consequent
capital management

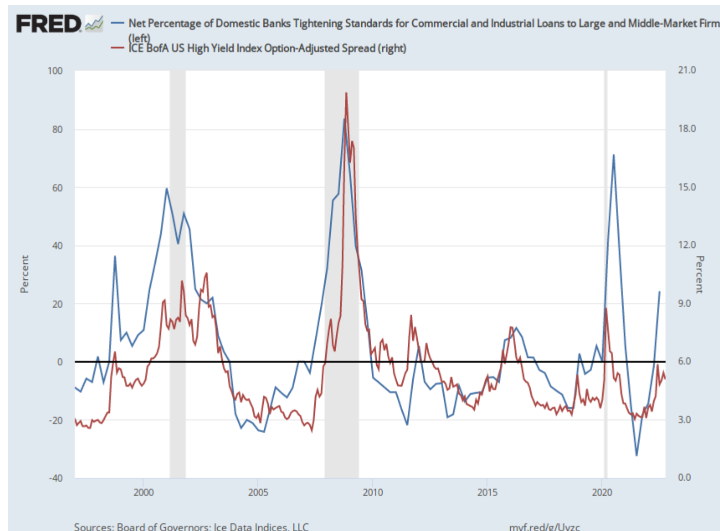
Capital Markets Review and Outlook

By: Cyril M. Theccanat, Chief Investment Officer

September 2022

Economy and Outlook

The pace and magnitude of central bank rate hikes worldwide continued in September as inflation fears remained center stage. Since the beginning of this year, more than 40 central banks around the world have increased interest rates by at least 75 bp at one time emphasizing and underscoring their commitment to bring down inflation. In September, the Federal Reserve raised its federal funds rate by 75 bp for the third consecutive time bringing the target rate to a range of 3% to 3.25%. The magnitude of the Fed's shift in monetary policy is reflected in the fact that in March 2021, the FOMC expected that the federal funds rate at the end of 2022 would be zero. Just a year and half later, at the FOMC's meeting this September, the forecast is now 4.5%. The central bank's goal is to bring down inflation by slowing the economy through a corresponding slowdown in employment gains and capital expenditure spending which would in turn be brought about by tightening financial conditions. However, as shown on the chart on this page, while there has been some increase in banks tightening lending standards for business loans, high yield spreads (red line) have not correspondingly widened. This suggests the Fed may have more to do on the interest rate hiking front. Market turmoil was further exacerbated in September with the unexpected move by the new government in the United Kingdom which planned to institute a massive package of tax cuts and subsidies, despite very high inflation. This had the effect of driving down the value of the British pound to a 37-year low against the US dollar and resulted in the skyrocketing of yields on government fixed income securities even beyond the UK. Later in the month, an about-face change in the proposed tax cut policy helped reverse some of the turmoil. An important issue facing the markets is the almost constant effort by investors to second-guess central banks and preemptively forecast a Federal Reserve pivot to cutting interest rates as early as next year. The Fed has repeatedly and firmly stated its goal to bring inflation down to its 2% target. This means interest rates are likely to remain higher and for a longer period of time than



the markets expect. Until these expectations are tempered, volatility in the risk markets is likely to continue.

Equity Markets

Equity markets plunged in the final month of the 3rd quarter on mounting fears that the combination of a slowing economy, a rising dollar and high inflation were likely to significantly pressure companies' profits and margins. The broad domestic equity market represented by the Russell 3000 index lost -9.3% for the month. Year-to-date, the index is down -24.6%. This is the first year since 2009 with three consecutive quarters of losses for the major indices. The declines for the month were fairly similar across the capitalization stack ranging from -9.3% for Large Cap to -9.6% for Small Cap. However, for the third quarter, Small Cap (-2.2%) outperformed Large Cap (-4.6%) cutting Large Cap's advantage for the first nine months of the year to just +0.5%. In terms of performance differentiation by style, Value outperformed Growth by roughly +100 bp across all capitalizations in September. However, for the third quarter, Growth outperformed Value by a substantial margin, especially in the Mid and Small Cap space. Year-to-date, Value maintains a significant lead over Growth across all capitalizations. While all 11 major S&P 500 sectors declined in September, Defensives outperformed Cyclicals as expected in a down market. Health Care (-2.6%) was the best performer while Real Estate (-13.2%) was the worst performer hurt by the spike in interest rates which pushed 30-year mortgage rates close to 7% for the first time since 2006; just a year ago, these rates were at 3%. Technology and Communications Services also led on the downside with losses of -12% each for the month. The 8% decline in oil prices in September weighed on the Energy sector which lost -9.3% for the month. Year-to-date, Energy remains the best performing sector with a gain of almost +35%. Inflation, rising yields, recession fears and weak currencies all weighed on international equity markets in September with the MSCI Developed Markets index losing -9.4% while the Emerging Markets index slumped -11.7%. The ongoing war in Ukraine continues to have a more adverse impact on Europe due to its energy dependency on Russia. The European Central Bank (ECB) also hiked interest rates by the largest amount (+75 bp) since the beginning of the common currency 23 years ago to aggressively combat high inflation; this follows a +50 bp increase in July. The euro also dropped and stayed below parity versus the U.S. dollar. The German and French equity markets lost -8.8% and -8.6% respectively in September. The worst performers among developed equity markets were Australia (-11.6%) and Japan (-10.4%) as the Japanese yen fell four full figures dropping -3.3% against the dollar. China, the largest component in the Emerging Markets index, declined -14.6% in September. Despite recent monetary policy stimulus measures by the Bank of China, the economic outlook is being dampened by the worsening contraction in the property market and intensified Covid-19 lockdowns. A weakening currency, with the Chinese renminbi falling below 7 to the U.S. dollar for the first time in more than two years has also been a negative factor. Spillover from the weakness in China together with geopolitical concerns led to double-digit declines for the equity markets in Korea and Taiwan. Year-to-date, the Developed Markets and Emerging Markets indices are both down -27%.

Fixed Income Markets

Interest rates spiked higher in September as the Federal Reserve raised its key federal funds rate for the third consecutive time by +75 bp and signaled more rate hikes to come. The yield on the 2-year Treasury shot up by +77 bp, the second largest monthly increase this year. Yields on 1-year thru 5-year Treasuries closed the month above 4%, while the yield on the 30-year bond increased by +52 bp bringing its yield to 3.8%. The Treasury yield curve inverted further with the 2-year/30-year yield spread decreasing an additional -25 bp to end the month at -43 bp. To put the magnitude of the inversion in perspective: the spread was +117 bp at the beginning of the year. Mirroring the downturn in the equity markets, the investment grade corporate bond market also declined in September as spreads widened resulting in an underperformance of -117 bp compared to duration-matched Treasuries. The corporate quality curve and the credit curve both steepened for the month as higher quality bonds outperformed lower quality issues, and as short to intermediate issues outperformed longer maturity bonds respectively. Outperforming sectors in the investment grade sector included Insurance, Healthcare/Pharma and Capital Goods while Banks, Media/Entertainment and Telecoms were among the laggards. For the month, the Bloomberg Investment Grade index lost -5.1% bringing its year-to-date decline to -18.1%. Although the high yield sector also underperformed in September as high yield spreads widened, the sector's higher coupon and shorter duration enabled it to outperform the investment grade sector on a total return basis. For the month, the Bloomberg High Yield index lost -4%. On a total return basis, the best performing sectors for the month were Transportation, Utility and Energy while Automotive, Housing and Telecommunications were the worst performers. For the first 9 months of the year, the High Yield index declined -14.7%. Government bond yields in Europe spiked higher in September, especially in the United Kingdom, following the new UK government's unwise proposals for massive spending increases together with large tax cuts despite high inflation. Yields across much of the UK government yield curve increased by 100 bp for the month. Yield increases in other parts of the world were more muted with Canadian government yields rising by less than 10 bp, while 10-year yields in Australia increased by 30 bp. The U.S. dollar also extended its broad-based strengthening trend with the dollar index (DXY) rising sharply by +2.8% for the month. As a result, the FTSE non-US government bond index lost -6.4% in September compared to the -3.4% decline for the U.S. government bond index. Year-to-date, the FTSE non-US Government Bond index's loss of -26.8% is more than twice the -12.9% decline for the U.S. government bond index.

			Returns as of 9/30/22 (In %)				
		Month	Q3	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	-9.3	-4.5	-24.6	-17.6	7.7	8.6
Russell 1000®	US Large Cap Equity	-9.3	-4.6	-24.6	-17.2	7.9	9.0
Russell 1000® Growth	US Large Cap Growth	-9.7	-3.6	-30.7	-22.6	10.7	12.2
Russell 1000® Value	US Large Cap Value	-8.8	-5.6	-17.8	-11.4	4.4	5.3
Russell Midcap®	US Mid Cap Equity	-9.3	-3.4	-24.3	-19.4	5.2	6.5
Russell Midcap® Growth	US Mid Cap Growth	-8.5	-0.7	-31.5	-29.5	4.3	7.6
Russell Midcap® Value	US Mid Cap Value	-9.7	-4.9	-20.4	-13.6	4.5	4.8
Russell 2000®	US Small Cap Equity	-9.6	-2.2	-25.1	-23.5	4.3	3.6
Russell 2000® Growth	US Small Cap Growth	-9.0	0.2	-29.3	-29.3	2.9	3.6
Russell 2000® Value	US Small Cap Value	-10.2	-4.6	-21.1	-17.7	4.7	2.9
MSCI ACWI ex-US	Global Equity ex-US	-10.0	-9.9	-26.5	-25.2	-1.5	-0.8
MSCI EAFE	Global Developed Mkts Equity	-9.4	-9.4	-27.1	-25.1	-1.8	-0.8
MSCI EM	Emerging Mkts Equity	-11.7	-11.6	-27.2	-28.1	-2.1	-1.8
Bloomberg/Barclays US Agg	US Core Fixed Income	-4.3	-4.8	-14.6	-14.6	-3.3	-0.3
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	-3.5	-3.8	-11.0	-11.5	-2.3	0.0
Bloomberg/Barclays US Credit	US Corporate Bonds	-5.1	-4.9	-18.1	-17.9	-3.6	0.0
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	-5.1	-5.3	-13.7	-14.0	-3.7	-0.9
Bloomberg/Barclays US Corp HY	US High Yield	-4.0	-0.6	-14.7	-14.1	-0.5	1.6
FTSE Non-US WGBI	Global Fixed Income ex-US	-6.4	-10.0	-26.8	-28.3	-9.9	-5.1

Disclosure: This Capital Market Review, written by Consequent Capital Management, represents the opinions, investment strategies and views of Consequent Capital Management and is based on current market conditions and is not intended to interpret laws or regulations. The views expressed in this Capital Market Review are subject to change without notice. This Capital Market Review commentary is provided for informational purposes only, based upon information generally available to the public from sources believed to be reliable, and should not be construed as investment or legal advice nor is it meant to be a solicitation or offer to purchase any product or service. Readers are encouraged to consult with their investment, legal or tax professional before making any investment decisions. This Capital Market Review is not designed to be a comprehensive analysis of any topic discussed herein and should not be relied upon as the only source of information used for making investment decisions. Consequent Capital Management believes the information contained in this material to be reliable but does not warrant its accuracy or completeness. Our discussion may include predictions, estimates or other information that might be considered forward-looking. While these forward-looking statements represent our current judgment on what the future holds, they are subject to risks and uncertainties that could cause actual results to differ materially. You are cautioned not to place undue reliance on these forward-looking statements, which reflect our opinions only as of the date of this presentation. Please keep in mind that we are not obligating ourselves to revise or publicly release the results of any revision to these forward-looking statements in light of new information or future events. Additionally, this Capital Market Review is not intended to represent advice or a recommendation of any kind, as it does not consider the specific investment objectives, financial situation, applicable risk factors, and/or particular needs of any individual client or investor and should not be relied upon as the basis for investment decisions. Past performance is not indicative or a guarantee of future results. Consequent Capital Management, LLC is registered with the U.S. Securities and Exchange Commission.