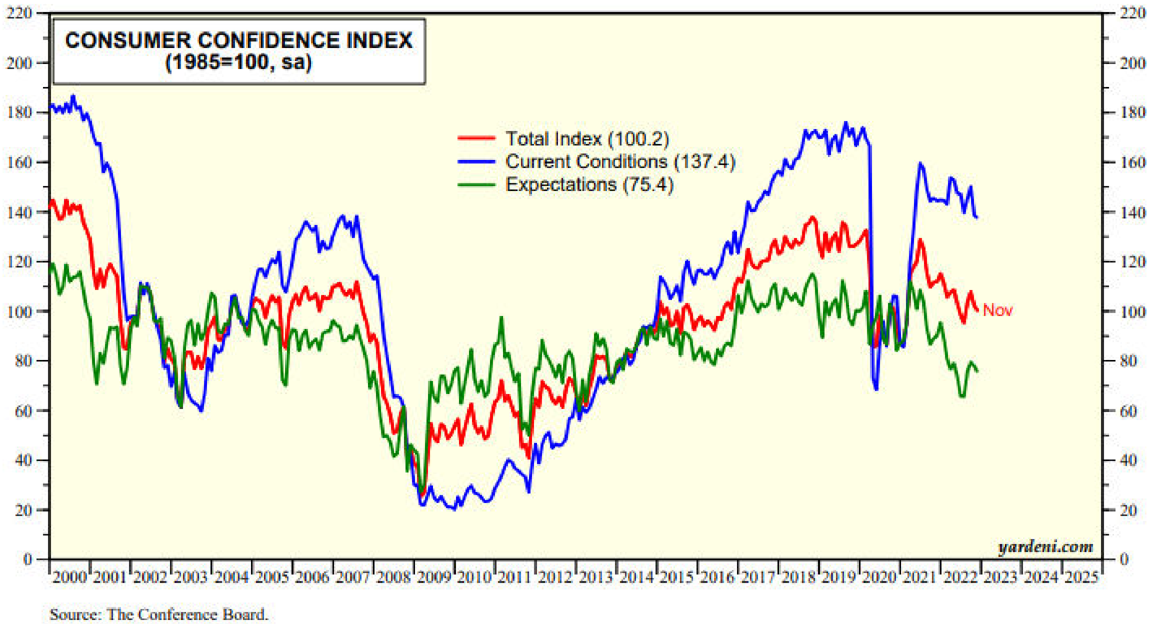
According to the U.S. Bureau of Labor Statistics (BLS), the unemployment rate rose to 3.7% in October from 3.5% in September. Total nonfarm payroll employment increased by 261,000 in October. Monthly job growth has averaged 420,000 thus far in 2022, compared with 562,000 per month in 2021. November figures will be released on December 2nd. Notable job gains occurred in health care, professional and technical services, and manufacturing. In October, the number of unemployed people increased by 306,000 to 6.1 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 62.2% in October, falling slightly from 62.3% in September. These are the highest readings since February 2020.

The U.S. savings rate was 2.3% in October, down from the September reading of 3.1%. The long-term average savings rate is approximately 9% after its stunning peak of 32.2% in April 2020. Personal income increased $155.3 billion in September (0.7%), according to the Bureau of Economic Analysis (BEA). The increase in current-dollar personal income in October primarily reflected increases in compensation and government social benefits. The increase in compensation was led by private wages and salaries. Within private wages and salaries, both services-producing industries and goods-producing industries increased. The increase in government social benefits reflected increases in "other" benefits, primarily reflecting one-time refundable tax credits issued by states. The $147.9 billion increase in current-dollar PCE in October reflected an increase of $85.9 billion in spending for goods and an increase of $61.9 billion in spending for services. Within goods, new motor vehicles (led by light trucks) and gasoline and other energy goods were the leading contributors to the increase. Within services, the largest contributor to the increase was spending for food services and accommodations. This increase was partly offset by a decrease in financial services and insurance (led by financial service charges, fees, and commissions).

In the minutes released from the Federal Reserve's November meeting, it expects to switch to smaller interest rate increases "soon" although some governors expressed concern over the impact that rate increases could have on financial stability and the economy. "A substantial majority of participants judged that a slowing in the pace of increase would likely soon be appropriate," the minutes stated. "The uncertain lags and magnitudes associated with the effects of monetary policy actions on economic activity and inflation were among the reasons cited regarding why such an assessment was important." The minutes noted that smaller interest rate increases would give the Fed an opportunity to evaluate the market impact on the succession of rate hikes. The post-meeting statement from the Fed added a sentence that read, "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." According to the minutes, "a few participants noted the importance of being prepared to address disruptions in U.S. core market functioning in ways that would not affect the stance of monetary policy, especially during episodes of monetary policy tightening." The minutes added "several participants noted the risks posed by nonbank financial institutions amid the rapid global tightening of monetary policy and the potential for hidden leverage in these institutions to amplify shocks." Fed Chairman Powell further indicated a reduction in the interest rate increases in a speech at the end of November citing "The time for moderating the pace of rate increases may come as soon as the December meeting."

Consumer Confidence decreased in November to 100.2 from a downward revised 102.2 in October. 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 November, most likely prompted by the recent rise in gas prices. The Present Situation Index moderated further and continues to suggest the economy has lost momentum as the year winds down. Consumers' expectations regarding the short-term outlook remained gloomy. Indeed, the Expectations Index is below a reading of 80, which suggests the likelihood of a recession remains elevated. Inflation expectations increased to their highest level since July, with both gas and food prices as the main culprits. Intentions to purchase homes, automobiles, and big-ticket appliances all cooled. The combination of inflation and interest rate hikes will continue to pose challenges to confidence and economic growth into early 2023." The Current Conditions Index (which is based on consumers' assessment of current business and labor market conditions) declined to 137.4 in November from a downward revised 138.7 in October. The Expectations Index (which is based on consumers' short-term outlook for income, business, and labor market conditions) decreased to 75.4 in November from a downward revised 77.9 in October. According to information from the BEA, the consumer is responsible for approximately 70% of the U.S. economy.

Consumer Confidence (as of November 30, 2022)



The Bloomberg U.S. Aggregate Bond Index returned 3.68% in November and has returned -12.62% on a year-to-date basis as of November 30. This return is on the heels of a -1.54% return for calendar year 2021. The 10-Year U.S. Treasury ended November at 3.61% after ending October at 4.05% 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 70 basis points (2-year: 4.31% and 10-year: 3.61%). 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 November at 133 basis points, 25 basis points tighter than the October month end of 158 basis points. Spreads began 2022 with a reading of ninety-two basis points.

West Texas Intermediate (WTI) finished November at $80.40 per barrel, decreasing 7.0% from October at $86.43 per barrel. WTI has increased 6.9% since beginning 2022 at $75.21 per barrel. This is on the heels of a 58.9% increase in 2021. Turmoil from the invasion of Ukraine by Russia, the related sanctions and increasing demand have been a significant factor in the increases in 2022. WTI is significantly higher than April 2020's close at $18.84 per barrel during the Saudi/Russia price war.

The Volatility Index (VIX) ended November at 20.58, decreasing 20.5% from the October month-end reading of 25.88. The VIX has increased 19.5% 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.

ZIEGLER CAPITAL MANAGEMENT, LLC

30 South Wacker Drive | Suite 2800 | Chicago, Illinois | 60606 | www.zieglercap.com

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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.