09.30.22

KEEP CALM AND CARRY ON

As we say goodbye to the longest reigning British monarch (and 2nd longest reigning of all time), perhaps we should take a page from Queen Elizabeth II's playbook. Always stalwart and steadfast, she did not allow the little things fluster her but kept an eye on the long-term goal. Whether it be a World War or a coal miners' strike, Prince Harry and Megan's thumbing their nose at the royal family or worse yet, Prince Andrew's embarrassing ties to Jeffrey Epstein; she remained a pillar of strength and determination for over 70 years. In a world full of chaos consumed by rising interest rates, jostling markets, war, famine, ongoing supply chain issues and tumultuous hurricanes, it seems impossible to plan for the future when the near and present dangers keep staring us directly in the face. This is especially true at the checkout counter, where a constant reminder of higher prices is making it increasingly difficult to maintain what the British do so well, a stiff upper lip.

Despite a mid-summer rebound, Fed Chairman Powell made it abundantly clear at his press conference in Jackson Hole that he would pull out the "Full Monty" and do what it takes to combat inflation; even at the risk of driving the country into recession. Well, blimey, bring out the tea and biscuits as this may be a bumpy ride! September was just that as bond volatility surpassed that of equities as the Fed continued to fight the bloody, sticky wicket.

Here on the continent, many investors have never seen a rising rate environment, especially not the 25 million+ new brokerage accounts that opened during the pandemic. Mesmerized by meme stocks and the ease of making "free money" in a stock market that wouldn't seem to quit, "Robinhooders" thought they had liberated Sherwood Forest. But, alas, all fairy tales come to an end and now they are paying the price for "slow quitting" their day job as companies begin to restore the post-Covid performance review. This combined with a wave of recent layoff announcements from Amazon to Ford, will hopefully begin to push the unemployment number up to a more reasonable recession level that will appease the Fed.

The "King's" (Chairman Powell) Speech is working as higher borrowing costs weave their way through the system. Despite the recent availability of automobiles, people aren't buying at current interest rates. With mortgages rates at 7%, the housing market and new construction are cooling, US manufacturing growth is waning (ISM manufacturing PMI dropped to 50.9 from 52.8, its slowest rate in 2 ½ years) and job openings dropped by 1.1 million in August.

Lest people forget, higher rates are just one tool in the Fed's arsenal. At the same time the Fed (along with other Central Banks) is in the process of reducing its balance sheet, draining liquidity from the bond market and freeing itself from the role of buyer of last resort. This has caused a surge in volatility in the bond market as spreads have risen across the board sending the 10-year US Treasury to its highest rates since 2008 and the 2-year over 4.2%. Meanwhile, across the pond, the 30-Year Gilt hit its highest yield in 25 years and the pound fell to its lowest level against the dollar ($1 to £0.94) after Parliament announced tax cuts to help counteract higher energy prices for British subjects. Not exactly what Queen Elizabeth had in mind for a Silver Jubilee! This in turn forced the hand of the BOE to jump in and reverse action on quantitative tightening and begin repurchasing government bonds. England's government and Central Bank appear to be playing teeter-totter on a very expensive playground.

It's not just Britain feeling the burn from the US dollar, which rose another 7.2% for the quarter. The strong dollar is adding fuel to the fire on what is already a delicate global currency conflagration. Both Europe and China are already suffering from higher prices; however, a higher dollar has exacerbated the problem by making imports and oil more expensive to buy. Just in time for OPEC+ to reduce production by 2 million barrels a day. It's enough to make your fish and chips go soggy.

We saw Q3 end with a crash of mass bear market selling into the final days of September, only to turn bad news into good as October started anew with a rally off negative data and a dovish move from a member of her Majesty's Commonwealth, Australia, which raised rates less than anticipated. Being a commodity rich country, perhaps Aussieland can foresee a break in inflation and/or a tick down in demand. Just as the sun never used to set on the British Empire, our global economy is intertwined and every decision casts a ripple to another shoreline. It is too early to know the outcome of a synchronized worldwide tightening, but little by little equilibrium will be restored. Until then, pour yourself a gin and tonic.

Closing Thoughts

Putting 70 years into perspective seems daunting, but in reality this is about the length of an individual's investment lifetime. Unless you were an enterprising lemonade salesman, most people begin building wealth in their early 20's through their company's retirement plan. As they become more successful, they start building that nest egg, rainy day fund, college and wedding funds, and dreaming of the day they can start the vacation fund and eventually retire. While Queen Elizabeth vowed to dedicate her whole life to her subjects and the crown, at Ulrich, we dedicate our lives to our clients' financial success. We understand during challenging times like these it is hard to stick to a strategic plan but just remember, in the words of Winston Churchill, "if you are going through hell, keep going."

Regards,

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Equity Markets

The S&P 500 Index sank 4.9% in 3Q and is down 23.9% year-to-date (YTD). Returns were quite mixed across sectors with Energy (+2.3%) and Consumer Discretionary (+4.4%) posting positive results and Communication Services (-12.7%) and Real Estate (-11.0%) delivering the lowest returns. Somewhat counterintuitively, value underperformed growth (Russell 1000 Value: -5.6%; Russell 1000 Growth: -3.6%) but value remains ahead on a YTD basis (Russell 1000 Value: -17.8%; Russell 1000 Growth: -30.7%).

Global ex-U.S. markets fared worse, driven mostly by U.S. dollar strength. The MSCI ACWI ex USA Index fell 9.9% (Local: -4.9%), bringing its YTD loss to 26.5% (Local: -16.2%). The U.S. dollar continued to strengthen, benefiting from its "safe haven" status as well as attractive interest rates relative to other developed markets. The yen and euro lost 6% versus the greenback and the British pound fell 8%. Across developed market countries, losses were broad-based with several posting double-digit declines. As in the U.S., value (MSCI ACWI ex USA Value: -10.4%) underperformed growth (MSCI ACWI ex USA Growth: -9.4%). Unlike the U.S., no sectors delivered a positive return in 3Q.

Emerging markets (MSCI Emerging Markets: -11.6%; Local: -8.2%) underperformed developed markets for the quarter but returns were mixed across countries. China (MSCI China: -22.5%) was one of the worst performers while several countries posted positive returns; two of the best were India (+6.5%) and Brazil (+8.5%). Returns were also mixed across regions: Latin America (+3.6%), Emerging Europe (-12.4%), and Emerging Asia (-14.0%).

Fixed Income Markets

The 10-year U.S. Treasury briefly touched an intra-quarter high of 4.0% in late September, the highest since 2008, before closing the quarter at 3.83%. At quarter-end, the yield curve was inverted by about 40 bps with the 10-year at 3.8% and the 2-year at 4.2%. The Bloomberg US Aggregate Bond Index fell 4.8% in 3Q, bringing its YTD return to a startling -14.6%, a historical worst for the first nine months of a year. Notably, the sharp sell-off has eroded gains over the past 10 years; the Aggregate's 10-year annualized gain is now a muted 0.9%. Mortgages and corporates underperformed U.S. Treasuries, with mortgage-backed securities doing especially poorly, underperforming like-duration U.S. Treasuries by 160 bps on poor technicals and rising rates. The yield-to-worst of the Aggregate Index climbed to 4.75%, up sharply from 1.75% at the beginning of the year. TIPS (Bloomberg TIPS: -5.1%; -13.6% YTD) were not immune from the sell-off. High yield corporates (Bloomberg High Yield: -0.6%) fared better, but the Index is down a similar 14.7% YTD. The yield-to-worst was 9.7% as of quarter-end.

The Bloomberg Municipal Bond Index fell 3.5% for the quarter and is down 12.1% YTD. The shorter duration 1-10 Year Blend fell 2.3% for the quarter and 7.7% YTD. The ratio of AAA Municipal yields to the 10-year U.S. Treasury fell to 86%, down from 92% at the end of 2Q. The 4.0% yield-to-worst of the Bloomberg Municipal Bond Index is the highest since 2009.

Interest rates also rose overseas and the U.S. dollar continued to strengthen, hurting unhedged fixed income returns. The Bloomberg Global Aggregate ex USD fell 8.8% (hedged: -2.2%). The YTD differential for hedged and unhedged investors is nearly 14 percentage points (unhedged: -23.9%; hedged: -9.9%). Losses were broad-based but the U.K. fell the most sharply; 13.2% in local currency terms and 20.2% in US$ in response to announced plans for massive fiscal stimulus in the form of unfunded tax cuts. Emerging markets performed similarly, with the JPM EMBI Global Diversified down 4.6% and the local currency JPM GBI-EM Global Diversified off 4.7%.

Real Assets

Real assets as a group posted negative returns in 3Q. Commodity prices, especially metals and oil, declined on concerns over slowing global growth; the S&P GSCI Index fell 10.3%. WTI Crude closed the quarter at $79/barrel, down more than 20% from 2Q. Gold (S&P Gold Spot Price Index: -7.5%), listed infrastructure (DJB Global Infrastructure: -1.1%), REITs (MSCI US REIT: -10.0%), and TIPS (Bloomberg TIPS: -5.1%) declined.

Returns for Various Periods - September 30, 2022

	Last Quarter	Year to Date	Last Year	**Last 3 Years**	Last 5 Years	Last 10 Years	**Last 15 Years**
MSCI:ACWI	(6.82)	(25.63)	(20.66)	**3.75**	4.44	7.28	**4.07**
Russell:3000 Index	(4.46)	(24.62)	(17.63)	**7.70**	8.62	11.39	**7.92**
Russell:3000 Growth Index	(3.37)	(30.57)	(23.01)	**10.16**	11.57	13.36	**9.87**
Russell:3000 Value Index	(5.56)	(17.97)	(11.79)	**4.37**	5.11	9.08	**5.71**
MegaCap							
Russell:Top 50	(5.53)	(26.41)	(17.48)	**10.28**	10.92	11.96	**8.19**
Russell:Top 200	(5.02)	(24.71)	(16.43)	**8.96**	9.95	12.09	**8.21**
Russell:Top 200 Growth	(4.24)	(30.53)	(21.01)	**12.23**	13.29	14.49	**10.74**
Russell:Top 200 Value	(5.97)	(16.33)	(10.18)	**4.26**	5.54	9.07	**5.28**
Large Cap							
S&P:500	(4.88)	(23.87)	(15.47)	**8.16**	9.24	11.70	**8.03**
Russell:1000 Index	(4.61)	(24.59)	(17.22)	**7.95**	9.00	11.60	**8.03**
Russell:1000 Growth	(3.60)	(30.66)	(22.59)	**10.67**	12.17	13.70	**10.10**
Russell:1000 Value	(5.62)	(17.75)	(11.36)	**4.36**	5.29	9.17	**5.71**
MidCap							
S&P:400 Mid Cap	(2.46)	(21.52)	(15.25)	**6.01**	5.82	10.04	**7.93**
Russell:Midcap Index	(3.44)	(24.27)	(19.39)	**5.19**	6.48	10.30	**7.55**
Russell:Midcap Growth	(0.65)	(31.45)	(29.50)	**4.26**	7.62	10.85	**8.01**
Russell:Midcap Value	(4.93)	(20.36)	(13.56)	**4.50**	4.76	9.44	**6.81**
Small Cap							
S&P:600 Small Cap	(5.20)	(23.16)	(18.83)	**5.48**	4.84	10.09	**7.77**
Russell:2000 Index	(2.19)	(25.10)	(23.50)	**4.29**	3.55	8.55	**6.40**
Russell:2000 Growth	0.24	(29.28)	(29.27)	**2.94**	3.60	8.81	**6.82**
Russell:2000 Value	(4.61)	(21.12)	(17.69)	**4.72**	2.87	7.94	**5.70**
Russell:Microcap	(0.48)	(25.48)	(27.46)	**6.86**	3.11	8.37	**5.46**
Non-US Equity							
MSCI:ACWI xUS	(9.91)	(26.50)	(25.17)	**(1.52)**	(0.81)	3.01	**0.57**
MSCI:EAFE	(9.36)	(27.09)	(25.13)	**(1.83)**	(0.84)	3.67	**0.61**
MSCI:EAFE Growth	(8.50)	(33.02)	(30.28)	**(1.49)**	0.67	4.70	**1.64**
MSCI:EAFE Value	(10.21)	(21.08)	(20.16)	**(2.79)**	(2.74)	2.39	**(0.60)**
MSCI:EAFE Small	(9.83)	(32.11)	(32.06)	**(2.16)**	(1.79)	5.28	**2.45**
MSCI:EM	(11.57)	(27.16)	(28.11)	**(2.07)**	(1.80)	1.05	**0.27**
Fixed Income							
Blmbg:Aggregate	(4.75)	(14.61)	(14.60)	**(3.26)**	(0.27)	0.89	**2.74**
Blmbg:TIPS	(5.14)	(13.61)	(11.57)	**0.79**	1.95	0.98	**3.25**
Blmbg:Long Gov/Credit	(9.03)	(28.94)	(27.41)	**(7.35)**	(1.17)	1.35	**4.44**
Blmbg:Long Credit A	(9.12)	(29.17)	(28.19)	**(7.44)**	(1.63)	1.47	**4.14**
Blmbg:HY Corp Cash Pay	(0.64)	(14.75)	(14.11)	**(0.44)**	1.58	3.94	**5.72**
Blmbg:Muni 1-10 Yr	(2.30)	(7.72)	(7.55)	**(0.83)**	0.71	1.41	**2.74**
Blmbg:Glb Agg xUSD	(8.85)	(23.88)	(24.77)	**(7.78)**	(4.03)	(2.39)	**0.32**
Blmbg:Glb Agg xUSD Hdg	(2.21)	(9.93)	(9.86)	**(2.99)**	0.71	2.21	**3.08**
JPM:EMBI Plus	(5.52)	(30.70)	(30.93)	**(9.87)**	(5.52)	(0.86)	**2.72**
Other Assets							
Blmbg:Commodity TR Idx	(4.11)	13.57	11.80	**13.45**	6.96	(2.14)	**(2.44)**
S&P GSCI	(10.31)	21.80	23.64	**12.19**	7.75	(3.95)	**(4.45)**
S&P:Gold Spot Price Ix	(7.49)	(8.56)	(4.84)	**4.32**	5.41	(0.59)	**5.49**
FTSE:NAREIT Equity Index	(9.94)	(28.13)	(16.41)	**(2.05)**	2.93	6.26	**4.86**
Alerian:MLP Index	8.05	18.90	19.56	**4.46**	1.90	0.66	**4.94**