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Investment Insights Monthly

From The Desk of Jack Kraft, CFA, Investment Strategist September 2023

Stocks Fall, Black Gold Booms

U.S. equities declined in the month of August amid an increase in bond yields as the 10-year Treasury hit its highest level (4.34%) since the Great Financial Crisis. The S&P 500 and Nasdaq posted negative returns for the first time since February with the indices losing 1.8% and 2.2%, respectively. The Dow fell 2.4%, while the Russell 2000 slipped 5.2%. The lone S&P 500 sector to end the month in positive territory was Energy as WTI Crude rallied for a third straight month.

At the stock level, the second-quarter earnings season was “better than feared” by investors with the earnings beat rate above the five-year average. The oft-cited “Magnificent Seven” stocks turned in a mixed month. Nvidia rose following another blowout quarterly report, while Google and Amazon also ended the month higher. Elsewhere, Meta, Apple, Tesla and Microsoft all ended the month of August lower. This is a change of pace from the first half of the year when the seven stocks accounted for roughly 75% of the S&P 500 gain.

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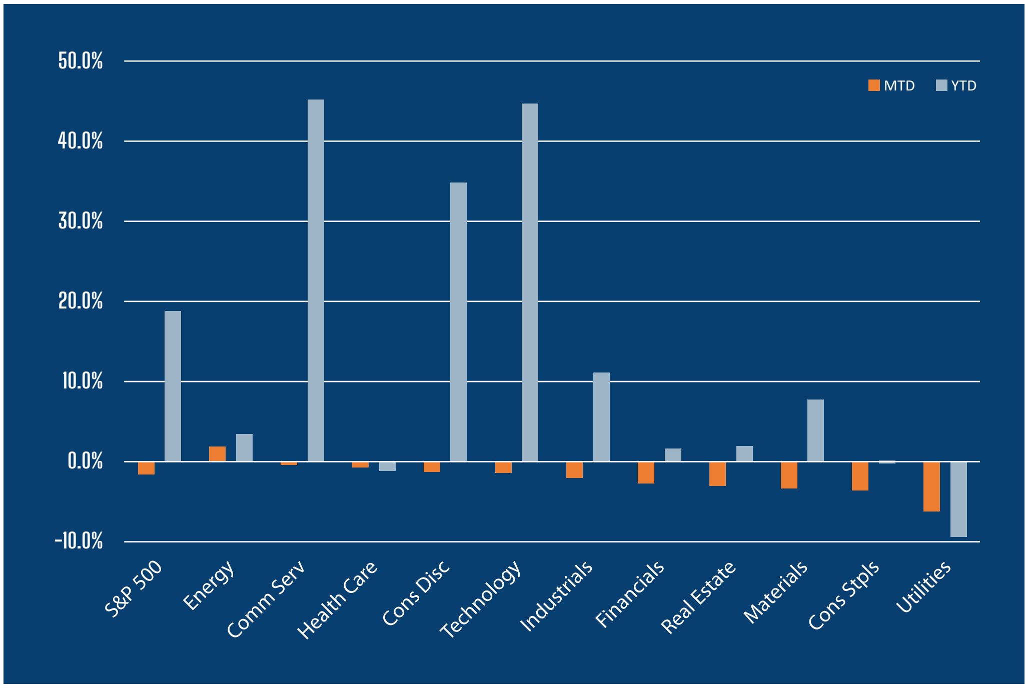
S&P 500 Sector Performance (August and Year-to-Date)



As of September 1, 2023
Source: Morningstar

Economic data in the month of August seemed to fit in the camp of a pausing U.S. Federal Reserve (Fed) and softer landing. GDP growth has continued to surprise to the upside in 2023 on the heels of strong consumer spending. This has been driven by an acceleration in real income growth and was reiterated by the August nonfarm jobs report, which showed increases in the labor-force participation rate and hourly earnings. The report also revealed a tick up in the unemployment rate, while job gains were in line with expectations. A cooling labor market along with signs of softening job creation from a weak July Job Openings and Labor Turnover Survey, or JOLTS, report helped coincide with investor calls for a soft landing and a pause to interest-rate hikes.

Due to the Fed being data-dependent, they tend to look at three data sets: the labor market, economic growth and inflation. A cooling labor market, coupled with GDP growth in line with pre-pandemic levels, is a good combination for a soft landing. However, the central bank still needs inflation to return to its target range of near 2%. Markets now look to the September Consumer Price Index (CPI) report for any indication if the disinflationary narrative will continue.

The short end of the yield curve was little changed from the prior month, while longer dated U.S. Treasuries shifted upward. As of August 21, the 30-year bond rate hit 4.45%, the highest level in more than 10 years. Bond yields have since given back some of the runup in rates since putting in a new 2023 high, but this may be a sign that the bond market expects higher rates to be here for longer.

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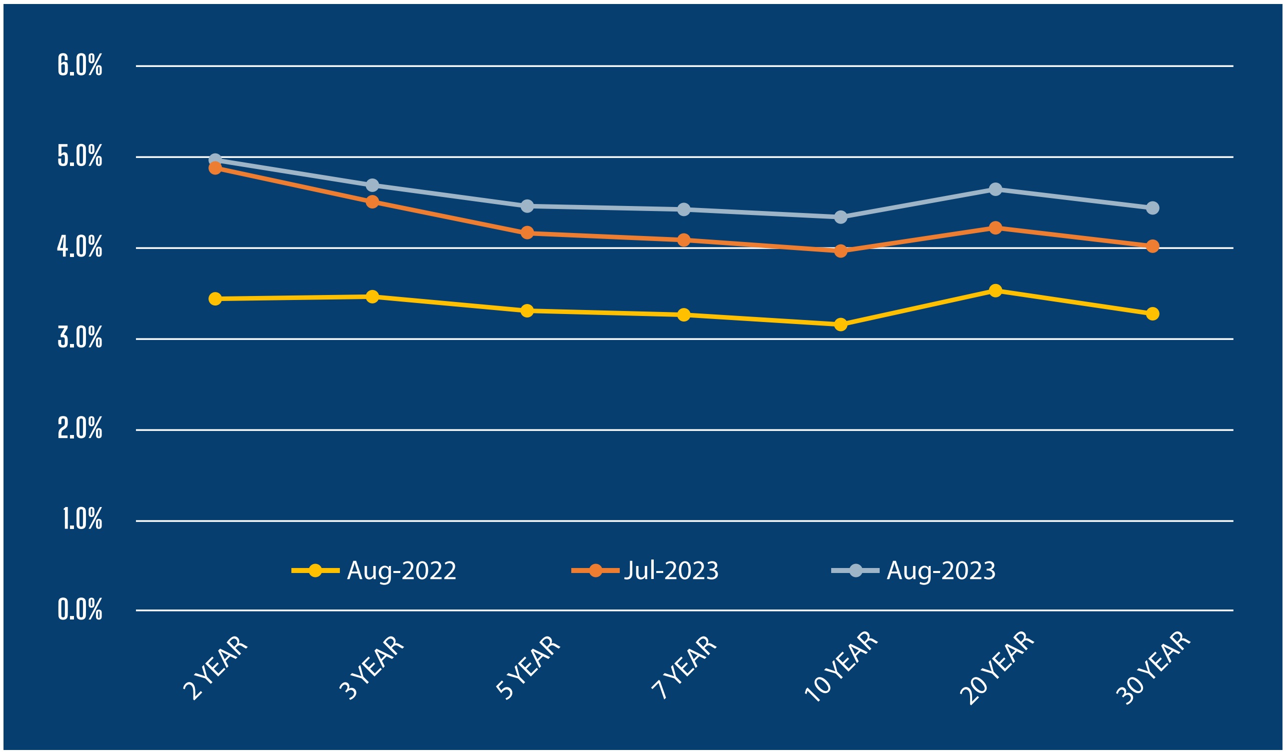
Change in Yield Curve



As of August 21, 2023
Source: Morningstar

Oil Production Cuts Flow Through

In commodities, higher oil prices garnered investor attention in August with WTI rising for its third straight month and into the first week of September. In fact, WTI Crude oil has rallied 30% from its low on March 17, hitting its highest level since November of last year. The rally in WTI Crude oil prices was partially due to an unexpected Saudi Arabia and Russia announcement to extend oil production cuts through the end of this year. These extended cuts are on top of April cuts agreed to by several OPEC+ nations, which also extend through the end of 2023.

This comes at a time when the U.S. is looking to replenish its Strategic Petroleum Reserve (SPR). The SPR has been drawn down to a four-decade low amid releases to bolster supply in an attempt to lower prices in 2022 amid the Russia-Ukraine war. The U.S. is now looking to refill these reserves around $70-$80 per barrel and will be contributing to oil demand at those levels rather than offering supply relief this go-round.

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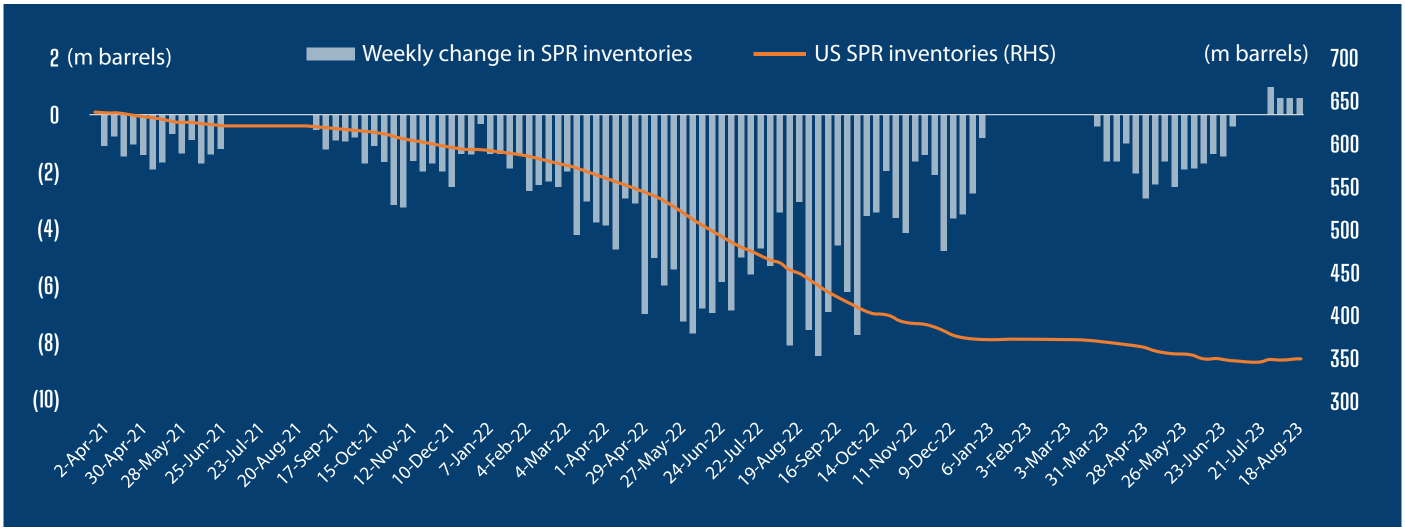
U.S. Strategic Petroleum Reserves



As of September 1, 2023
Source: Jefferies

If higher oil prices are sustained, it could drill a hole right through the Fed's plan for lower inflation, pushing any rate cuts that market participants have been hoping for out further into 2024 and beyond. Historically, oil prices, when compared to the long-term inflation rate (measured by the 5-year TIPS breakeven yield), have been positively correlated. This can be seen in the chart below going back to the post-pandemic rise in oil prices until the recent divergence of the two indicators. Furthermore, WTI Crude prices since the start of the year have been largely disinflationary for headline inflation. At the current price level WTI Crude oil prices will start to move above its price 12 months ago. Thus, turning that disinflationary force into, once again, an inflationary force. To be clear, energy prices are very volatile and there is no guarantee that current levels will hold. Additionally, energy is one small piece of broader inflation gauges, such as the Consumer Price Inflation (CPI) index.

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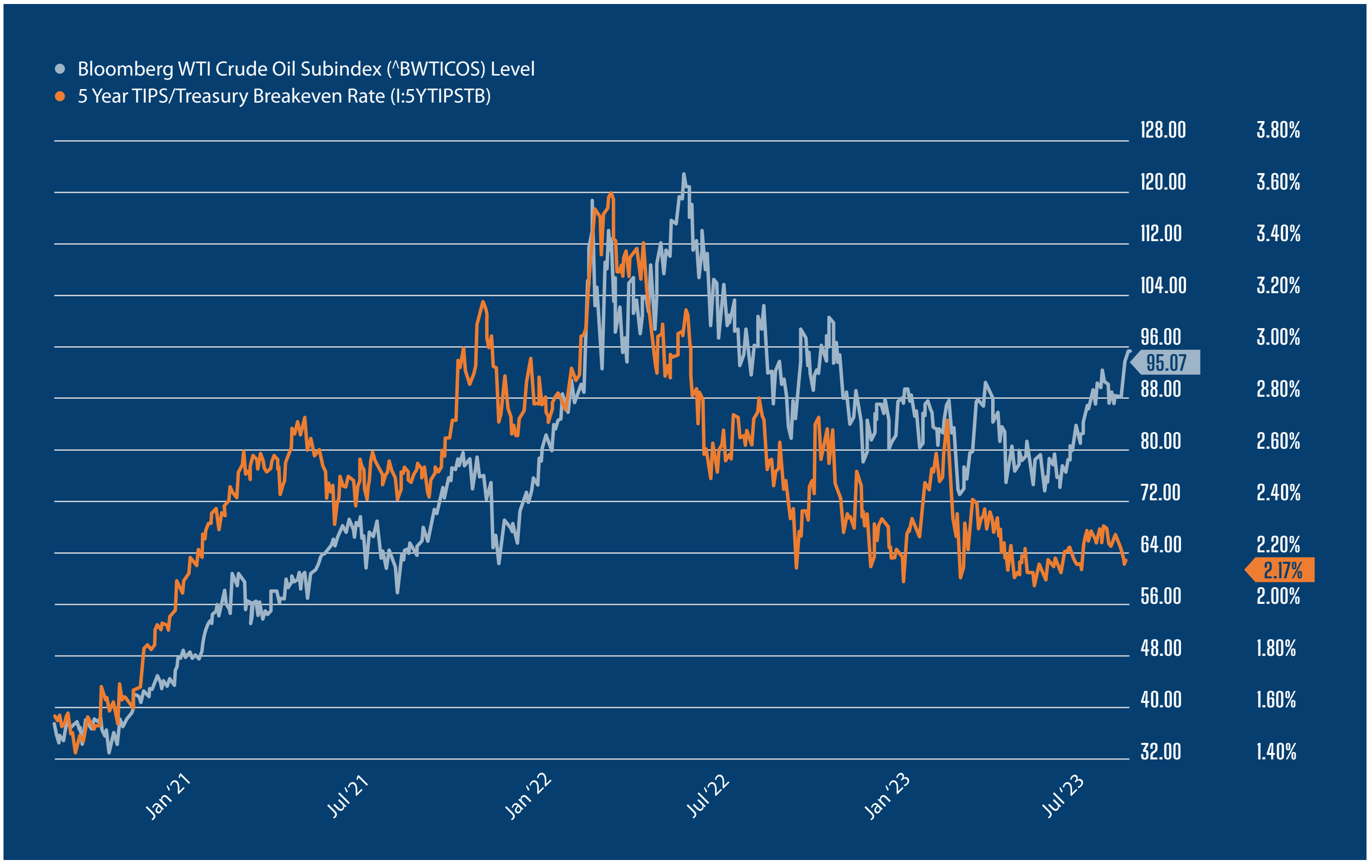
WTI Crude Oil Price vs. Long-Term Inflation Breakeven



As of September 6, 2023
Source: Ycharts

Higher fuel prices, however, do have a knock-on effect that can contribute to broader inflation. For example, jet fuel prices are 20% higher since July. The question is if companies affected by higher fuel costs will try to pass this cost onto consumers and, more importantly, if the consumer can take more price increases without cutting back. In the midst of all this, student loan payments have resumed, leaving uncertainty on how this added cost will weigh on some 43 million borrowers. These are just a few wrinkles that could impact GDP growth going forward and curtail the Fed's plans for a soft landing in 2024.

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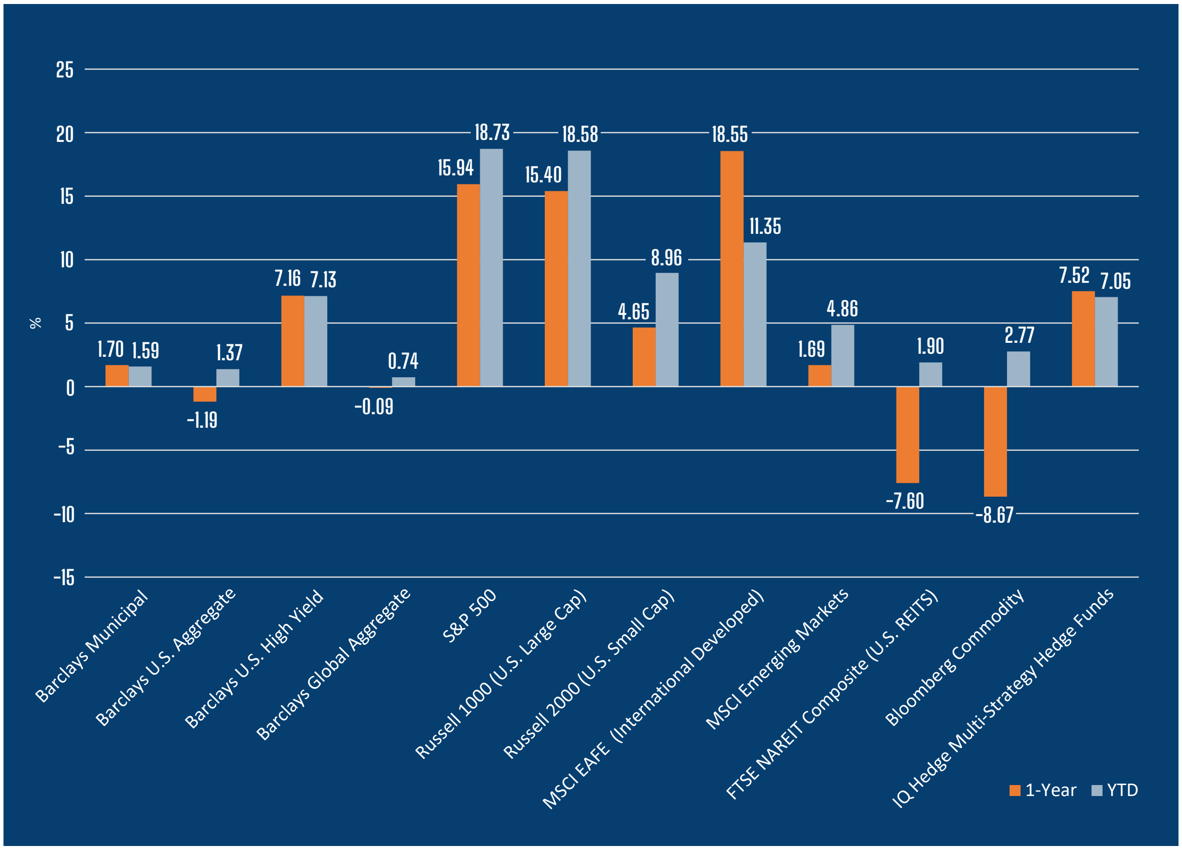
Asset Class Returns

Comparing Recent 1-Year and Year-to-Date Total Returns



As of August 31, 2023
Source: Conway Investment Research

Fixed Income

- Treasury and sovereign debt yields continued their trek higher in August and that led to losses in core fixed income and municipal bonds.
- Although credit spreads widened a bit last month, higher carry more than offset any losses.
- Bonds outside the U.S. were also impacted by U.S. dollar strength versus most developed and emerging currencies.

Equities

- Equities fell across the board in August, but after posting sharp losses during the first half of the month, prices rallied over the final two weeks.
- Growth beat value in large caps, but value led growth across small caps.
- Small-cap stocks lagged large-cap stocks by a fairly wide margin in August.
- Non-U.S. equities posted losses in both local and U.S. dollar terms last month and underperformed U.S. equities in August. Unlike the U.S., small caps led large caps.
- Value also outperformed growth within Europe, Australasia and Far East (EAFE) equities.
- The stronger U.S. dollar cost investors 200 basis points (bps) in EAFE equities and 148 bps within emerging-market equities.

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August 31, 2023	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Barclays U.S. Treasury Bill 1-3 Month	0.46%	0.90%	3.25%	4.38%	1.61%	1.65%	1.05%
Barclays Municipal	-1.44%	-1.05%	1.59%	1.70%	-1.32%	1.52%	2.81%
BBgBarc U.S. Govt/Credit Intermediate	0.35%	0.78%	1.92%	1.57%	-0.70%	1.21%	1.05%
Barclays U.S. Aggregate	-0.64%	-0.71%	1.37%	-1.19%	-4.41%	0.49%	1.48%
Barclays U.S. High Yield	0.28%	1.66%	7.13%	7.16%	1.81%	3.32%	4.47%
S&P/LSTA Leveraged Loan	1.17%	2.47%	9.11%	9.42%	5.97%	4.40%	4.22%
Barclays Global Aggregate	-1.37%	-0.68%	0.74%	-0.09%	-6.12%	-1.21%	0.06%
JPM GBI EM Global Diversified	-2.69%	0.11%	7.92%	11.34%	-2.25%	1.20%	-0.07%
U.S. Equity Indices							
DJ Industrial Average	-2.01%	1.36%	6.37%	12.58%	9.08%	8.31%	11.43%
S&P 500	-1.59%	1.57%	18.73%	15.94%	10.52%	11.12%	12.81%
NASDAQ Composite (Price)	-2.17%	1.79%	34.09%	18.78%	6.03%	11.59%	14.61%
Russell 1000	-1.75%	1.63%	18.58%	15.40%	9.93%	10.77%	12.55%
Russell 1000 Growth	-0.90%	2.44%	32.17%	21.94%	8.25%	13.81%	15.63%
Russell 1000 Value	-2.70%	0.72%	5.88%	8.59%	11.59%	7.11%	9.15%
Russell Mid Cap	-3.47%	0.36%	9.40%	8.38%	9.25%	7.35%	10.04%
Russell 2500	-3.93%	0.85%	9.72%	6.64%	9.52%	5.43%	9.13%
Russell 2000	-5.00%	0.81%	8.96%	4.65%	8.12%	3.14%	7.96%
Russell 2000 Growth	-5.21%	-0.77%	12.68%	6.78%	2.67%	2.46%	8.17%
Russell 2000 Value	-4.81%	2.37%	4.94%	2.17%	13.54%	3.18%	7.36%
Non-U.S. Equity Indices							
MSCI World	-2.35%	0.96%	16.54%	16.21%	8.93%	8.88%	9.86%
MSCI ACWI	-2.75%	0.83%	15.22%	14.53%	7.73%	7.99%	9.12%
MSCI ACWI Ex-U.S.	-4.50%	-0.58%	9.22%	12.49%	4.49%	3.83%	4.87%
MSCI EAFE	-3.82%	-0.70%	11.35%	18.55%	6.58%	4.65%	5.43%
MSCI EAFE Growth	-4.68%	-2.81%	11.26%	15.62%	2.57%	4.82%	6.16%
MSCI EAFE Value	-2.95%	1.48%	11.52%	21.63%	10.43%	4.07%	4.46%
MSCI Europe	-3.95%	-0.99%	13.07%	23.31%	8.13%	5.51%	5.59%
MSCI Japan	-2.42%	0.53%	13.84%	15.77%	4.26%	3.49%	5.81%
MSCI AC Asia	-4.92%	-0.16%	6.60%	5.33%	-0.16%	1.96%	5.09%
MSCI EAFE Small Cap	-3.31%	0.99%	6.94%	9.70%	2.83%	1.95%	6.07%
MSCI ACWI Ex-U.S. Small Cap	-2.76%	2.22%	9.55%	10.57%	5.39%	3.56%	5.97%
MSCI Emerging Markets	-6.13%	-0.22%	4.86%	1.69%	-1.01%	1.36%	3.37%
MSCI EM Asia	-6.14%	-0.21%	3.97%	0.12%	-2.65%	1.52%	4.99%
MSCI China	-8.95%	0.93%	-4.51%	-7.36%	-14.14%	-3.75%	2.66%
MSCI EM Eastern Europe	-6.02%	0.99%	26.57%	52.10%	-32.86%	-20.27%	-10.20%
MSCI EM Latin America	-7.22%	-2.42%	16.04%	18.96%	14.50%	4.69%	1.68%
MSCI EM Small Cap	-1.31%	5.24%	16.53%	13.63%	11.32%	6.65%	5.84%
MSCI Frontier Markets	-0.89%	6.13%	12.04%	0.93%	3.69%	2.74%	3.35%
Hedge Fund Indices							
IQ Hedge Multi-Strategy	-0.43%	1.56%	7.05%	7.52%	0.98%	1.93%	2.80%
Real Assets Indices							
FTSE NAREIT Composite	-3.26%	-1.22%	1.90%	-7.60%	4.32%	3.42%	7.10%
Alerian MLP	0.47%	6.45%	16.78%	18.78%	34.84%	5.80%	1.84%
Bloomberg Commodity	-0.77%	5.44%	-2.77%	-8.67%	15.18%	6.68%	-0.93%
S&P Global Infrastructure	-4.68%	-2.73%	0.98%	-1.09%	7.96%	4.87%	6.26%
Other							
CBOE Market Volitility (VIX)	-0.44%	-0.15%	-37.38%	-47.55%	-19.91%	1.08%	-2.23%

Source: Morningstar

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