September 2022: Market Review

Equity markets experienced a sharp decline in September driven by higher-than-expected global inflation readings and, in turn, higher investor expectations on the Federal Reserve's terminal rate of interest. The Fed raised short term interest rates with a third consecutive 75-basis point hike after the August consumer price index showed stickier inflation (CPI +8.3% year-over-year). Federal Reserve Chairman Jerome Powell spoke with hawkish rhetoric in his speech, admitting that his unyielding commitment to reducing inflation will not be painless for consumers and rates may need to stay higher for longer. After the rate increase, the Fed Funds rate is 3.125% and most FOMC committee members expect it to be between 4.0% and 4.5% by the end of 2022. Equities and bonds, historically negatively correlated asset classes, fell in tandem giving investors few places to hide in September. The S&P 500 Index declined -9.2% during the month and is down -23.9% year-to-date, a new low for the year. The Dow Jones Industrial Average fell -8.8%, entering bear market territory (20% off recent highs). The tech heavy, NASDAQ Composite Index dropped -10.4% and is now down -32.0% year-to-date.

In domestic markets, returns declined across all capitalization sizes and style classifications. Value style equities outperformed growth only in the large cap equity space as the Russell 1000 Value Index fell -8.8% versus a decline of -9.7% for the Russell 1000 Growth Index. The Russell Midcap Growth Index declined -8.5%, while the Russell Midcap Value Index was down -9.7%. Similarly, the Russell 2000 Growth Index fell -9.0%, beating the Russell 2000 Value Index return of -10.2%. WTI crude oil ended the month at $79 per barrel (down from $90 last month), continuing the move lower in oil prices.

Developed international equities underperformed U.S. equities in U.S. dollar terms, as stubbornly high inflation readings persisted, and recession concerns intensified. Disappointing European corporate earnings and pessimistic commentary from the European Central Bank and the Bank of England added to the recession fears. The war in Ukraine produced mixed signals as Ukrainian forces made new advances against Russian occupation in the east, but Putin's annexation of four contested eastern regions of Ukraine and a mysterious attack on the two Nord Stream pipelines pointed to an escalating conflict. The MSCI EAFE Index decreased -9.4% and the MSCI ACWI ex-US Index (which includes emerging markets) fell -10.0%. The MSCI Emerging Markets Index fell -11.7% in September as emerging markets were negatively impacted by the persistent rise of the U.S. dollar. Additionally, Chinese equites, a large component of emerging markets, fell as economic growth forecasts were impacted by a collapse in real estate and dampened by the zero-tolerance approach to Covid-19.

U.S. fixed income markets declined as the Federal Reserve's message conveying interest rates will stay higher for longer reduced investors' expectations of a Fed pivot in the near term and increased the probability that a Fed policy error could occur. The yield on the 2-year U.S. Treasury rose to 4.22%, widening the yield curve inversion over the 10-year U.S. Treasury to -43 basis points at the end of the month. The Bloomberg U.S. Aggregate Bond Index declined -4.3% in the month, bringing year-to-date returns to -14.6% and marking the worst decline in investment grade bonds through September on record. The Bloomberg +20 Year Index fell -8.2%. The Bloomberg High Yield Bond Index (-4.0%) modestly outperformed investment grade bonds.

The Federal Reserve's aggressive policy tightening to reign in high inflation has made it increasingly difficult for investors to form expectations for economic and labor market growth in the near term, thus causing financial markets to remain volatile. However, not all economic reports have been negative, as U.S. initial jobless claims hit another multi-year low, and Morgan Stanley's supply-chain stress index fell. Additionally, public markets are more attractive as S&P 500 forward earnings multiples are approximately 9% below their long-term average and high-quality fixed income valuations are at 10-year lows. These attractive valuations may be a silver lining to long-term investors.

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