MONTH IN REVIEW

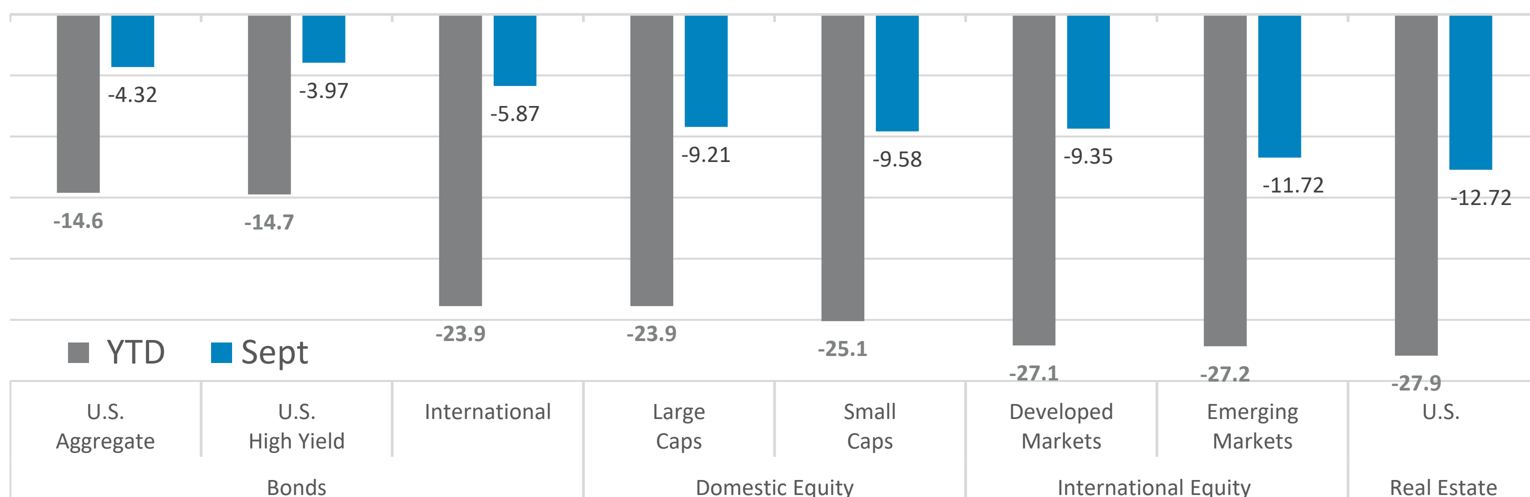
September 2022

Quick Takes

- **Risk Assets Deepen Selloff.** Risk assets continued their year-to-date decline as the Fed conducted another supersized 75bps hike in interest rates and Fed speak commentary took on a hawkish tone.
- **Inflation Surprises In A Bad Way.** Inflation, as measured by the Consumer Price Index (CPI), took market participants by surprise and increased for the month of August. Other inflation metrics like Producers Price Index and Personal Consumption Expenditures also showed signs of heating up, much to market participants' chagrin.
- **Dollar Climbs Higher, Pound Collapses.** The dollar spent most of the month climbing higher and picked up steam after the United Kingdoms announced a plan to cut taxes, this news sent the British Pound into a steep decline. This abated at the end of the month as the UK's central bank returned to bond buying.
- **GDP and Labor Markets.** GDP for the second quarter of the year dropped yet again on the quarter-over-quarter metric. Labor markets remained tight despite the Fed's tightening of monetary policy with weekly jobless claims for the majority of the month.

Asset Class Performance

With inflation metrics coming in hot for the previous month combined with the supersized 75bps interest rate hike and hawkish commentary from Fed members, markets across almost all major asset classes declined for the month, deepening their year-to-date losses.



Source: Bloomberg, as of December 31, 2021. Asset-class performance is presented by using total returns for an index proxy that best represents the respective broad asset class. U.S. Bonds (Barclays U.S. Aggregate Bond TR), U.S. High Yield (Barclays U.S. HY 2% Issuer-Capped TR), International Bonds (Barclays Global Aggregate ex USD TR), Large Caps (S&P 500 TR), Small Caps (Russell 2000 TR), Developed Markets (MSCI EAFE NR USD), Emerging Markets (MSCI EM NR USD), Real Estate (FTSE NAREIT All Equity REITS TR).

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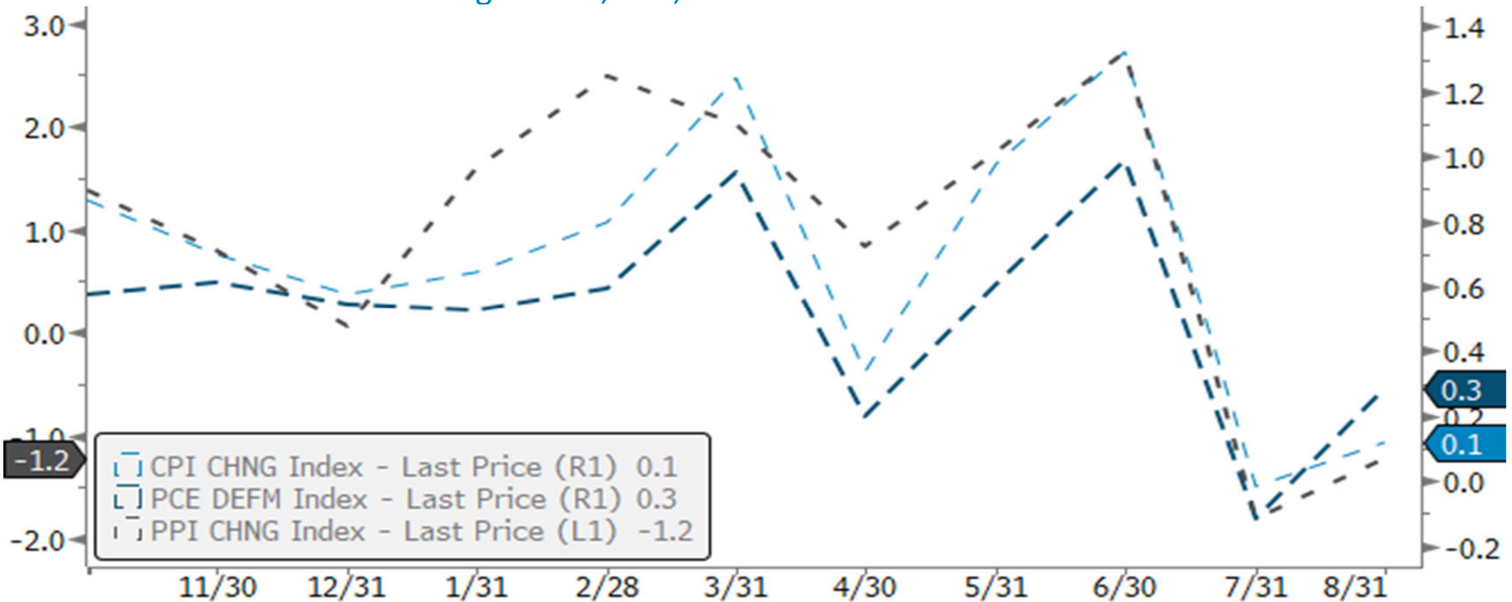
Inflation Ignores Fed Action, Increases for Month of August

Consumer Driven Inflation Metrics Climbed, but Producer Inflation Cooled

Change in CPI, PCE, and PPI Month over Month



Source: Bureau of Labor statistics, Bureau of Economic Analysis Bloomberg

Despite the recent monetary tightening actions taken by the Fed, the effects of quantitative tightening and increasing the Fed Funds Target Rate has yet to reverberate to inflation. As illustrated in the chart above the Consumer Price Index (CPI) and the PCE (Personal Consumption Expenditure) Deflator, the Fed's preferred inflation tracking metric, both climbed for the month of August. Both metrics rose by more than survey estimates on the month-over-month measure. While certainly not the desired outcome of the Fed and market participants alike, one area that showed some signs of stabilizing was the Producer Price Index (PPI). The PPI is an inflation measure for goods manufacturers and landed mostly inline with expectations for the month of August. Producers have been plagued by supply chain constraints since the start of the global pandemic and have not been able to keep pace with demand. As the Fed's actions work their way through the economy and supply chains recover, goods inflation should begin to stabilize, and the September release of PPI numbers could be hinting that this is beginning to happen. With CPI numbers coming in hotter than expected and PPI showing early signs of stabilizing, it appears that consumer spending has shifted from physical goods-oriented purchases to more service-oriented purchases.

While the effects of the Fed's recent tightening actions may not have made their way through the economic system, one area of continued concern is the labor market. Despite many public companies recently announcing hiring freezes, with some even announcing layoff plans, high frequency datapoints, like weekly jobless claims and weekly continuing claims, illustrated throughout the month of September that jobs are not difficult to find labor seekers. It is likely that the Fed will continue to tighten until labor markets show signs of slackening to a more sustainable long-term level. Once labor markets reach the Fed's acceptable level, income should also stabilize, which should lead to moderating consumer spending.

<u>Bottom Line</u>: Last month's reading on inflation related data gave market participants false hope that inflation was beginning to show signs of moderating. Most inflation metrics released for the month of September showed that August's inflation still increased, despite the Fed's tightening of monetary policy. High frequency labor market data releases also hinted that the labor market remains ever tight and that the Fed's fight against inflation is not over yet.

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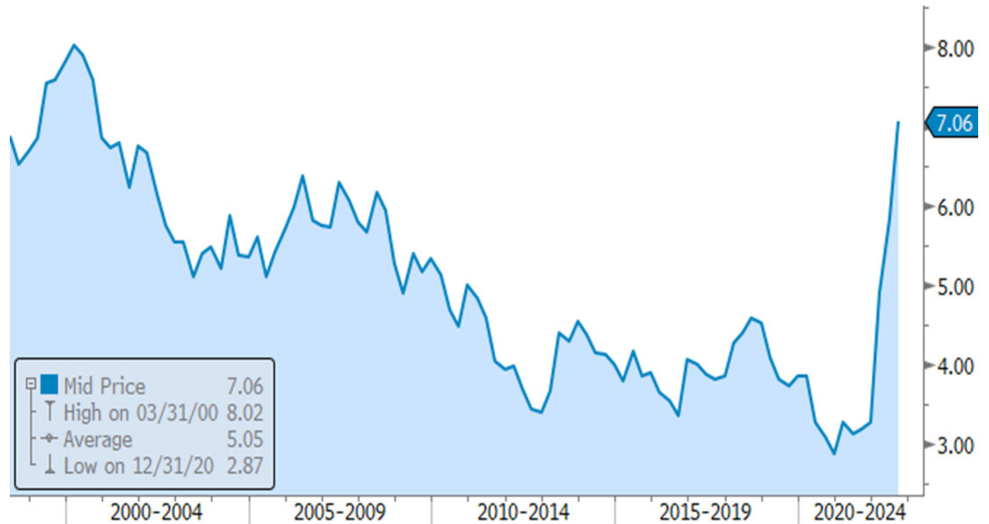
Tightening Monetary Policy Looms Over Housing Market

After the flurry of easy money during the global pandemic, housing prices skyrocketed, and the home-buying market tightened in an extreme way. Now with the Fed's interest rate hikes hitting mortgage rates, Existing Home Sales have returned to pre-pandemic levels. While the drop in activity should help to bring inflation down, the housing market remains tight. Pre-pandemic, 30-year mortgage rates were sub-5%. Now, after the Fed's monetary tightening policy conducted year-to-date, the average 30-year mortgage rate was just north of 7%. Mortgage rates haven't been this high since the early 2000s as illustrated in the chart to the right. And while Existing Home Sales have returned to pre-pandemic levels, the reading still managed to come in above survey expectations, combined with Pending Home Sales falling less than expected for the month of August, it appears that demand for shelter remains robust. However, given that most of the data that compiles these releases is at least a month old, and sometimes longer, it's possible that the recent hawkish tone taken on by the Fed has not fully impacted the housing market. This could imply that mortgage rates haven't reached their peak yet and may continue to grind higher. As the cost of buying homes continues to rise and become more burdensome for consumers, this may work its way through to the labor markets. Laborers searching for a new job may forego relocating for a new job and thus increase friction (the time it takes for job providers to find job seekers) in the labor markets and eventually that should begin to slacken the labor markets and thereby increase the unemployment rate. While this may sound like a troubling situation, with the labor markets being as tight as they are, consumers are able to obtain more compensation and typically, when a consumer has more resources to consume; they will consume more. To wrangle inflation the Fed will likely have to continue tighten monetary policy until this reverberates into slackening the labor market, which has the potential to send the economy into a recessionary environment.

30-Year Mortgage Rate Hits Highest Level Since Early 2000s

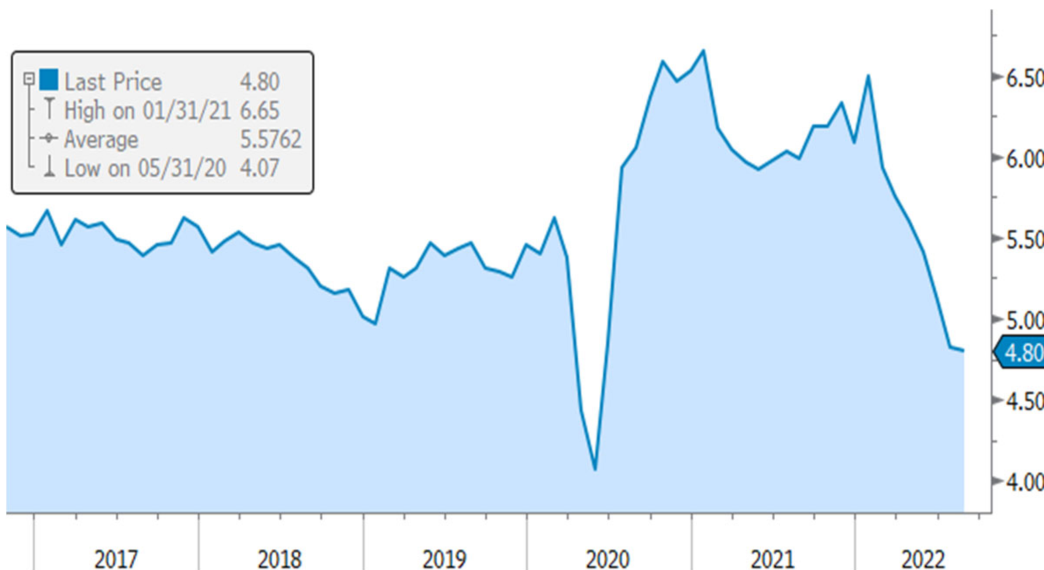
Daily Average 30-Year Mortgage Rate



Source: Bankrate.com, Bloomberg

Existing Home Sales Fall to Pre-Pandemic Levels

US Existing Home Sales



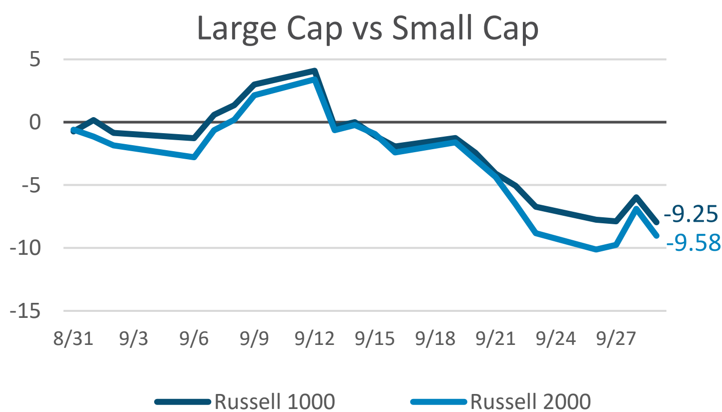
Source: National Association of Realtors, Bloomberg

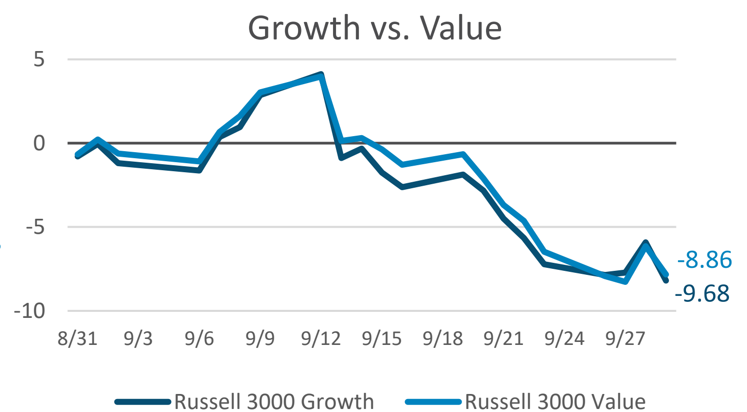
<u>Bottom Line</u>: Mortgage rates have reached levels not seen since the early 2000s, which has weighed on the tight housing market. This should help to wrestle the persistently hot inflation in the US economy and may help slacken labor markets. While market participants have seen the first signs of this beginning to happen, it appears that the Fed's tightening actions haven't accomplished enough and further tightening is likely on its way. It remains to be seen if the Fed will be able to thread the needle to slow inflation without sending the economy into a recessionary period.

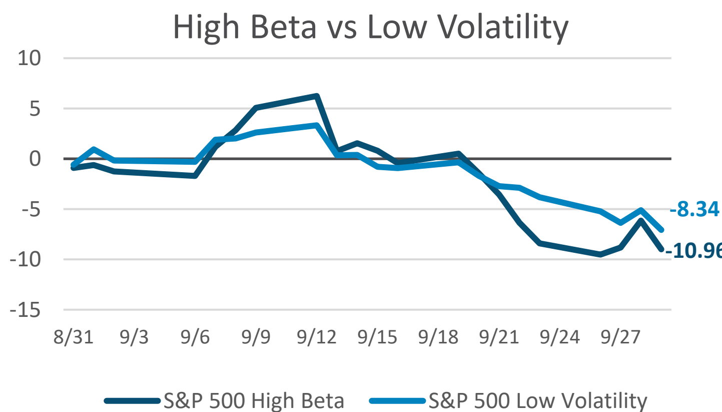
Equity Themes

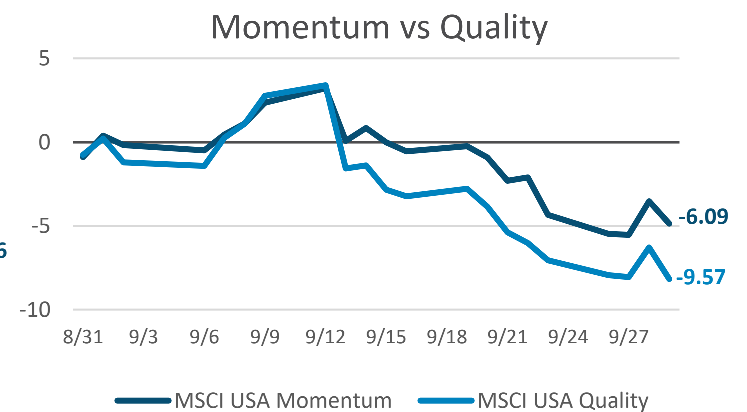
What Worked, What Didn't

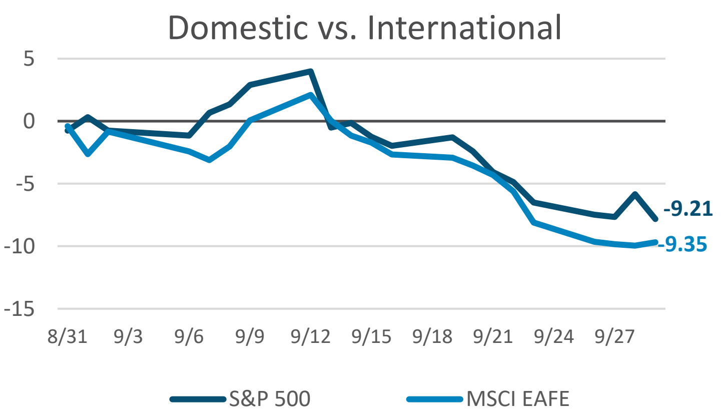
- **Large Over Small, Value Over Growth.** While almost all major asset classes were in the red for the month of September, Large Cap equities provided some, but not much, downside protection versus their Small Cap peers. Value Style equities outperformed Growth style equities by a little over 80bps for the month of September.
- **Low Vol and Momentum Outperform Again.** Low Volatility equities were deeply in the red for the month, but less than their High Beta peers and Momentum outperformed Quality equities for the month of September.
- **Domestic over International, Developed over Emerging.** Domestic equities eked out a small margin of outperformance versus Developed International equities but Developed International equities candidly outperformed Emerging Market equities for the month of September.

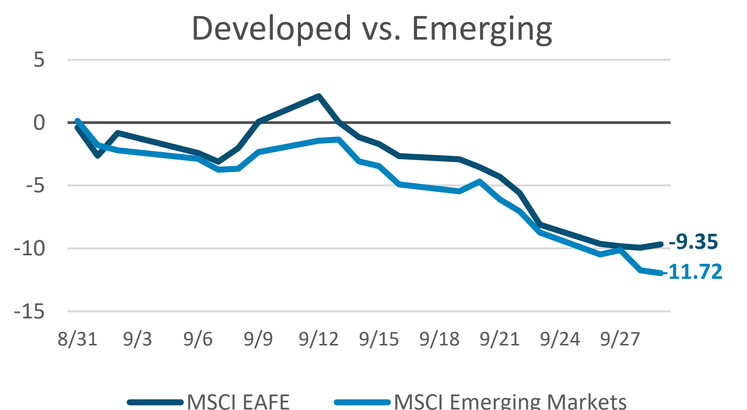










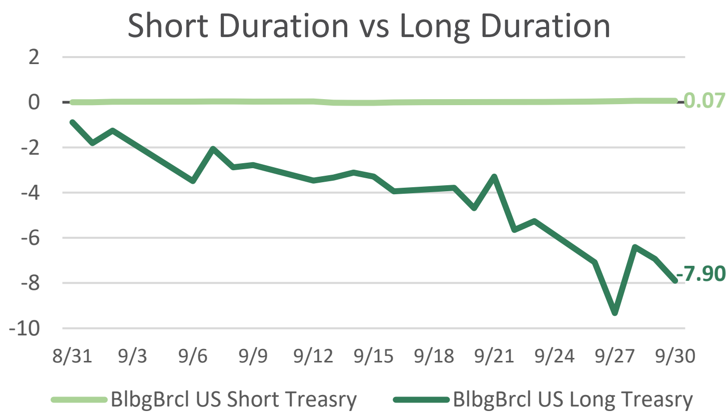


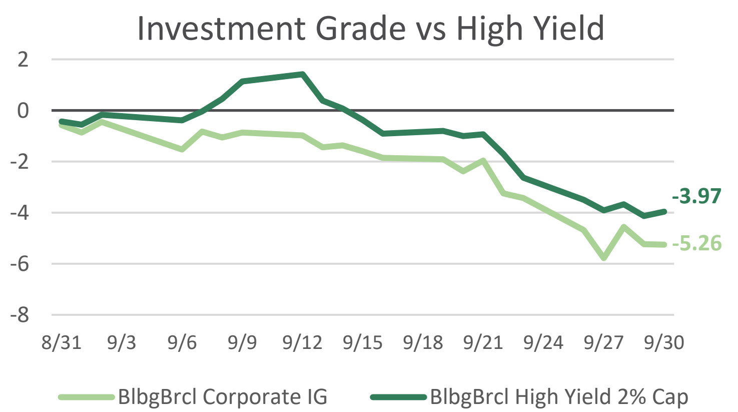
Source: Bloomberg.

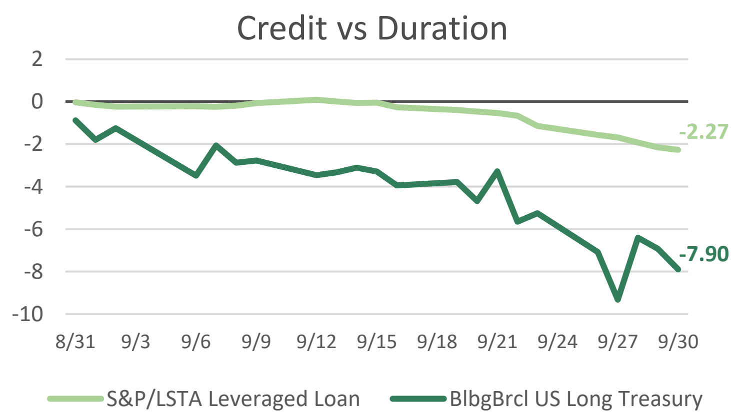
Bond Themes

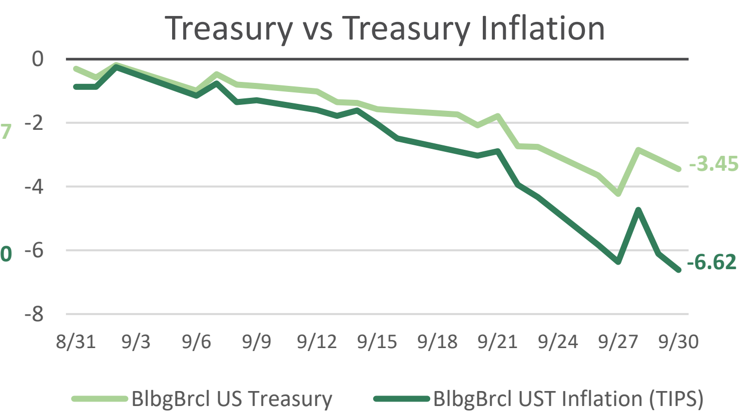
What Worked, What Didn't

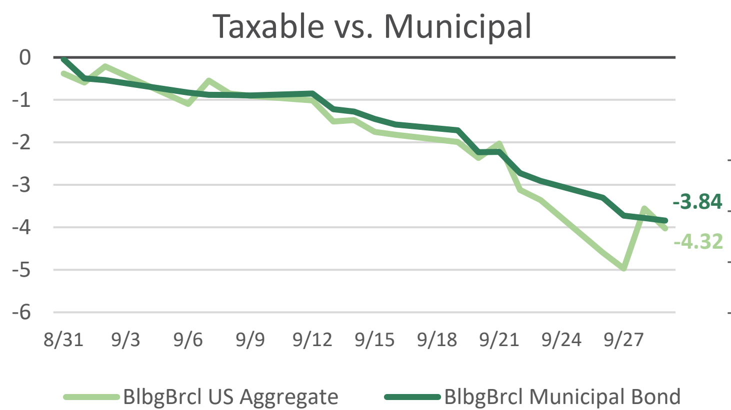
- **Rates Grind Higher.** Longer Dated bonds suffered as rates climbed higher on the back of the Fed's Hawkish tone. This led to Longer Duration steeply falling for the month of September while Shorter Duration bonds were up 7bps for the month.
- **Credit Protects to the Downside, TIPS Stumble.** TIPS posted another negative month, but Credit was able to offer some downside protection, but were still in the red for the month, versus Long Duration treasuries.
- **Munis Outperform Taxables and Domestic Outperforms International.** Munis, while still negative for the month of August, outperformed their taxable peers and International bonds underperformed their Domestic peers for the month of September.

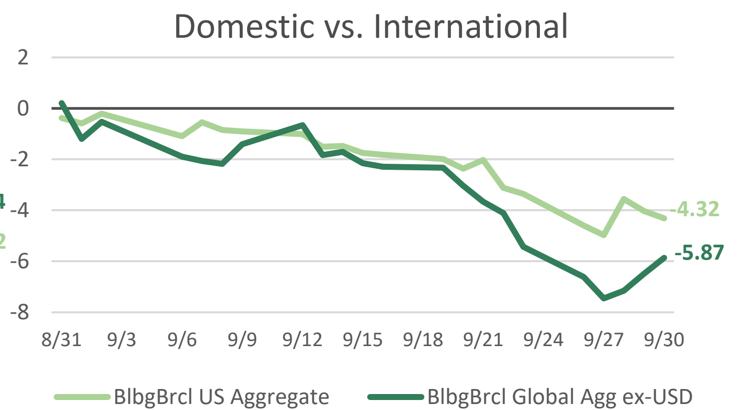












Source: Bloomberg.

September 2022

Asset Class Performance

MONTH IN REVIEW

The Importance of Diversification. From period to period there is no certainty what investment will be the best, or worst, performer. Diversification mitigates the risk of relying on any single investment and offers a host of long-term benefits, such as less portfolio volatility, improved risk-adjusted returns, and more effective compounding.

	Sep-01	Sep-02	Sep-06	Sep-07	Sep-08	Sep-09	Sep-12	Sep-13	Sep-14	Sep-15	Sep-16	Sep-19	Sep-20	Sep-21	Sep-22	Sep-23	Sep-26	Sep-27	Sep-28	Sep-29	Sep-30	Sep	YTD
High	HYB 0.26	IBD 0.49	RE 1.15	MCG 2.44	MCG 1.37	IEQ 2.55	EM 1.49	USB -0.56	SCG 0.70	USB -0.30	HYB 0.34	SCV 1.11	USB -0.45	USB 0.32	IBD -0.20	USB -0.31	LCG -0.67	SCG 0.93	SCG 3.55	IBD 0.00	RE 0.97	HYB -3.30	USB -14.38
	LCV 0.25	USB 0.29	MCG -0.22	SCG 2.33	SCG 1.11	SCG 2.04	IEQ 1.39	IBD -1.90	LCG 0.56	IBD -0.34	USB -0.07	MCV 1.02	EM -0.55	HYB -0.30	IEQ -0.29	HYB -1.27	SCG -1.10	MCG 0.42	MCG 2.94	USB -0.53	IBD 0.56	USB -3.91	HYB -15.25
	RE 0.18	HYB -0.07	IEQ -0.25	MCV 2.28	LCV 0.95	SCV 2.00	SCV 1.27	HYB -2.28	EM 0.50	SCV -0.52	RE -0.08	LCG 0.84	LCG -0.94	60/40 -0.92	EM -0.49	RE -1.31	HYB -1.18	LCG 0.07	SCV 2.68	HYB -0.94	USB -0.24	IBD -6.29	LCV -17.78
	LCG 0.02	60/40 -0.39	HYB -0.27	RE 1.95	MCV 0.82	MCG 1.98	LCG 1.23	60/40 -2.66	MCG 0.46	HYB -0.63	IBD -0.30	SCG 0.72	HYB -1.02	IEQ -1.31	HYB -0.60	LCG -1.54	EM -1.22	EM -0.11	MCV 2.61	IEQ -1.18	IEQ -0.36	60/40 -7.06	MCV -20.44
	MCV -0.22	MCG -0.58	LCG -0.36	LCG 1.94	SCV 0.60	LCG 1.92	SCG 1.12	EM -3.08	IEQ 0.33	LCV -0.67	60/40 -0.56	MCG 0.70	IBD -1.03	SCG -1.31	LCV -0.91	MCG -1.58	MCG -1.27	SCV -0.20	IBD 2.42	60/40 -1.31	EM -0.37	MCG -7.66	SCV -21.26
	USB -0.43	MCV -0.60	MCV -0.37	SCV 1.90	LCG 0.55	MCV 1.51	MCV 1.06	IEQ -3.48	IBD 0.30	60/40 -0.75	IEQ -0.61	LCV 0.64	60/40 -1.08	IBD -1.46	60/40 -0.94	60/40 -1.65	USB -1.29	HYB -0.21	IEQ 2.41	LCV -1.72	HYB -0.46	LCV -7.73	60/40 -22.10
	60/40 -0.51	IEQ -0.66	LCV -0.41	IBD 1.79	HYB 0.44	EM 1.48	MCG 0.98	MCV -3.64	60/40 0.22	MCV -0.80	LCG -0.89	HYB 0.38	SCV -1.33	SCV -1.49	RE -0.99	LCV -1.92	60/40 -1.36	60/40 -0.35	LCV 2.29	MCG -1.77	60/40 -0.50	LCG -8.17	IEQ -27.20
	IBD -0.77	SCV -0.70	60/40 -0.59	LCV 1.72	RE 0.29	LCV 1.40	LCV 0.89	LCV -3.68	LCV 0.16	IEQ -0.88	EM -0.92	IEQ 0.35	LCV -1.44	RE -1.51	USB -1.07	MCV -1.93	IEQ -1.48	MCV -0.40	60/40 2.00	SCG -1.90	SCV -0.66	SCG -8.32	IBD -27.27
	EM -0.79	SCG -0.82	SCG -0.71	HYB 1.44	60/40 0.10	IBD 1.24	IBD 0.88	RE -3.70	HYB 0.15	SCG -1.00	LCV -0.95	EM 0.32	SCG -1.46	MCV -1.60	LCG -1.15	SCV -2.37	LCV -1.50	LCV -0.42	RE 1.94	MCV -2.17	MCV -0.66	IEQ -8.90	EM -27.98
	SCV -0.85	LCV -0.83	USB -0.94	60/40 1.29	IEQ 0.07	60/40 1.22	RE 0.86	SCV -3.75	USB 0.13	MCG -1.06	SCV -1.02	60/40 0.31	MCG -1.50	MCG -1.63	MCV -1.65	SCG -2.46	SCV -1.64	USB -0.43	HYB 1.79	EM -2.23	SCG -0.70	MCV -8.99	RE -28.58
	MCG -0.94	EM -0.92	SCV -1.19	EM 0.89	USB -0.32	RE 0.95	60/40 0.74	SCG -4.06	SCV 0.10	EM -1.06	MCV -1.47	IBD 0.08	IEQ -1.70	LCV -1.66	SCV -1.99	EM -2.47	MCV -1.73	IBD -0.45	LCG 1.76	LCG -2.34	MCG -1.00	SCV -9.67	SCG -29.14
	IEQ -1.35	LCG -1.19	EM -1.19	IEQ 0.88	EM -0.54	HYB 0.40	HYB 0.30	MCG -4.26	MCV -0.12	LCG -1.46	MCG -1.55	RE -0.13	MCV -1.74	EM -1.67	MCG -2.58	IBD -2.53	IBD -1.74	IEQ -0.68	USB 1.61	SCV -2.49	LCV -1.06	EM -11.21	LCG -30.75
Low	SCG -1.40	RE -1.29	IBD -1.21	USB 0.69	IBD -1.61	USB -0.01	USB -0.15	LCG -4.87	RE -1.31	RE -1.83	SCG -1.99	USB -0.15	RE -2.44	LCG -1.73	SCG -2.60	IEQ -3.19	RE -2.68	RE -1.43	EM 0.87	RE -2.86	LCG -1.70	RE -13.53	MCG -31.60

Legend

- 60/40 Allocation (60/40)
- Large Growth (LCG)
- Large Value (LCV)
- Mid Growth (MCG)
- Mid Value (MCV)
- Small Growth (SCG)
- Small Value (SCV)
- Intl Equity (IEQ)
- Emg Markets (EM)
- U.S. Bonds (USB)
- High Yield Bond (HYB)
- Intl Bonds (IBD)
- Real Estate (RE)

Source: Bloomberg. Asset-class performance is presented by using market returns from an exchange-traded fund (ETF) proxy that best represents its respective broad asset class. Returns shown are net of fund fees for and do not necessarily represent performance of specific mutual funds and/or exchange-traded funds recommended by the Prime Capital Investment Advisors. The performance of those funds may be substantially different than the performance of the broad asset classes and to proxy ETFs represented here. U.S. Bonds (iShares Core U.S. Aggregate Bond ETF); High-Yield Bond (iShares iBoxx $ High Yield Corporate Bond ETF); Intl Bonds (SPDR® Bloomberg Barclays International Corporate Bond ETF); Large Growth (iShares Russell 1000 Growth ETF); Large Value (iShares Russell 1000 Value ETF); Mid Growth (iShares Russell Mid-Cap Growth ETF); Mid Value (iShares Russell Mid-Cap Value ETF); Small Growth (iShares Russell 2000 Growth ETF); Small Value (iShares Russell 2000 Value ETF); Intl Equity (iShares MSCI EAFE ETF); Emg Markets (iShares MSCI Emerging Markets ETF); and Real Estate (iShares U.S. Real Estate ETF). The return displayed as "Allocation" is a weighted average of the ETF proxies shown as represented by: 30% U.S. Bonds, 5% International Bonds, 5% High Yield Bonds, 10% Large Growth, 10% Large Value, 4% Mid Growth, 4% Mid Value, 2% Small Growth, 2% Small Value, 18% International Stock, 7% Emerging Markets, 3% Real Estate. 090822001 MKS

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