Capital Market Review

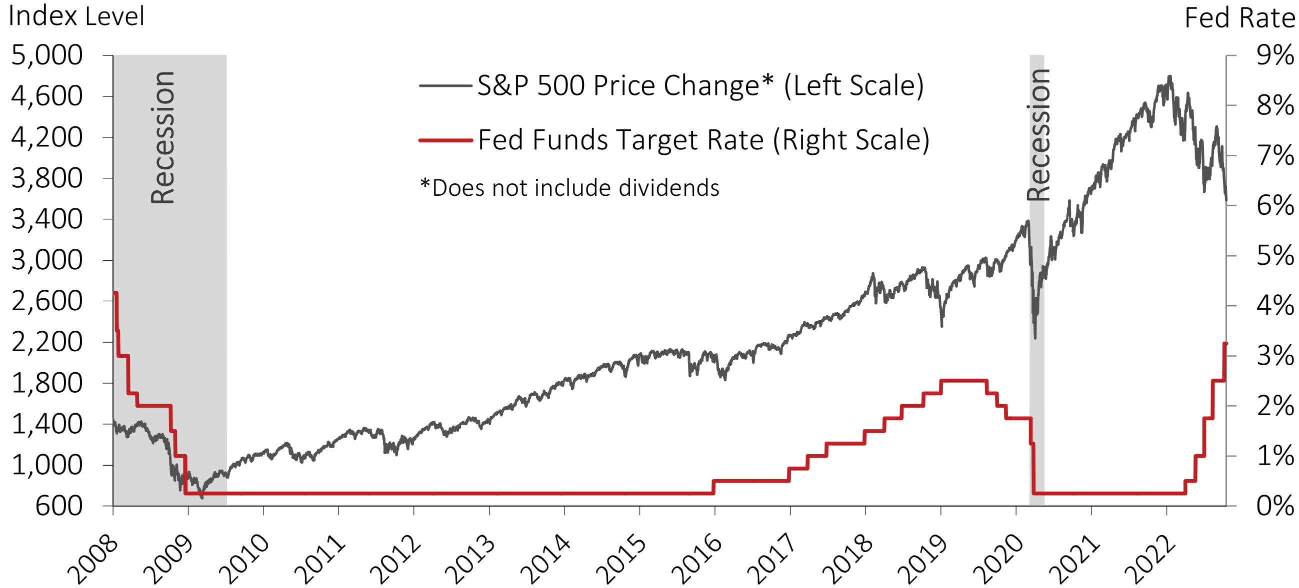
September 30, 2022

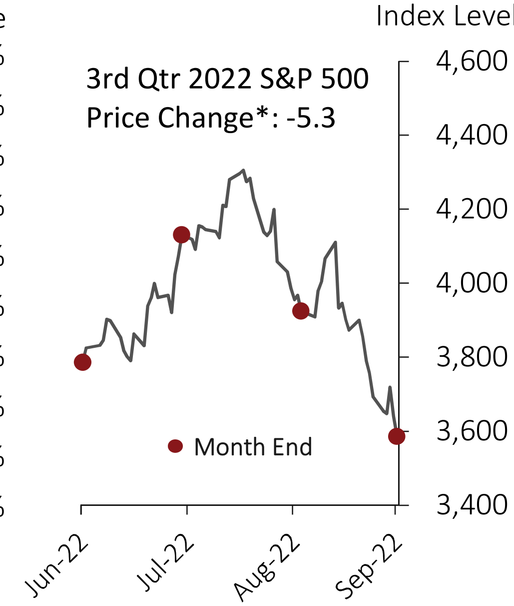



DeMarche

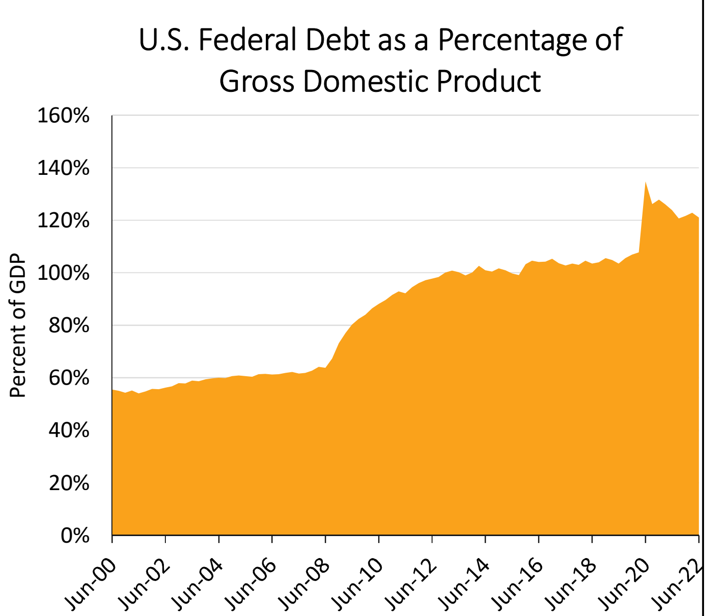
Watch the Capital Markets Review Key Takeaways Video

Persistent Price Pressures Push Policy





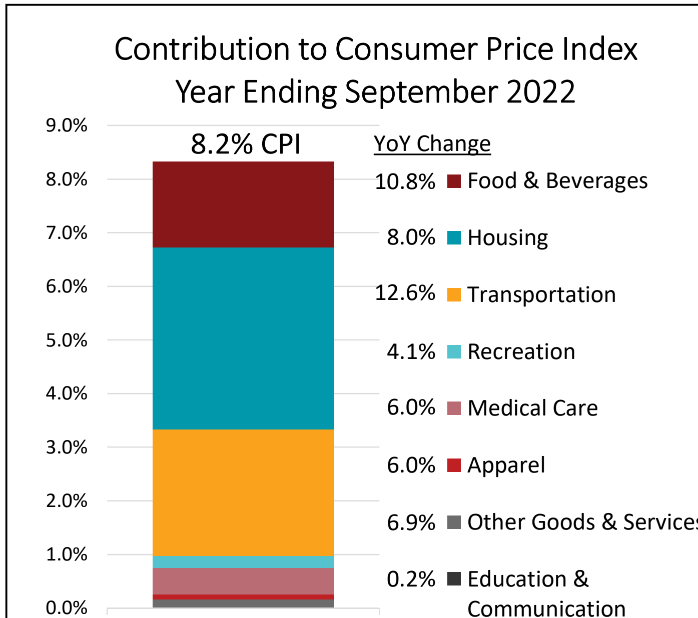
Source: Standard & Poor's, Federal Reserve



Source: St. Louis Federal Reserve (FRED)

Inflation has been the major story this year. In response the Federal Reserve has become more aggressive in raising interest rates to combat it. Higher interest rates work to curtail demand and slow the economy. So far, we have experienced a slowdown in 2022 and markets have repriced downward in response.

The dramatic increase in government expenditures fueled the high inflation. The chart to the left shows the amount of debt per GDP. The line jumps in 2020 and 2021. The chart to the right shows the inflation components that are responsible for the increase in inflation. The main culprits are prices of transportation (includes energy) and food/beverage increasing double digits over the past year.

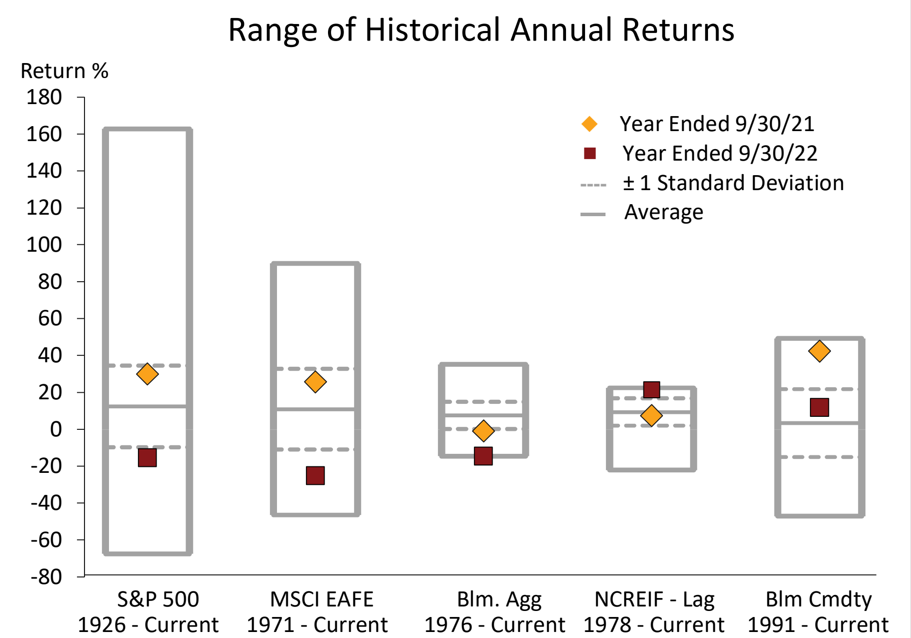


Source: Bureau of Labor Statistics, Contribution is change x weight

INDEX	3rd Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
MSCI World	-6.2	-25.4	-19.6	4.6	5.3	8.1
Russell 3000	-4.5	-24.6	-17.6	7.7	8.6	11.4
S&P 500	-4.9	-23.9	-15.5	8.2	9.2	11.7
MSCI EAFE USD	-9.4	-27.1	-25.1	-1.8	-0.8	3.7
Bloomberg Aggregate	-4.8	-14.6	-14.6	-3.3	-0.3	0.9
FTSE Non-US Gov't Bond	-10.0	-26.8	-28.3	-9.9	-5.1	-3.1
Bloomberg Global Aggregate	-6.9	-19.9	-20.4	-5.7	-2.3	-0.9
NCREIF (Private RE)	0.6	9.4	16.1	9.9	8.6	9.5
Bloomberg Commodity	-4.1	13.6	11.8	13.5	7.0	-2.1

*Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized. *Does not include Canada or Brazil.*

Indicator Year Ending 9/30	2022	2021	2020	2019	50-YEAR Average
GDP Annual Growth Rate	1.8	5.0	-2.0	2.3	2.7
Unemployment	3.5	4.7	7.8	3.5	6.2
Inflation (CPI)	8.2	5.4	1.4	1.7	4.0
10-Year Interest Rates	3.8	1.5	0.7	1.7	6.0



Source: DeMarche

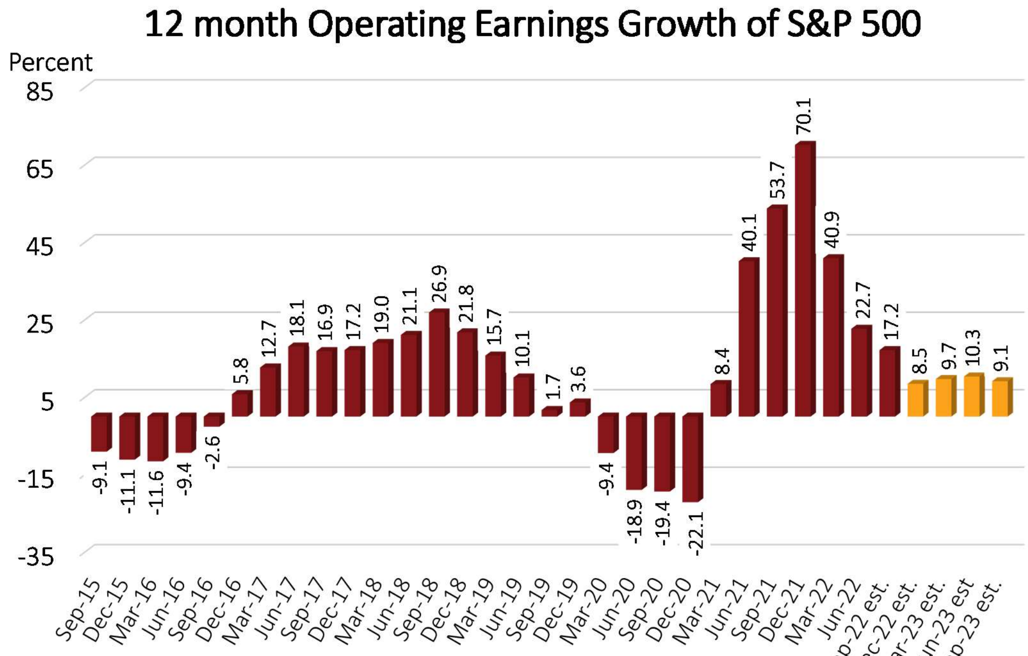
- We experienced another tough quarter and now equity markets around the globe are in bear market territory. The markets opened the quarter (July) positively, but later fell to new lows at the end of the quarter. Inflation reports in September reinforced the belief that the Federal Reserve would have to be aggressive in combatting inflation. The Fed increased interest rates 75 basis points on September 21st. The S&P 500 hit a new year-to-date low on September 30th.
- Bonds continued to provide little diversification to portfolios in the quarter, falling 4.8 percentage points, as measured by the Bloomberg Aggregate. The yield on the 10-year U.S. Treasury briefly traded above 4% late in September. As bond yields increase, it puts downward pressure on bond prices. For the last decade, bonds have earned investors less than one percent.
- The U.S. dollar strengthened and broke out of its almost decade long trading range to hit 20 year highs versus a basket of currencies. A strong dollar cuts both ways: it provides a headwind to foreign countries that have to buy commodities in dollars (e.g. oil); it makes imports into America cheaper which helps reduce domestic inflation; but it also makes U.S. exports more expensive on the global stage, potentially harming export related companies; and it hurts U.S. multinationals that have to convert foreign currency revenue into more expensive dollars.
- The chart to the left shows the range of historical annual returns for various asset classes. The past 12 months is one of the lower returns posted for global equities. Both the S&P 500 and the MSCI EAFE are over one standard deviation from the mean. The impact of rate increases on bonds is even starker as the Aggregate return is the lowest since 1976.

DeFact

The S&P 500 has moved higher in every calendar year (20 observations) following mid-term elections since 1942. The gain has averaged 20.1% with a range of 1.4% to 37.6%. By contrast, the calendar year return of the S&P 500 in the year of the mid-term elections shows positive and negative years. The average is 9.5% with seven negative returning years. ~DeMarche

INDEX	3rd Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
S&P 500	-4.9	-23.9	-15.5	8.2	9.2	11.7
S&P Mid-Cap 400	-2.5	-21.5	-15.2	6.0	5.8	10.0
S&P Small-Cap 600	-5.2	-23.2	-18.8	5.5	4.8	10.1
Russell 1000	-4.6	-24.6	-17.2	7.9	9.0	11.6
Russell 1000 Growth	-3.6	-30.7	-22.6	10.7	12.2	13.7
Russell 1000 Value	-5.6	-17.8	-11.4	4.4	5.3	9.2
Russell 2000	-2.2	-25.1	-23.5	4.3	3.6	8.6
Russell 2000 Growth	0.2	-29.3	-29.3	2.9	3.6	8.8
Russell 2000 Value	-4.6	-21.1	-17.7	4.7	2.9	7.9

Notes: Data are presented as percent returns. All 3-, 5- and 10-year returns are annualized.



Source: Standard & Poor's

- Small cap stocks outperformed large cap stocks in the quarter, a reversal to the dominance that large cap stocks have seen over the past decade. This is primarily due to small cap healthcare stocks outperforming large cap healthcare stocks. The Russell 2000 index fell 2.2% compared to 4.6% for the Russell 1000. Small cap stocks retreated about the same as large cap year-to-date.

- Small cap growth actually posted positive return in the quarter, eking out a 20 basis point return. Small cap growth, like large cap growth, bore the brunt of the interest rate increases during this year. Small cap value fell 4.6% in the quarter due to weakness in the real estate sector.

- Large cap growth stocks outperformed large value in the quarter due to relative strength of the consumer discretionary sector. Large growth has been the best sector to be invested in over the past decade due to the strong performance of the mega cap names. Those same mega cap names came down to earth a bit in the past 12 months with the exceptions of Apple and Tesla (both outperformed the index). Meta (Facebook) fell over 59% in the past 12 months and also fell out of the top 10 stocks by market cap.

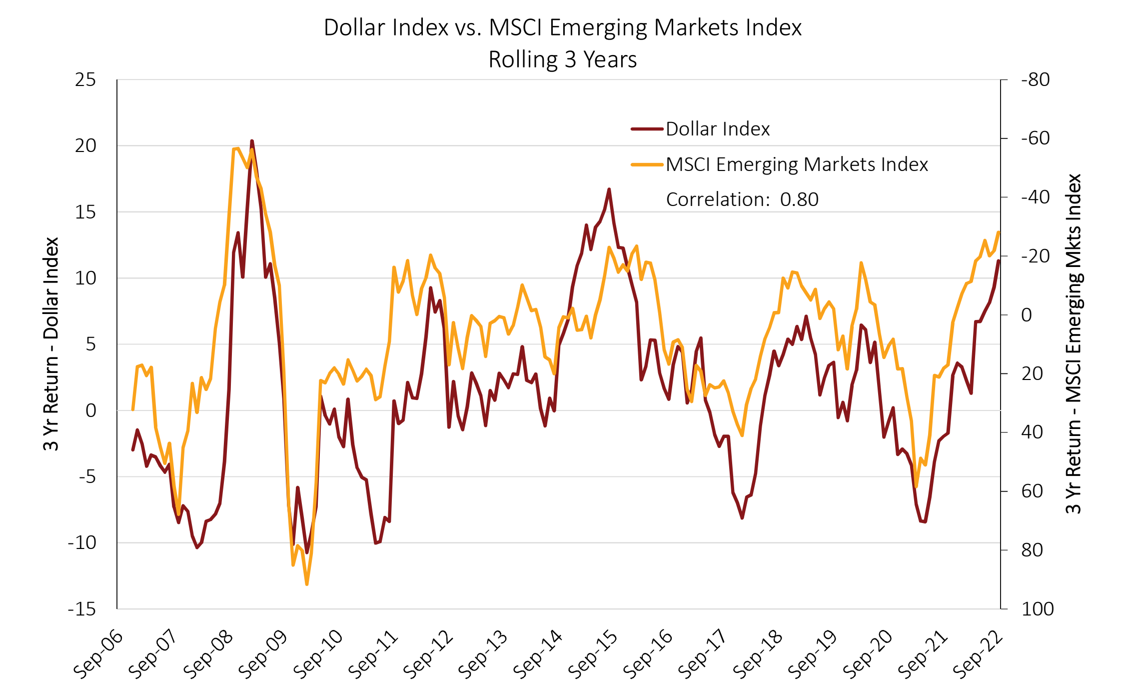
- S&P 500 earnings should be challenged by slowing growth and the U.S. potentially on the brink of a recession. Following a spectacular 2021, earnings growth has slowed in 2022. The chart to the left shows earnings growth expectations slowing to single digits. While earnings growth will be hard to come by in 2023, the drawdown in the market has set the stage for more competitive longer term performance for equities.

DeFact

The only sector in the S&P 500 that has posted positive returns year-to-date has been the energy sector. Year-to-date the sector has returned almost 35%. In fact, since Feb 2020 (just before COVID), energy has posted the best cumulative return versus all other sectors. The worst sector for the year has been communication services, retreated 39%, where Facebook (Meta) has fallen out of the top ten in S&P 500 market cap. ~JP Morgan

INDEX	3rd Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
MSCI EAFE Local	-3.6	-14.5	-11.1	2.5	2.8	7.4
MSCI EAFE USD	-9.4	-27.1	-25.1	-1.8	-0.8	3.7
Growth	-8.5	-33.0	-30.3	-1.5	0.7	4.7
Value	-10.2	-21.1	-20.2	-2.8	-2.7	2.4
MSCI Japan	-7.7	-26.4	-29.3	-2.6	-0.6	4.8
MSCI AC Asia-ex Japan	-13.8	-27.9	-28.7	-1.3	-1.2	3.0
MSCI China	-22.5	-31.2	-35.4	-7.2	-5.6	2.4
MSCI Germany	-12.6	-37.7	-37.1	-7.0	-6.7	1.3
MSCI France	-8.9	-29.1	-24.0	-1.4	-0.4	5.1
MSCI UK	-10.8	-18.7	-14.1	-1.7	-1.1	1.9
MSCI EAFE Small Cap	-9.8	-32.1	-32.1	-2.2	-1.8	5.3
MSCI EM	-11.6	-27.2	-28.1	-2.1	-1.8	1.0
MSCI All Country-ex US	-9.9	-26.5	-25.2	-1.5	-0.8	3.0

Notes: Data are presented as percent returns. All 3-, 5- and 10-year returns are annualized.



Source: Federal Reserve of St. Louis (FRED)

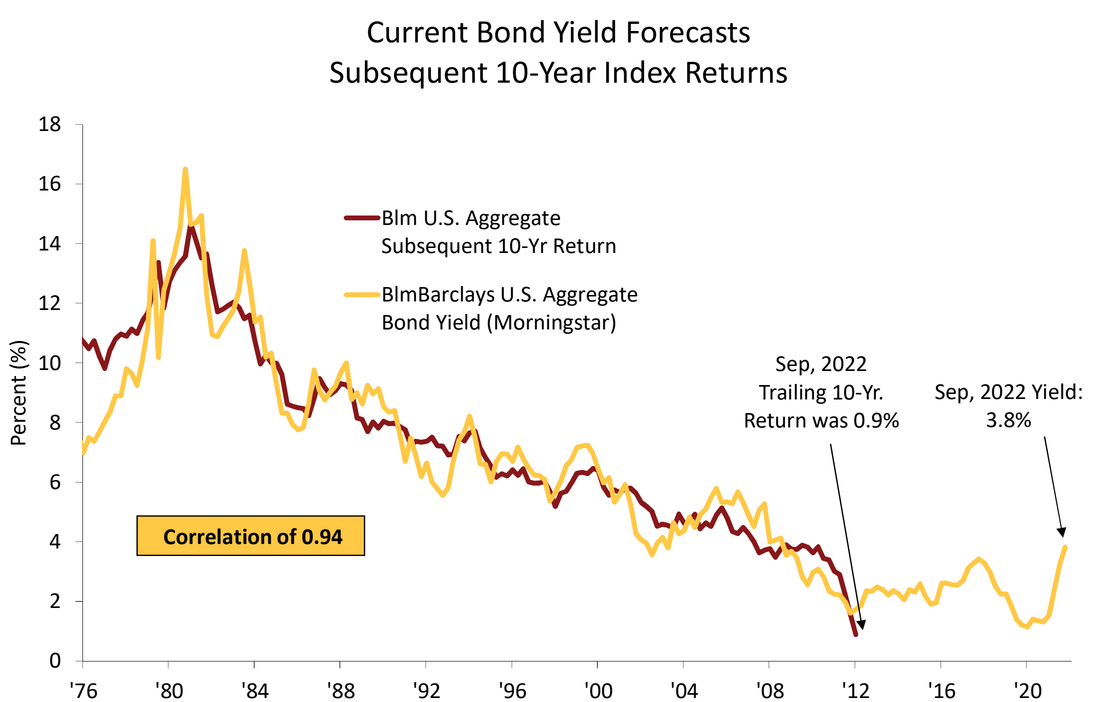
- King Dollar showed its strength this year. The return in local currency for EAFE was a negative 3.6% for the quarter, but when translated back to dollars, the return was a negative 9.4%. Over the past twelve months, the negative currency impact on the EAFE index was 14 percentage points.
- After posting good relative performance earlier this year, China resumed its downward trajectory during the 3rd quarter. Now Chinese stocks are down over 35 percentage points for the past twelve months. The yuan was not immune to King Dollar's rise. The exchange rate hit a 14 year low at 7.27 yuan to the dollar in the quarter. Couple that with aggressive COVID policies and housing market stress, and the backdrop for a weak Chinese market was set.
- Mirroring the U.S., international small cap stocks bore the brunt of the market's fear of an economic slowdown compared to large cap stocks over the past year. Industrials make up the largest weight in the index and are negatively impacted by an expected slowdown in economic growth.
- As we already mentioned, dollar movements provides tailwinds or headwinds to international returns. As the chart to the left shows, when the dollar strengthens (red line moves up), the return of international stocks, in this case emerging market stocks, retreats (yellow line, inverted). The correlation over the past 20 years shows an 80% correlation of dollar strength/weakness and international returns.

DeFact

The emerging market index constituent weights changed significantly in just one quarter. China used to have a weight of 35.1% as of June 2022; it is now 30.8%. India, due to the strong relative performance of its equity market, jumped from third place at 12.6% to second place at 15.1% at the end of September. In the third quarter, Indian stocks posted positive returns. ~Blackrock, JP Morgan

INDEX	3rd Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
Bloomberg 1-3 Gov Credit	-1.5	-4.5	-5.1	-0.4	0.7	0.8
Bloomberg Aggregate	-4.8	-14.6	-14.6	-3.3	-0.3	0.9
Bloomberg Gov Credit Long	-9.0	-28.9	-27.4	-7.3	-1.2	1.4
Bloomberg US TIPS	-5.1	-13.6	-11.6	0.8	2.0	1.0
ICE BofA Merrill Lynch High Yield	-0.7	-14.6	-14.0	-0.7	1.4	3.9
CSFB Leveraged Loan (bank loans)	1.2	-3.3	-2.6	2.1	3.0	3.7
Bloomberg Global Aggregate	-6.9	-19.9	-20.4	-5.7	-2.3	-0.9
JPM EmgMkt Bd Glbl Dvrsfd (hard)	-4.6	-23.9	-24.3	-7.2	-2.6	1.1

Notes: Data are presented as percent returns. All 3-, 5- and 10-year returns are annualized.



Source: DeMarche, Morningstar

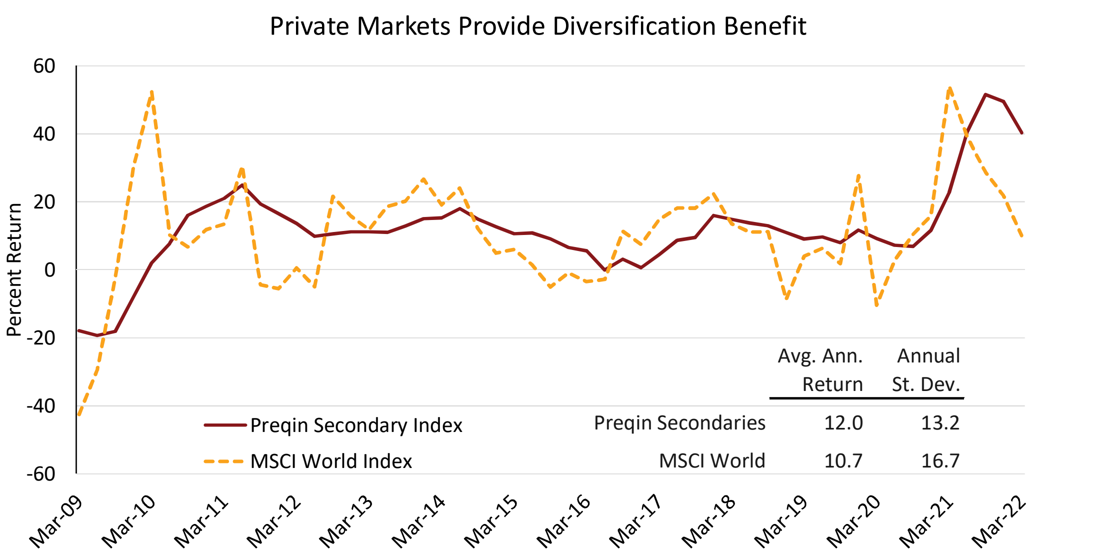
- In the quarter, interest rates increased again and bond prices fell. As of this printing, the futures market expects the Fed to increase the Fed Funds rate to about 4.25% by the end of the year. The current rate upper limit is 3.25% at the end of September. The Fed has increased rates 75 basis points at each of the last two meetings.
- Lower credit quality sectors such as bank loans and high yield have performed reasonably well against the Aggregate. Both sectors are shorter in duration and have higher yields than the Aggregate, which felt downward price pressure from increasing rates. Both sectors have yet to see dramatic credit spread widening to Treasuries this year, which signals that while an economic slowdown is here, an earnings recession is still a ways off – if it even happens at all.
- While it is painful to go through, the repricing of interest rates provides a chance for investors to make more rational risk/reward decisions when determining asset allocation policies. Bond yields have moved upward and with it the yields on the broad index. The yield on the Aggregate is now 3.8%. As the chart to the left shows, the yield is highly correlated to the return an investor can achieve over the next decade. We haven't seen yields this high in over a decade.

DeFact

The rout in fixed income was not just a domestic phenomenon. Global bond markets have suffered unprecedented losses in 2022, with the Bloomberg Global Aggregate Bond index (unhedged) down almost 15% from its high in January 2021. To put this into context, global fixed income investors have not endured a rout like this since official data began in 1990. ~T Rowe

INDEX	3rd Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
NCREIF Property (Private RE)	0.6	9.4	16.1	9.9	8.6	9.5
Apartment	1.2	10.6	18.2	11.1	9.0	9.2
Industrial	1.1	18.8	34.6	25.2	20.6	16.7
Office	-0.7	1.5	3.2	3.6	4.8	7.0
Retail	0.4	4.4	6.7	0.2	1.2	6.2
NCREIF Timberland	2.4	7.7	12.6	5.8	4.7	5.9
NCREIF Farmland	2.0	6.2	10.2	6.5	6.3	9.5
NAREIT (Public RE)*	-11.2	-28.4	-17.4	-1.7	3.5	6.6
Bloomberg Commodity	-4.1	13.6	11.8	13.5	7.0	-2.1
HFR FOF Composite	-0.7	-7.2	-6.8	4.0	3.0	3.4
Conservative	0.2	-1.4	-0.7	4.7	3.8	3.6
Diversified	-0.2	-4.9	-4.6	4.6	3.5	3.6
Strategic	-1.9	-14.2	-13.7	3.0	2.0	3.3
Private Market Indexes as of 3/31/2022	Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
Preqin Private Equity	0.1	25.1	25.1	24.6	20.4	16.6
Preqin Private Debt	1.3	16.2	16.2	10.7	9.3	9.5
Preqin Infrastructure	5.9	20.9	20.9	12.6	11.7	11.0

Notes: Data are presented as percent returns. All 3-, 5- and 10-year returns are annualized.
**Public RE is not a less liquid strategy. It is listed for comparative purposes.*



Source: Preqin, DeMarche

- Commodity price movements often foreshadow inflation as commodities are inputs into the price of goods and services. Commodity prices fell in the past two quarters, primarily due to relief in crude oil and industrial metals prices. Over the past years, energy (oil and natural gas) were major contributors to the increase in commodity prices as together, they make up about 28% of the Bloomberg Commodity index.
- Real estate continues to be a diversifier to portfolios this year and is proving to be a good inflation hedge. As we continue to see, industrial sector of real estate has posted strong one year and longer term returns.
- Hedge funds over the past year have provided some downside protection to stock and bond portfolios. Hedge funds with a strategic bias performed the worst due to the directional aspect of the investment strategies they employ. The most conservative oriented strategies have performed the best.
- The chart to the left shows how private assets can provide diversification and return to portfolios, especially very volatile markets. In this case, we look at private equity secondaries and compare to global equities. The lines move roughly in the same direction over time but the secondaries line standard deviation is less with a higher return. We continue to advocate for private assets within portfolios.

DeFact

Demand for lithium is expected to outpace global supply as consumers switch to battery-powered vehicles. Currently supply and demand are balanced at about 550,000 metric tons per year. Demand is expected to grow to over 1 million metric tons by 2025 and over two million metric tons by 2030. It takes 4 to 7 years to build a lithium mine and 2 years to build a battery plant according to Simon Moores, an industry analyst. ~WSJ

39th Annual DeMarche Client and Investor Conference

September 21, 2022 – September 23, 2022

Conference Summary

Session I - *Inflation, Recession, Stagflation?*

1. Strategic Horizon
2. Macro Outlook and Asset Allocation
3. Why Farmland, why now?
4. Rising Interest Rate Environment
5. A Case for Bank Loans

Session II - *Finding Opportunities in Alternatives*

1. Illiquidity Premium
2. Direct Lending
3. Secondary Investing
4. Commodities as a Strategic Investment
5. Real Estate Debt

Session III - *Back to Basics: Traditional Assets Role*

1. Framing SRI and ESG Investment Policies
2. A Case for Traditional Assets
3. Is Value Back?
4. A Case for Emerging Markets
5. Global Market Perspectives
6. DC Plans – Retirement Income

Key Takeaways

- Stay invested
- Invest globally as opportunities arise
- Rebalance with discipline
- Buy undervalued assets that don't dominate indexes
- Consider allocation to private assets as liquidity allows
- Own inflation protection when cheap as a hedge
  - Real Assets, TIPs, Infrastructure, Real Estate