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MARKET MINUTE

SEPTEMBER REVIEW 2022

This month's Market Minute reflects the views of our Investment Office and was composed by
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OVERVIEW

September was a volatile month for both fixed income and equity markets as it was marked by a hawkish late-September Federal Reserve meeting that began to convince markets that a recession—rather than just a soft-patch—was looming for the US economy in 2023. The Fed raised the Fed Funds rate by 75 basis points—in line with market expectations—in September but also signaled they were not done hiking rates and communicated through their dot-plot forecast that most Fed officials expected the need to increase the Fed Funds rate to at least between 4.5% and 4.75% next year and keep it there for the remainder of 2023.[1] The net result was a deterioration of the market's expectations for economic growth next year as well as further pressure to next year's corporate earnings growth.

In light of this backdrop, both stocks and bonds traded lower for the month with the S&P 500 Index losing -9.2% while the Bloomberg Agg Bond Index was -4.3%. Given September declines, the S&P 500 Index dropped back in bear market territory and finished the month at a new year-to-date low.[2] The Fed's hawkish stance was mirrored during the month by central banks around the world, most of which hiked aggressively in the month. Foreign equities and fixed income also traded lower during the month, while the US dollar continued its months-long rally against nearly every foreign currency.[2]

U.S. EQUITY MARKETS *As of September 30, 2022*

U.S. EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
DJIA	-8.8%	-6.2%	-19.7%	-13.4%
S&P 500	-9.2%	-4.9%	-23.9%	-15.5%
Russell 2000	-9.6%	-2.2%	-25.1%	-23.5%
Russell 1000 Growth	-9.7%	-3.6%	-30.7%	-22.6%
Russell 1000 Value	-8.8%	-5.6%	-17.8%	-11.4%

There were no places to hide in September, as US large and mid-caps (Russell 1000 Index, Russell Mid-Cap Index) were both down -9.3%, while US small caps (Russell 2000 Index) were down -9.6%. Every sector within the S&P 500 ended the month lower, with only one sector (Healthcare) losing less than -7.7% for the month.[2] Volatility was the hallmark of the month, as US equities moved up or down by more than 1 percentage-point 13 of the 21 trading days in September—typically 1 percent moves occur less than 25% of the time—and the VIX Index averaged over 31 in the final week of trading—more that 50% higher than its long run average of 19.5.[2]

INTERNATIONAL EQUITY *As of September 30, 2022*

INTERNATIONAL EQUITY MARKETS				
Index	1 Month	Quater-To-Date	Year-To-Date	1 Year
MSCI ACWI ex USA	-10.0%	-9.9%	-26.5%	-25.2%
MSCI EAFE	-9.4%	-9.4%	-27.1%	-25.1%
MSCI Emerging Markets	-11.7%	-11.6%	-27.2%	-28.1%
MSCI EAFE Small Cap	-11.5%	-9.8%	-32.1%	-32.1%

International equities fell in concert with US equites with the MSCI EAFE Index finishing September down -9.4%. Emerging markets (MSCI EM Index) fell by -11.7% in September, weighed down by Chinese equities (MSCI China Index), which fell -14.6% during the month due to continued lockdowns in select cities related to its zero-COVID policies and generally slowing economy.

The strength of the US dollar also weighed heavily on non-US equities returns—adding about a third of their total declines for the month in US dollar terms.[2] The MSCI EAFE Index fell only -6.2% in local currency terms and the MSCI EM Index was down -9.4% in their local currencies. Developed Asian-Pacific equities—Japan, Hong Kong, Australia, and New Zealand—fared the worst during the month as their currencies generally fell against the dollar and their exposure to the slowing Chinese economy is significant.[2]

FIXED INCOME *As of September 30, 2022*

FIXED INCOME MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
BarCap US Aggregate	-4.3%	-4.8%	-14.6%	-14.6%
BarCap Global Aggregate	-5.1%	-6.9%	-19.9%	-20.4%
BarCap US High Yield	-4.0%	-0.6%	-14.7%	-14.1%
JPM Emerging Market Bond	-6.1%	-4.2%	-22.2%	-22.2%
BarCap Muni	-3.8%	-3.5%	-12.1%	-11.5%

As with equities, September was an ugly month for fixed income as well. The US yield curve moved up during the month, volatility touched levels on par with the immediate aftermath of the US COVID lockdown in March-2020, and spreads widened across the board. Most of the damage to fixed income markets related to duration as the Fed hiked rates in September by 75 basis points but signaled more hikes to come in Q4-2022 and in H1-2023. As a result, yields surged, and the yield on the 10-Year Treasury briefly moved above 4% late in the month before ending September at 3.8%--about 60 basis point higher than at the start of September.[2] The Bloomberg US Aggregate Bond Index finished September down -4.3%. The Bloomberg US Corporate High Yield Index fell by -4.0% as it was helped by its generally shorter duration despite credit spreads widening out. Emerging Market Debt (JP Morgan EM Debt Index) ended the month down -6.1% in part due to the negative impact of the US dollar strength during the month.

CONCLUSION

As we head into the final quarter of 2022, markets are increasingly focused on the potential for a recession in 2023. The Federal Reserve has made clear that it intends to engineer a fall in inflation back down to its 2% target. This seems all but certain to mean that the Fed spurs a recession of sorts next year to better balance overall supply and demand within the US economy. Some aspects of inflation are likely to ease as global supply chains disruptions and shortages continue to ease, but other sectors of the economy like housing, energy, and food could challenge the Fed's goal of 2% inflation and anchored expectations for low inflation going forward. We believe that volatility will remain elevated as markets determine what a 2023 recession means to US corporate earnings as well as the likelihood the Fed overtightens in the face of backward-looking data. Amid a global economic slowdown, the downside risk is that a modest US slowdown in 2023 becomes a more prolonged recession extending beyond next year.

SOURCES

1 https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20220921.pdf
2 Bloomberg