

## MARKET COMMENTARY - 3Q 2022

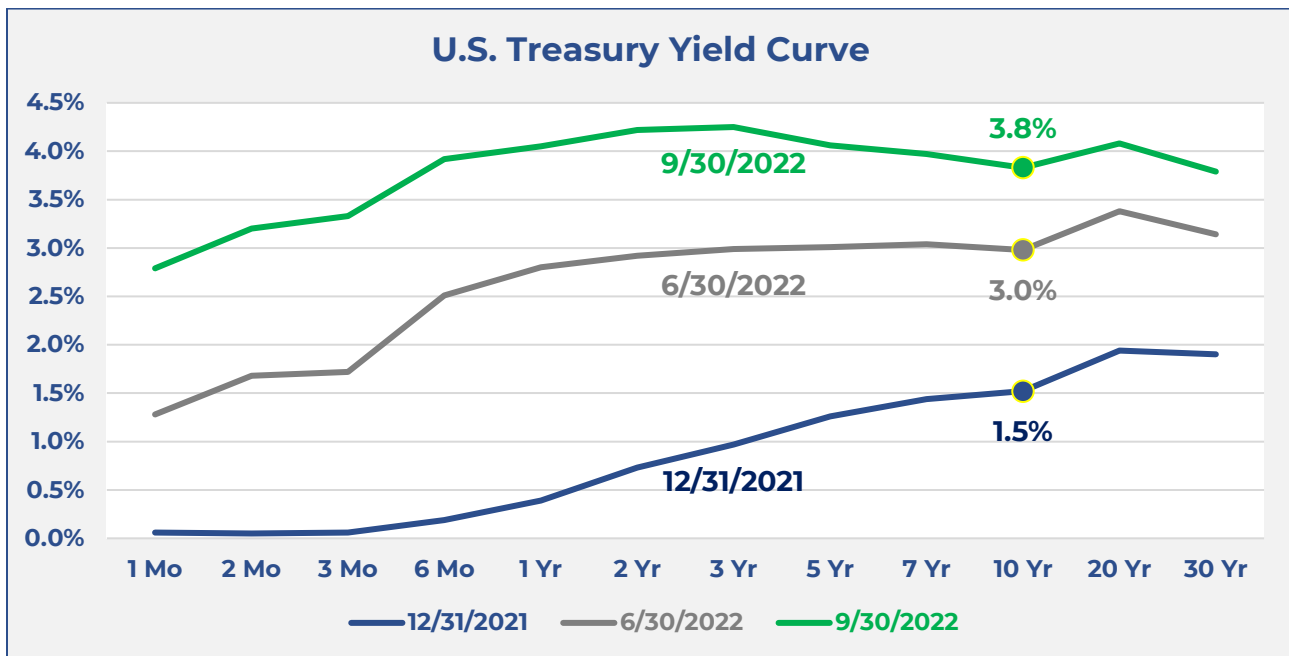


### 2022 3Q in Review

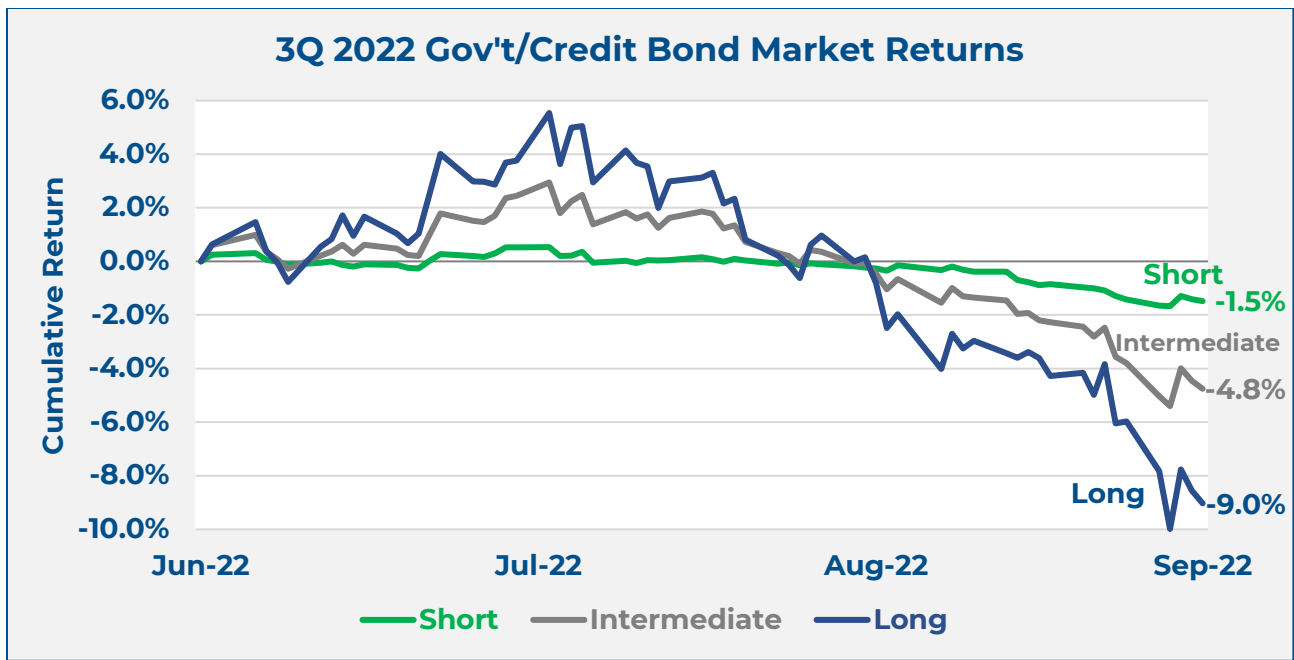
The third quarter of 2022 was a difficult period for financial markets due to a hawkish Federal Reserve, rising interest rates and persistent elevated inflation.

Asset Class	Index	QTD	YTD	1 Year	3 years	5 Years
<b>Global Equity</b>	<b>MSCI ACWI</b>	<b>-6.8%</b>	<b>-25.6%</b>	<b>-20.7%</b>	<b>3.7%</b>	<b>4.4%</b>
US Large Cap	S&P 500	-4.9%	-23.9%	-15.5%	8.2%	9.2%
US Large Cap Growth	Russell 1000 Growth	-3.6%	-30.7%	-22.6%	10.7%	12.2%
US Large Cap Value	Russell 1000 Value	-5.6%	-17.8%	-11.4%	4.4%	5.3%
US Small Cap	Russell 2000	-2.2%	-25.1%	-23.5%	4.3%	3.6%
International	MSCI EAFE	-9.4%	-27.1%	-25.1%	-1.8%	-0.8%
Emerging Markets	MSCI EM	-11.6%	-27.2%	-28.1%	-2.1%	-1.8%
<b>Commodities</b>	<b>S&amp;P Global Natural Resources</b>	<b>-5.0%</b>	<b>-6.6%</b>	<b>0.3%</b>	<b>8.4%</b>	<b>5.0%</b>
<b>Real Estate</b>	<b>CRSP US REIT</b>	<b>-11.0%</b>	<b>-29.3%</b>	<b>-18.7%</b>	<b>-1.6%</b>	<b>3.1%</b>
Muni Bonds	Bloomberg Municipal Bond	-3.5%	-12.1%	-11.5%	-1.9%	0.6%
Taxable Bonds	Bloomberg Aggregate Bond	-4.8%	-14.6%	-14.6%	-3.3%	-0.3%
High Yield Bonds	Bloomberg High Yield Bond	-0.6%	-14.7%	-14.1%	-0.5%	1.6%

The U.S. Federal Reserve actions and comments had a major impact on stock and bond markets. The Fed raised the Fed Funds rate by 0.75% in both July and September in its latest attempts to lower inflation, resulting in a Fed Funds target range of 3.00% to 3.25%. Following the most recent Fed meeting on September 21, Fed Chairman Jerome Powell's comments were surprisingly aggressive, stating that the Fed will "keep at it" and continue to do what is necessary to fight persistent high inflation. The Fed Funds rate is projected to rise by an additional 1.25% by the end of the year due to expected hikes at the next two Fed meetings as the FOMC "is strongly committed to returning inflation to its 2% objective." The Fed action and commentary caused interest rates to rise significantly across the curve. The U.S. 10-Year Treasury yield ended the third quarter at 3.8%, its highest level since 2010. The annual inflation rate for the 12 months ending August 31, 2022 sits at 8.3%.



Rising interest rates are detrimental to fixed-coupon bond prices. During 3Q 2022, shorter duration/maturity (-1.5%) bond positioning fared much better than intermediate (-4.8%) and longer (-9.0%) duration/maturity bond indices.



Several market pundits publicly criticized the Fed's recent actions. They claimed that the Fed waited too long to initiate the fight against inflationary signals in 2021 and is now making another critical policy error by ignoring recent data that inflation is easing. The Fed is potentially overtightening financial conditions, which could trigger a deeper and longer recession. Several of the important inflation signals are backward-looking, so improvements in the signals (housing demand, energy costs, food prices) are not reflected in the Fed's decision making.

Housing, the largest component of inflation, has been discussed in the headlines significantly in the last several weeks. Price decreases in home sales take time to work itself into the CPI calculation. Forward-looking data indicates that the significant rise in mortgage rates has caused mortgage applications and home sales to drop significantly. Home builders are reporting high cancellation rates and offering substantial incentives to avoid additional cancellations.

Additionally, WTI crude oil prices have declined to 2021 levels, dropping from around \$130 in March 2022 to \$82 at the end of September, as production has increased and demand has fallen. Food supply was a concern earlier in the year, but record crop yields have led to a rapid price decline in grains, poultry and beef.

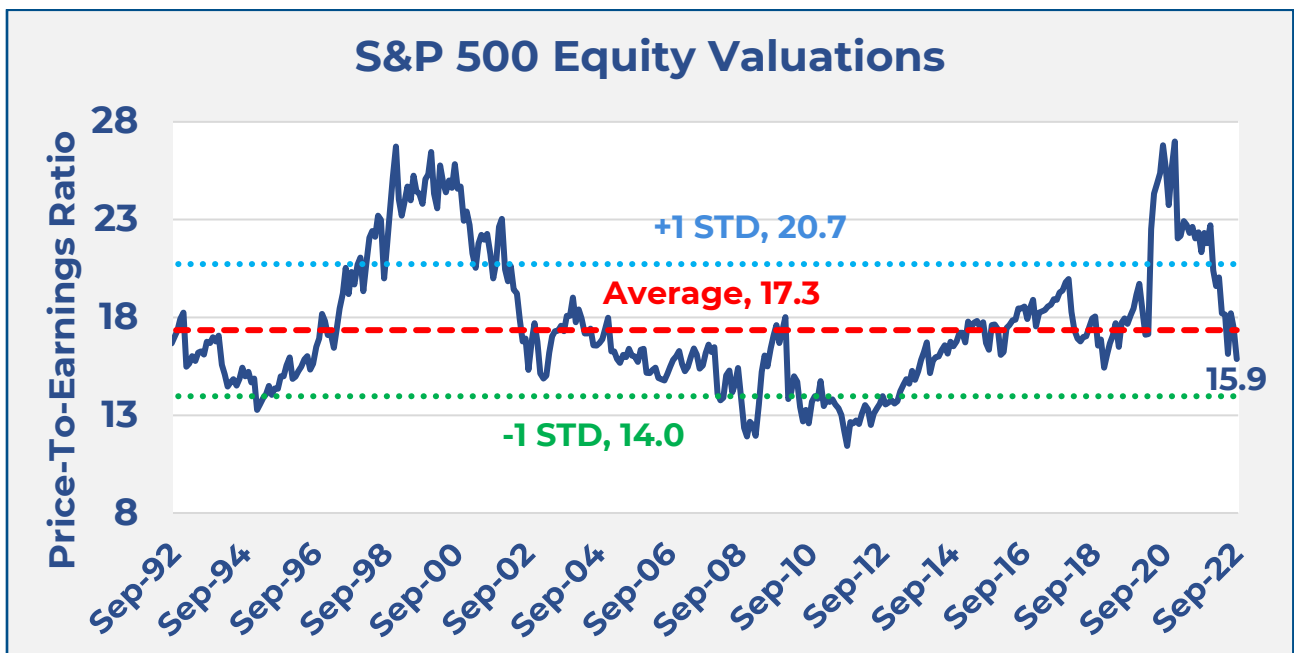
After an initial rally over the first 6 weeks of the quarter, equities dropped back down to 2022 lows, falling -15.8% over the remainder of the quarter.



Source: YCharts

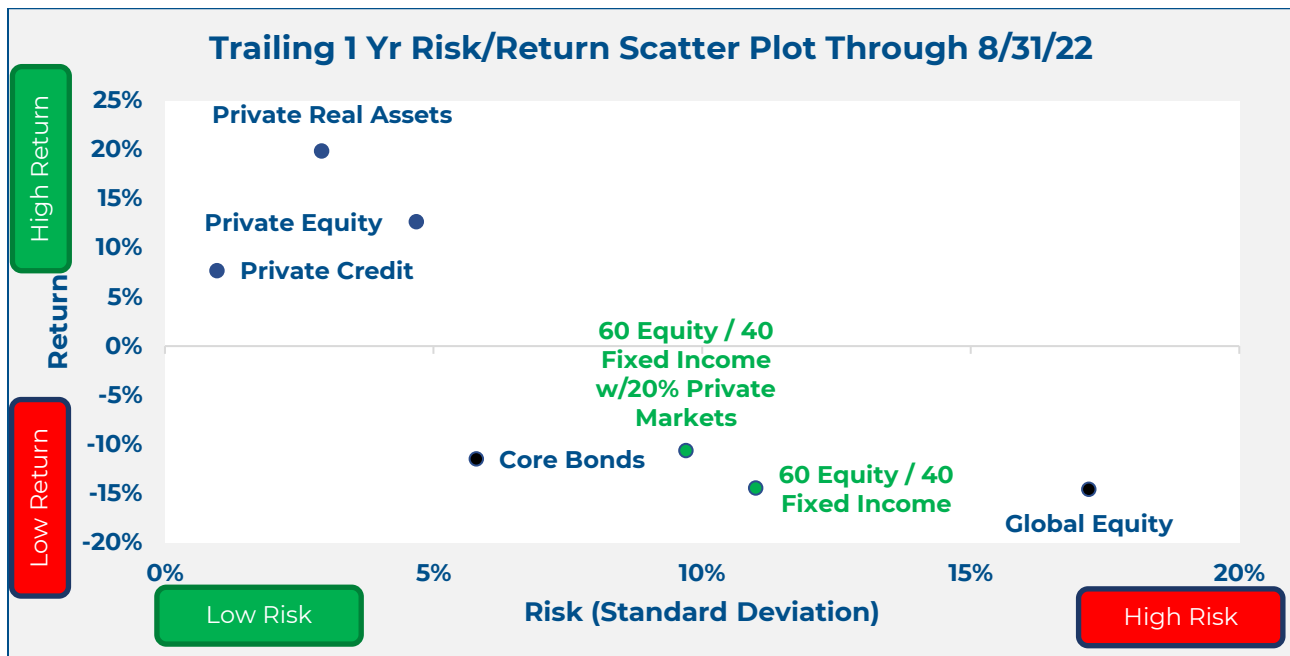
Earnings growth for the S&P 500 is estimated at +3.2% for the quarter, which would be the lowest level of growth since Q3 2020. This estimated earnings growth rate, although positive, is significantly lower than the +9.8% that was expected as of June 30, 2022 (source: Factset Earnings Insight September 23, 2022).

The significant drop in stock prices has significantly outpaced the forecasted earnings growth, which has resulted in improved stock valuations as reflected in the below chart. The most recent S&P 500 valuation metrics have improved across the board.



Source: Bloomberg, GSIS, JPM

Semi-Liquid private market investments continue to provide attractive positive returns with lower levels of market volatility relative to public stocks and bonds. On the chart below we plot the risk and return of each of the private market asset classes as well as the two major market benchmarks. The three private market asset classes are all skewed toward the most optimal part of the chart where return is maximized with lower risks.



Source: GSIS Calculations, YCharts, MSCI

## GSIS 2022 Allocation Positioning

Our rigorous dynamic asset allocation process generated significant excess performance during the quarter.

- The **Private Credit** portfolios are structured with shorter term loans and floating rate provisions. These portfolios were able to largely sidestep the impact of rising rates to produce positive returns. The niche credit exposure in this asset class continues to demonstrate very uncorrelated returns to public core bonds.
- **Private Real Assets**, specifically core/core+ real estate, continues to perform well with low return volatility. The rental residential allocation remains a key driver of the real estate performance and continues to have strong rent growth while providing a good inflation hedge. A structural and persistent housing supply shortage, high inflation and higher interest rates have made it more expensive to build and buy housing. Both home sales and new construction are stalling, which is a positive for the residential rental allocation. This asset class was the best performer in client accounts in 2021 and continues to hold the top spot in 2022.
- The **Private Equity** strategies have fared significantly better than public market equities. Most of the private equity exposure is skewed to the highest quality, most mature part of the private equity universe, which is less subject to mark down risk and valued based on current company metrics not forward-looking expectations. Private equity managers have

produced mid-single digit positive returns while public equities have fallen by over 25% in 2022.

- Within **Core Public Fixed Income**, the short duration tilt we implemented outperformed traditional core fixed income benchmarks during the quarter as interest rates continue to rise on the back of the Fed actions.
- In **Global Public Equities**, our modest overweight to non-U.S. equities lagged during the quarter as the U.S. Dollar strengthened relative to a basket of foreign currencies.

The active strategic allocation shifts from traditional public assets into core private markets continue to significantly improve absolute and relative performance for our clients. These investments have been significantly accretive to returns while dampening portfolio volatility in this period of increased economic uncertainty and market turbulence.

Thank you for your Trust and Confidence.



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