Q2

Quarterly Market Review

Second Quarter 2023

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Quarterly Market Review

Second quarter 2023

This report features world capital market performance and a timeline of events for the past quarter. It begins with a quarterly topic, followed by a global overview. It then features the returns of stock and bond asset classes in the US and international markets.

Overview:

Then and Now: An Update on Today’s Bond Market

Think back to this time last year. Inflation was soaring to a 40-year high of 9.1%. The Federal Reserve (Fed) had just made its third-consecutive rate hike, raising the federal funds rate by 0.75% for the first time in more than 25 years. The S&P 500® Index was down just shy of 20% — the index’s worst 6-month start to a year since 1970.

At the same time, the U.S. bond market, measured by the Bloomberg U.S. Aggregate Bond Index, was down more than 10%. Calls for an impending recession were a dime a dozen. Put simply, these were tough times for many investors’ portfolios.

Oh, how times have changed. The market and economic statistics in **Figure 1** help paint the picture. The stock and bond markets have turned around. Inflation has cooled. Some inflation measures using 12-month averages may even overstate current inflation given the rate of price increases have been coming down recently. An estimate of annualized inflation based on the most recent quarter from the Federal Reserve Bank of Cleveland puts current Consumer Price Index (CPI) at 3%, nearing the Fed’s 2% target. Economic growth also appears strong. And while the Fed has been clear that more rate hikes may come this year, there are many signs that the period of rising rates, or at least significantly rising rates, may be ending.

So, what are bond investors to make of this? We offer a few considerations for allocating to bonds in today’s market.

Figure 1 | How Times Have Changed

	June 30, 2022	June 30, 2023
S&P 500 Index Trailing 6-Month Return (%)	-19.96	16.89
Bloomberg US Aggregate Bond Index Trailing 6-Month Return (%)	-10.35	2.09
Consumer Price Index Annual Change (%)	9.1	4.0
GDP Growth Trailing Quarter (%)	-0.6	2.2[1]
Federal Funds Rate Upper Limit (%)	1.75	5.25
Last Fed Rate Decision	+0.75	Pause

Data as of 6/30/2022 and 6/30/2023. Source: Bloomberg, Federal Reserve Board of Governers (FRED), U.S. Bureau of Labor Statistics, Bureau of Economic Analysis, and Federal Reserve Bank of Atlanta GDPNow.
[1] Estimate from Federal Reserve Bank of Atlanta GDPNow.

A Note for Inflation-Sensitive Investors

While the rate of inflation has been declining, prices have continued to rise. This has an impact on future consumption that can be meaningful for some investors. The upside to consider, however, is that lower inflation expectations today mean generally lower costs to buy inflation insurance. As an example, equities with a higher link to inflation, which can help mitigate inflation risk, trade as value stocks today with higher-than-market expected returns.

1. Laura Saunders, “Your Child Picked a College! Tee Up Your 529 Plan,” Wall Street Journal, May 5, 2023.
2. In US dollars. Based on S&P 500 Index annual returns, 1926–2022. S&P data © 2023 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

Then and Now: An Update on Today's Bond Market

Risk-Free Might not Be Without Risk

U.S. Treasury bonds are typically considered risk-free investments. **Figure 2** shows the current U.S. Treasury yield curve — a plot of interest rates across Treasuries maturing at different periods — compared to a year ago. We can see that:

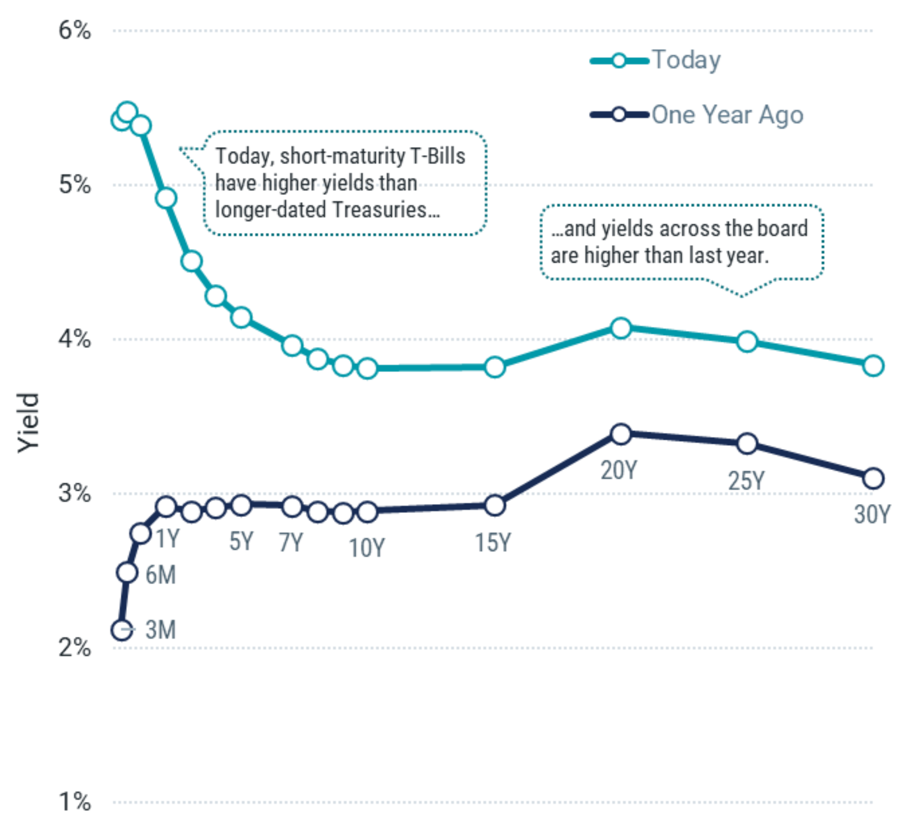
1. Across the board, yields are higher today than before.
2. Investors can earn much higher yields at very short maturities (e.g., Treasuries maturing in three months) versus longer maturities (e.g., Treasuries maturing in 10 or 20 years).

One potential takeaway is to see short-term Treasuries (T-Bills) as a solid investment with a yield of more than 5% and the backing of the U.S. government. In addition, the prices of shorter-term, lower-duration bonds generally don't fluctuate meaningfully as rates rise. So, why not allocate one's bond portfolio exclusively to T-Bills? Or maybe all of one's portfolio to avoid the potential volatility of stocks?

There are a few considerations. First, the goal of the portfolio matters. T-Bills may be better suited for investors seeking extreme stability within their portfolio than for investors aiming for growth (more to come on this). Second, investors must contemplate reinvestment risk. If rates fall before these short-term bonds mature, buying new bonds may not produce the same level of return that an investor could lock in for longer with an intermediate bond today.

It may also mean forgoing the potential price appreciation from falling bond yields that longer-duration bonds may realize (bond prices rise as rates fall). These are important considerations for investors who do not need portfolios with high stability but have chosen to shorten the duration of their fixed-income allocations.

Figure 2 | The Treasury Curve Looks Different Today Than a Year Ago



Then and Now: An Update on Today's Bond Market

Looking Beyond U.S. Treasuries Can Make a Difference

What are the options for investors seeking moderate or more aggressive growth? In a word, diversification. Looking beyond Treasuries may provide diversification across issuers, the opportunity to increase yield, and greater potential for price appreciation if rates fall.

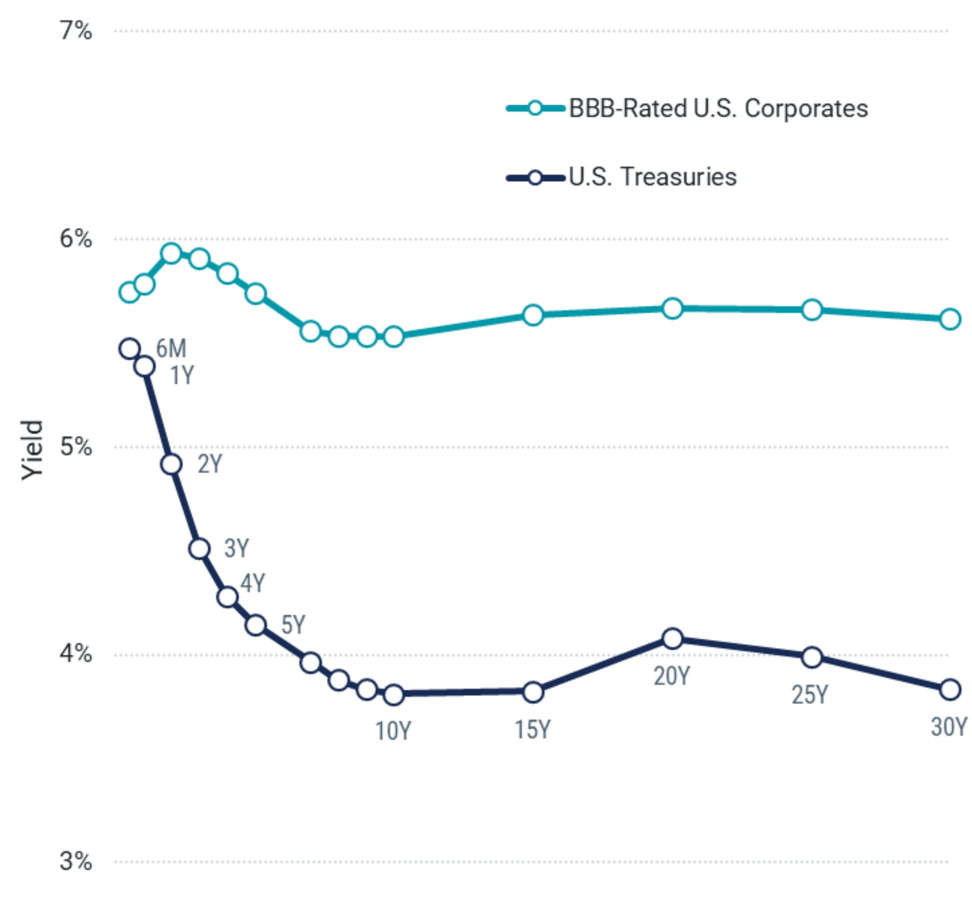
We present a current example in **Figure 3** by comparing the BBB-rated U.S. corporate bond yield curve with the U.S. Treasury yield curve. Two things stand out.

- BBB corporates offer higher yields than Treasuries across all maturities, reflecting in part differences in credit risk (more to come on this, too).
- Unlike the sharply inverted Treasury curve, the BBB corporate curve is relatively flat.

As a result, investors can earn higher yields on longer-dated BBB corporates than Treasuries of the same maturity. This provides an opportunity to increase duration and lock in higher rates for longer than could be achieved today if the opportunity set were only Treasuries.

This doesn't mean investors have to choose one or the other. Various mixes of bonds across multiple yield curves can offer both the potential benefits of issuer diversification as well as opportunities to address different investor goals (e.g., different aggregate duration profiles).

Figure 3 | Corporate Bonds Can Offer Opportunities for Higher Yields for Longer



Data as of 6/30/2023. Source: Bloomberg.

Diversification does not assure a profit, nor does it protect against loss of principal.

Then and Now: An Update on Today's Bond Market

To offer a little more context on the role of corporate bonds in fixed-income allocations designed for growth, consider the long-term returns of U.S. corporate bonds versus T-Bills and the broader U.S. Treasury market shown in **Figure 4**.

And, while corporate bonds are expected to carry higher risk of default than Treasuries, it's important to recognize that default rates have historically been low among investment-grade corporate bonds (those rated AAA to BBB). Default rates have been higher among high-yield bonds (those rated BB and below). See **Figure 5**.

As with any investment, considering diversification levels of the strategy and how bonds are selected and weighted within the portfolio can have a meaningful impact on its expected performance. We believe strategies should look beyond just stated credit ratings and the level of outstanding debt an issuer has (as many indexes do).

Figure 4 | Corporate Bonds Have Historically Outperformed Treasuries
Cumulative total return from 6/30/1997-6/30/2023

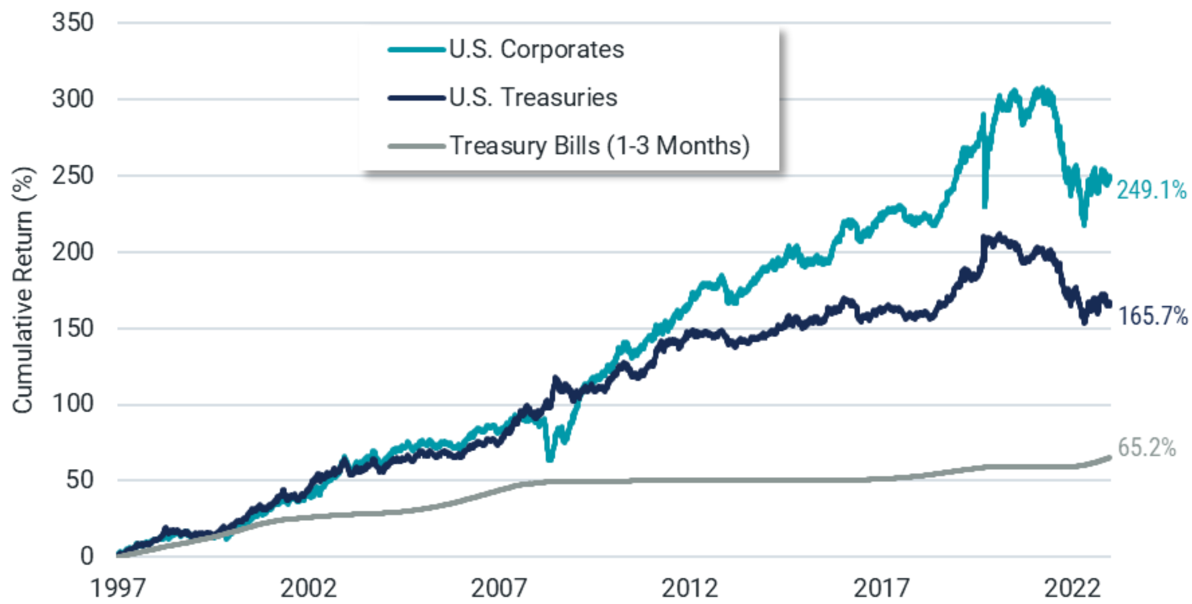


Figure 5 | Investment Grade Bonds Have Historically Had Low Default Rates

	Investment Grade				High Yield		
	AAA	AA	A	BBB	BB	B	CCC/C
Annual Average Default Rate (%)	0.00	0.01	0.05	0.19	0.86	4.19	24.92
Annual Maximum Default Rate (%)	0.42				11.05		

Figure 4: Data from 6/30/1997 - 6/30/2023. Source: Morningstar. U.S. Corporates, U.S. Treasuries and Treasury Bills (1-3 Months) are represented by the Bloomberg U.S. Corporate Bond Index, the Bloomberg U.S. Treasury Index and the Bloomberg U.S. 1-3 Month Treasury Bill Index, respectively.

Figure 5: Data from 1981 – 2020. Source: S&P Global Ratings Research and S&P Global Market Intelligence's CreditPro®. Default rate refers to the percentage of bond issuers that fail to make timely interest payments or repay the principal amount as per the terms of the bond agreement. See Glossary for definitions of Credit Ratings and Credit Quality.

Then and Now: An Update on Today's Bond Market

Trying to Time Rate Cuts from the Fed May Fall Flat

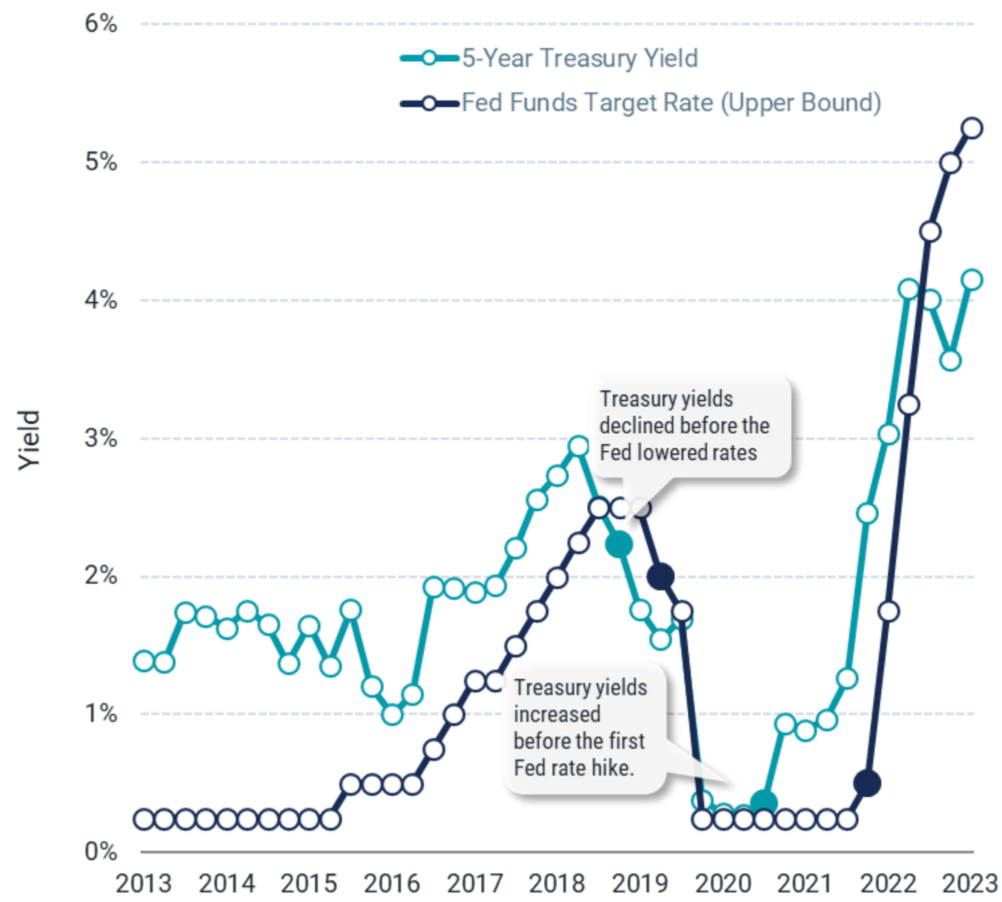
Finally, we think investors should consider that attempting to precisely time interest-rate changes is, at best, a difficult game to play. Consider bond investors who shortened duration when the Fed was raising rates intending to extend duration once the Fed changed course. The challenge is that the market is forward-looking, and bond prices generally reflect expectations of the market each day.

We see evidence of this in **Figure 6**, which shows changes in the federal funds rate and the five-year Treasury yield. The Treasury yield (teal line) fell in 2018, and the Fed subsequently lowered rates in 2019 (dark blue line). Similarly, the Treasury yield began climbing in 2021, and the federal funds rate followed suit in 2022.

The takeaway is that attempting to benefit from increasing duration in one's fixed income portfolio after a Fed decision to lower rates may result in missing the boat. The market typically leads these types of announcements.

We believe a better course of action for investors is to allocate to a mix of bonds at a duration and level of credit quality that makes sense for their long-term goals and make small adjustments as goals and circumstances change. For investors who have shortened duration in the face of uncertain markets or perceived opportunities that have arisen from aggressive Fed action, we think it's worth considering whether the allocation they have today fits their goals for tomorrow.

Figure 6 | Bond Yields Have Typically Moved Ahead of Rate Changes from the Fed



Data from 6/30/2013 – 6/30/2023. Source: Bloomberg.

Quarterly Market Summary

Index returns

Q2 2023	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
	STOCKS				BONDS	
	8.39%	3.03%	0.90%	0.71%	-0.84%	0.73%
Since Jan. 2001						
Average Quarterly Return	2.3%	1.5%	2.5%	2.2%	0.9%	0.9%
Best Quarter	22.0%	25.9%	34.7%	32.3%	4.6%	4.6%
	2020 Q2	**2009 Q2**	**2009 Q2**	**2009 Q3**	**2001 Q3**	**2008 Q4**
Worst Quarter	-22.8%	-23.3%	-27.6%	-36.1%	-5.9%	-4.1%
	2008 Q4	**2020 Q1**	**2008 Q4**	**2008 Q4**	**2022 Q1**	**2022 Q1**

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.
Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net dividends]), Emerging Markets (MSCI Emerging Markets Index [net dividends]), Global Real Estate (S&P Global REIT Index [net dividends]), US Bond Market (Bloomberg US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Global Aggregate ex-USD Bond Index [hedged to USD]). Bloomberg data provided by Bloomberg.

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Long-Term Market Summary

Index returns as of June 30, 2023

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
1 Year	STOCKS				BONDS	
	18.95%	17.41%	1.75%	-3.02%	-0.94%	1.51%
5 Years						
	11.39%	4.58%	0.93%	1.35%	0.77%	0.95%
10 Years						
	12.34%	5.40%	2.95%	3.80%	1.52%	2.48%

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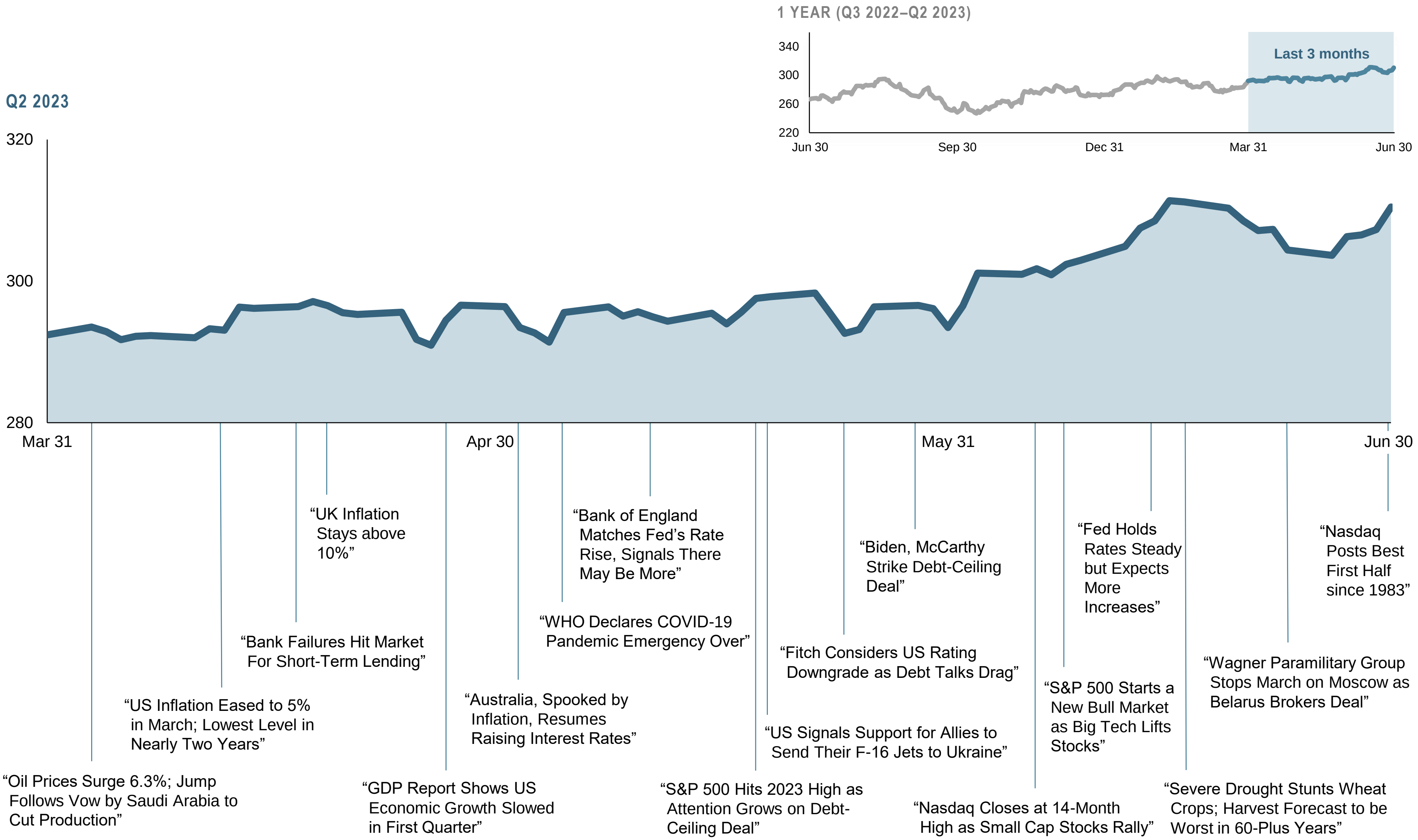
World Stock Market Performance

MSCI All Country World Index with selected headlines from Q2 2023

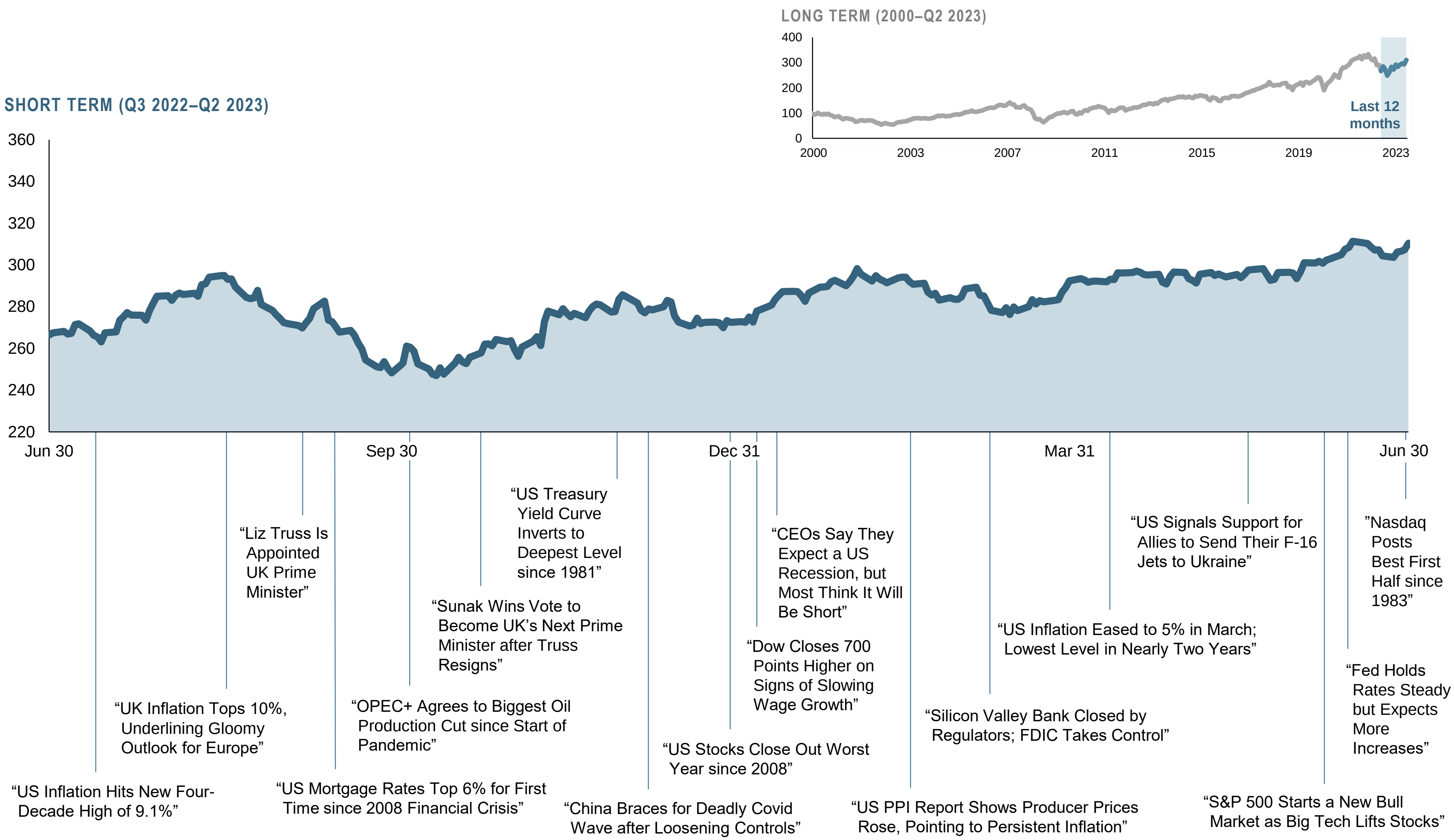


These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Graph Source: MSCI ACWI Index (net dividends). MSCI data © MSCI 2023, all rights reserved. Index level based at 100 starting January 2000.
It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. **Past performance is not a guarantee of future results.**

World Stock Market Performance

MSCI All Country World Index with selected headlines from past 12 months



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Graph Source: MSCI ACWI Index (net dividends). MSCI data © MSCI 2023, all rights reserved. Index level based at 100 starting January 2000.
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US Stocks

Second quarter 2023 index returns

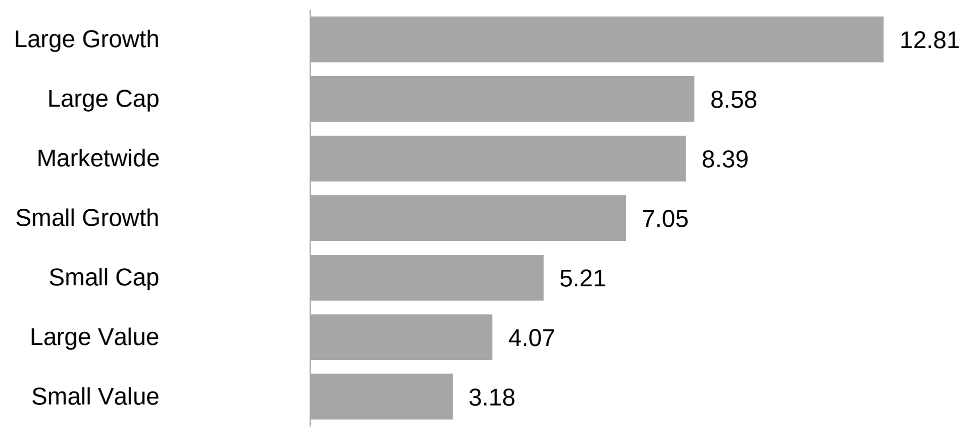
The US equity market posted positive returns for the quarter and outperformed both non-US developed and emerging markets.

Value underperformed growth.

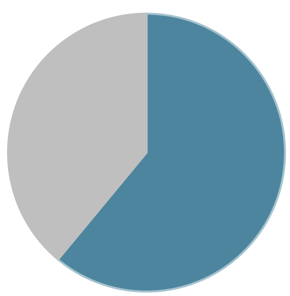
Small caps underperformed large caps.

REIT indices underperformed equity market indices.

Ranked Returns (%)



World Market Capitalization—US



Period Returns (%)

				Annualized		
Asset Class	QTR	YTD	1 Year	3 Years	5 Years	10 Years
Large Growth	12.81	29.02	27.11	13.73	15.14	15.74
Large Cap	8.58	16.68	19.36	14.09	11.92	12.64
Marketwide	8.39	16.17	18.95	13.89	11.39	12.34
Small Growth	7.05	13.55	18.53	6.10	4.22	8.83
Small Cap	5.21	8.09	12.31	10.82	4.21	8.26
Large Value	4.07	5.12	11.54	14.30	8.11	9.22
Small Value	3.18	2.50	6.01	15.43	3.54	7.29

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Market segment (index representation) as follows: Marketwide (Russell 3000 Index), Large Cap (Russell 1000 Index), Large Value (Russell 1000 Value Index), Large Growth (Russell 1000 Growth Index), Small Cap (Russell 2000 Index), Small Value (Russell 2000 Value Index), and Small Growth (Russell 2000 Growth Index). World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. Russell 3000 Index is used as the proxy for the US market. Dow Jones US Select REIT Index used as proxy for the US REIT market.

International Developed Stocks

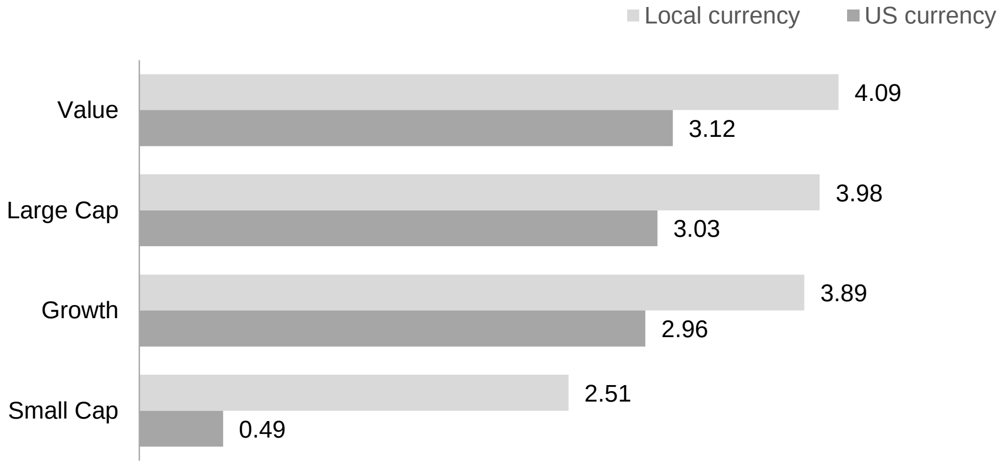
Second quarter 2023 index returns

Developed markets outside of the US posted positive returns for the quarter and underperformed the US market, but outperformed emerging markets.

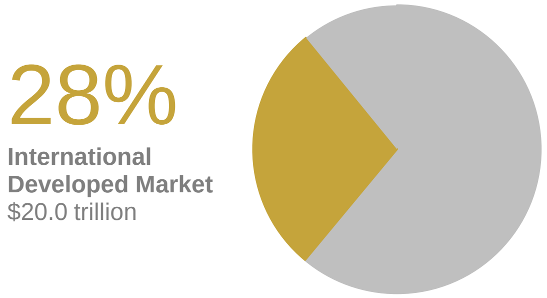
Value outperformed growth.

Small caps underperformed large caps.

Ranked Returns (%)



World Market Capitalization—International Developed



Period Returns (%)

				Annualized		
Asset Class	QTR	YTD	1 Year	3 Years	5 Years	10 Years
Value	3.12	8.92	15.49	12.07	3.24	4.25
Large Cap	3.03	11.29	17.41	9.30	4.58	5.40
Growth	2.96	13.76	19.40	6.24	5.46	6.28
Small Cap	0.49	5.50	10.05	6.42	1.83	5.97

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Market segment (index representation) as follows: Large Cap (MSCI World ex USA Index), Small Cap (MSCI World ex USA Small Cap Index), Value (MSCI World ex USA Value Index), and Growth (MSCI World ex USA Growth Index). All index returns are net of withholding tax on dividends. World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. MSCI World ex USA IMI Index is used as the proxy for the International Developed market.

Emerging Markets Stocks

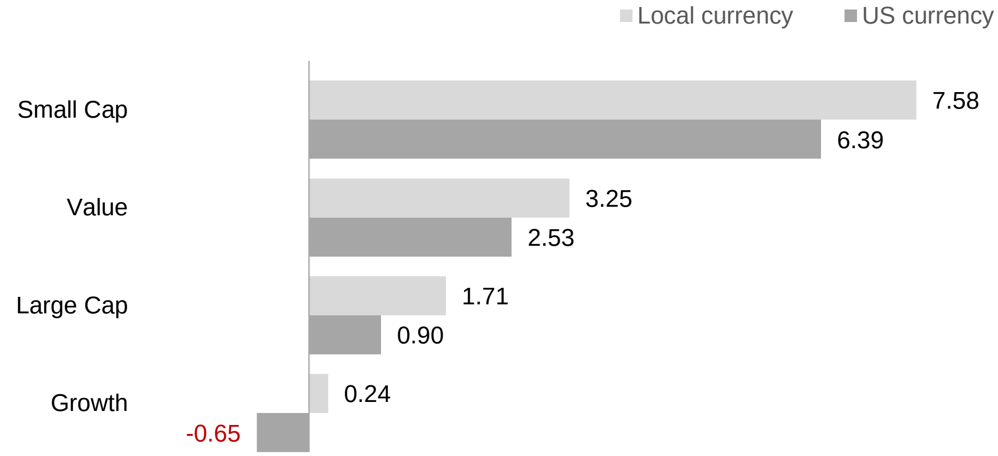
Second quarter 2023 index returns

Emerging markets posted positive returns for the quarter and underperformed both US and non-US developed markets.

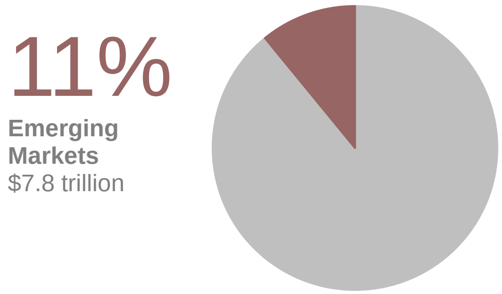
Value outperformed growth.

Small caps outperformed large caps.

Ranked Returns (%)



World Market Capitalization—Emerging Markets



Period Returns (%)

				Annualized		
Asset Class	QTR	YTD	1 Year	3 Years	5 Years	10 Years
Small Cap	6.39	10.50	13.28	13.72	4.93	4.63
Value	2.53	6.53	4.13	6.27	1.22	1.99
Large Cap	0.90	4.89	1.75	2.32	0.93	2.95
Growth	-0.65	3.32	-0.45	-1.36	0.53	3.79

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Market segment (index representation) as follows: Large Cap (MSCI Emerging Markets Index), Small Cap (MSCI Emerging Markets Small Cap Index), Value (MSCI Emerging Markets Value Index), and Growth (MSCI Emerging Markets Growth Index). All index returns are net of withholding tax on dividends. World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. MSCI Emerging Markets IMI Index used as the proxy for the emerging market portion of the market.

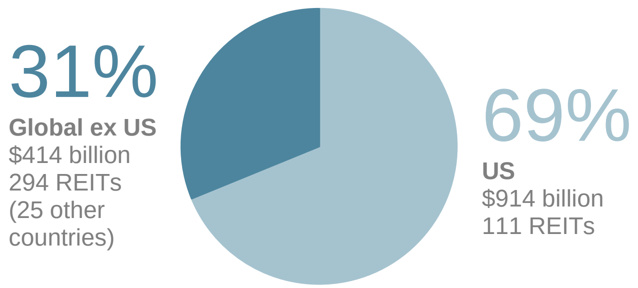
Real Estate Investment Trusts (REITs)

Second quarter 2023 index returns

US real estate investment trusts outperformed non-US REITs during the quarter.

Ranked Returns (%)

Total Value of REIT Stocks



Period Returns (%)

				Annualized		
Asset Class	QTR	YTD	1 Year	3 Years	5 Years	10 Years
US REITS	2.92	5.77	-0.69	9.17	3.28	5.75
Global ex US REITS	-2.98	-3.85	-7.02	0.31	-2.61	1.36

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.
Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Total value of REIT stocks represented by Dow Jones US Select REIT Index and the S&P Global ex US REIT Index. Dow Jones US Select REIT Index used as proxy for the US market, and S&P Global ex US REIT Index used as proxy for the World ex US market. Dow Jones and S&P data

Fixed Income

Second quarter 2023 index returns

Interest rates increased across all bond maturities in the US Treasury market for the quarter.

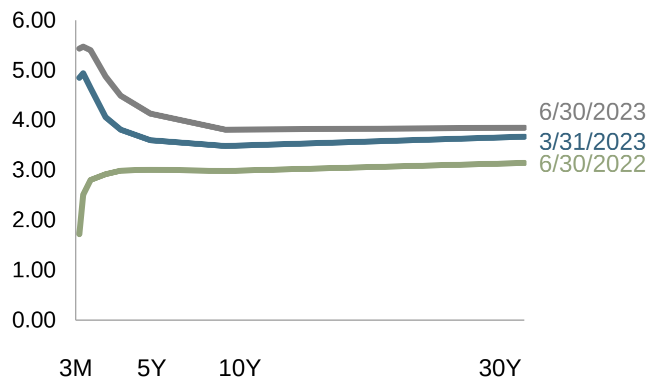
On the short end of the yield curve, the 1-Month US Treasury Bill yield increased 50 basis points (bps) to 5.24%, while the 1-Year US Treasury Bill yield increased 76 bps to 5.40%. The yield on the 2-Year US Treasury Note increased 81 bps to 4.87%.

The yield on the 5-Year US Treasury Note increased 53 bps to 4.13%. The yield on the 10-Year US Treasury Note increased 33 bps to 3.81%. The yield on the 30-Year US Treasury Bond increased 18 bps to 3.85%.

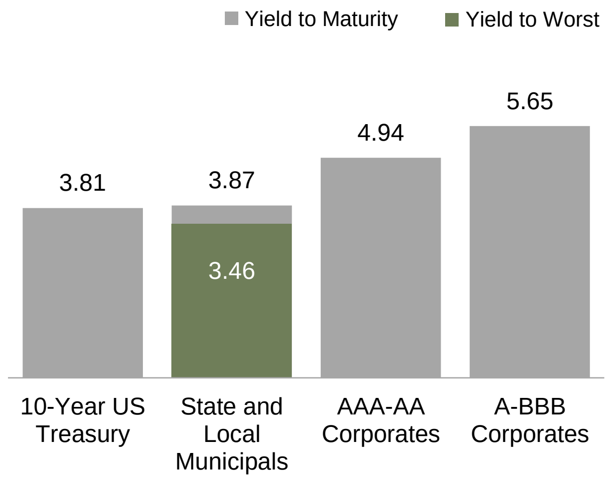
In terms of total returns, short-term US treasury bonds returned -0.90% while intermediate-term US treasury bonds returned -1.15%. Short-term corporate bonds returned +0.07% and intermediate-term corporate bonds returned -0.16%.[1]

The total returns for short- and intermediate-term municipal bonds were -0.37% and -0.72%, respectively. Within the municipal fixed income market, general obligation bonds returned -0.41% while revenue bonds returned +0.04%.[2]

US Treasury Yield Curve (%)



Bond Yield Across Issuers (%)



Period Returns (%)

				Annualized		
Asset Class	QTR	YTD	1 Year	3 Years	5 Years	10 Years
Bloomberg U.S. High Yield Corporate Bond Index	1.75	5.38	9.06	3.13	3.36	4.43
ICE BofA US 3-Month Treasury Bill Index	1.17	2.25	3.59	1.27	1.55	0.98
ICE BofA 1-Year US Treasury Note Index	0.42	1.67	1.93	0.23	1.30	0.89
Bloomberg Municipal Bond Index	-0.10	2.67	3.19	-0.58	1.84	2.68
FTSE World Government Bond Index 1-5 Years (hedged to USD)	-0.27	1.53	0.28	-1.15	0.95	1.14
Bloomberg U.S. Aggregate Bond Index	-0.84	2.09	-0.94	-3.96	0.77	1.52
FTSE World Government Bond Index 1-5 Years	-1.19	0.87	-0.27	-2.84	-0.77	-0.67
Bloomberg U.S. TIPS Index	-1.42	1.87	-1.40	-0.12	2.49	2.08
Bloomberg U.S. Government Bond Index Long	-2.29	3.73	-6.79	-12.02	-0.88	1.81

1. Bloomberg US Treasury and US Corporate Bond Indices.
2. Bloomberg Municipal Bond Index.

One basis point (bps) equals 0.01%. **Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.** Yield curve data from Federal Reserve. State and local bonds and the Yield to Worst are from the S&P National AMT-Free Municipal Bond Index. AAA-AA Corporates represent the ICE BofA US Corporates, AA-AAA rated. A-BBB Corporates represent the ICE BofA Corporates, BBB-A rated. Bloomberg data provided by Bloomberg. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield). Bloomberg data provided by Bloomberg.

Global Fixed Income

Second quarter 2023 yield curves

With the exception of Japan, interest rates generally increased across global developed markets for the quarter.

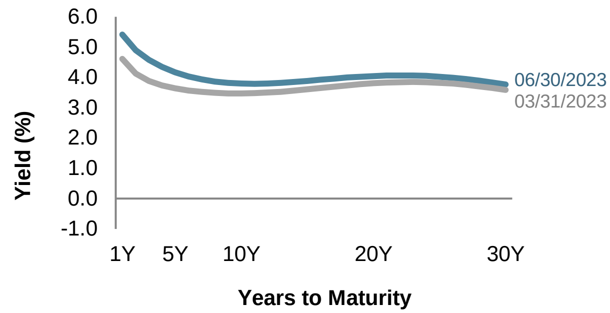
Realized term premiums were broadly negative across global developed markets.

In Japan, ultrashort-term nominal interest rates were negative. In the UK, Germany, Canada, and Australia, the short-term segment of the yield curve was inverted.

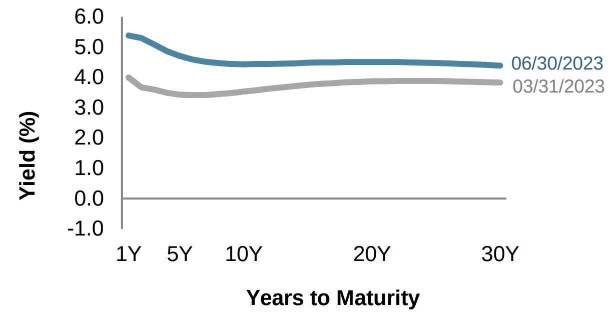
Changes in Yields (bps) since 03/31/2023

	1Y	5Y	10Y	20Y	30Y
US	79.6	53.1	32.5	23.9	18.1
UK	138.7	127.0	90.6	64.2	56.6
Germany	54.3	22.2	9.4	4.0	3.8
Japan	-1.0	-3.0	-1.8	-3.3	-1.3
Canada	72.1	63.3	36.3	8.9	6.1
Australia	118.9	92.6	72.3	57.1	54.9

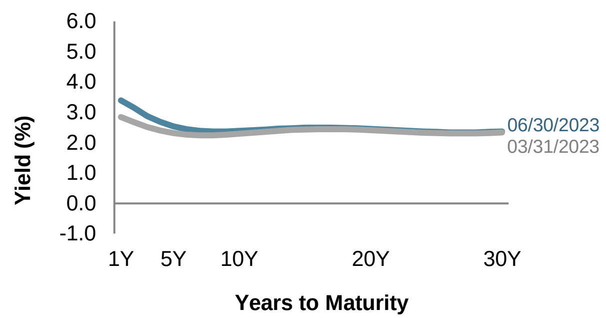
US



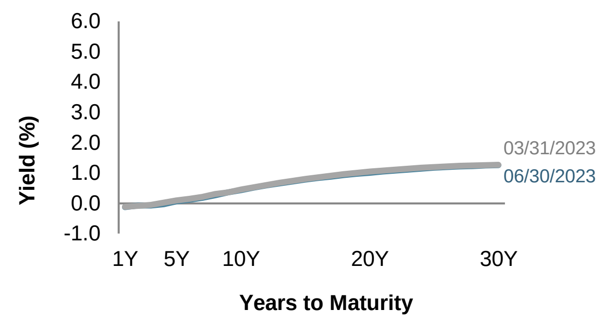
UK



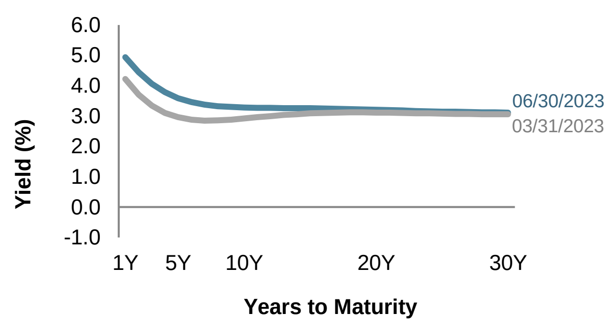
Germany



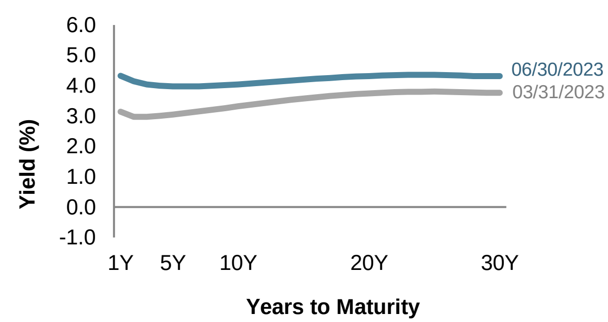
Japan



Canada



Australia



One basis point (bps) equals 0.01%. Source: ICE BofA government yield. ICE BofA index data © 2023 ICE Data Indices, LLC.

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Commodities

Second quarter 2023 index returns

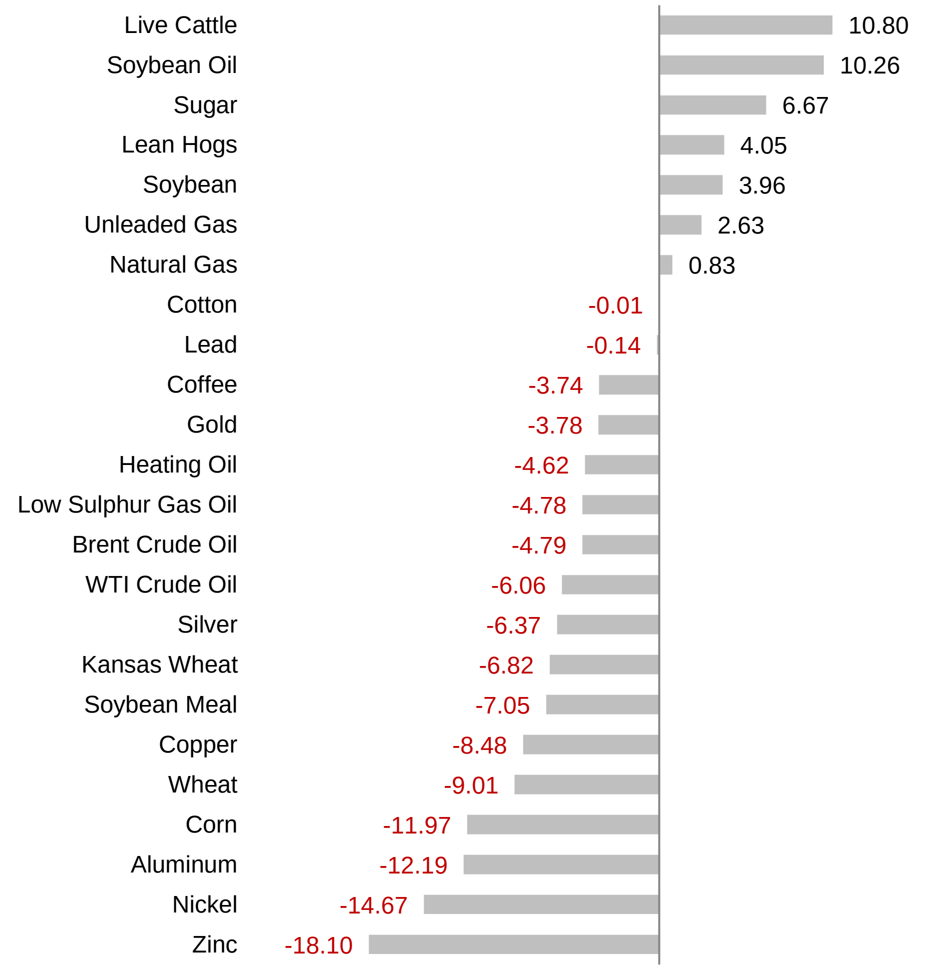
The Bloomberg Commodity Total Return Index returned -2.56% for the second quarter of 2023.

Zinc and Nickel were the worst performers, returning -18.10% and -14.67% during the quarter, respectively. Live Cattle and Soybean Oil were the best performers, returning +10.80% and +10.26% during the quarter, respectively.

Period Returns (%)

				Annualized		
Asset Class	QTR	YTD	1 Year	3 Years	5 Years	10 Years
Commodities	-2.56	-7.79	-9.61	17.82	4.73	-0.99

Ranked Returns (%)



Past performance is not a guarantee of future results. Index is not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.
Commodities returns represent the return of the Bloomberg Commodity Total Return Index. Individual commodities are sub-index values of the Bloomberg Commodity Total Return Index. Data provided by Bloomberg.

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