Community Foundation For Muskegon County - Vanguard

Community Foundation for Muskegon County

Quarterly performance report

Period ended September 30, 2023

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Market commentary

For the quarter ended September 30, 2023

Q3 Commentary

Rising Rates Halt Equity Rally during the Third Quarter

Equity markets saw negative returns for the quarter as the Federal Reserve (Fed) continued its “higher for longer” messaging to the financial markets. Other economic concerns included a looming U.S. government shutdown and the challenges surrounding China’s property crisis. For the quarter, U.S. equities[1] returned -3.3% but generated a strong one-year result of 20.4%. The third quarter saw negative performance across all size categories as large-cap[2] stocks returned -3.1%, ahead of both small-cap[3] and mid-cap[4] equities, which produced returns of -4.6% and -5.1%, respectively. Small-cap companies are typically more impacted during rising rate environments as tight financial conditions make borrowing more expensive. For the one-year period, all size categories produced positive returns: large-cap stocks led the pack with a 21.8% advance, followed by mid-cap stocks at 12.6%, and small-caps at 12.4%.

The third quarter also saw a decline in the performance of the “magnificent seven,” which are seven growth companies involved in the research and development of Artificial Intelligence, that are responsible for most of the S&P 500’s year-to-date gains. In the third quarter, growth[5] stocks returned -3.3%, slightly lagging their value[6] counterparts that produced a -3.2% return. The discrepancy between value and growth is much larger over a 1-year period as growth had a performance of 26.6%, nearly double the return of value equities at 14.1%. The Energy[7] sector was resilient during the third quarter as oil prices increased, generating a return of 12.8%. Communication Services[8] was the only other sector in positive territory during the quarter with a 2.2% return. Utilities[9] and Real Estate[10] were the worst performing sectors with returns of -9.3% and -8.5%, respectively.

International stocks[11] were also negative for the third quarter, consistent with the performance of the broad U.S. equity markets with a return of -3.3%. Developed markets[12] were down by -4.0%, trailing their emerging markets[13] counterparts, which had a return of -1.6%. The one-year performance figure for international stocks was a respectable 20.4%. Over the last 12 months, developed markets gained 23.8% as emerging markets produced a return of 10.7%.

Fixed Income Markets Continue Their Slide Amidst Uncertainty

U.S. and international fixed income markets generated negative returns in the third quarter, a continuation of the second quarter where most fixed income sectors finished in the red. During the third quarter, the Fed increased rates once by 25bps at their July meeting and held rates steady during the September meeting. Inflation, as measured by the Consumer Price Index (CPI), showed a year-over-year (YoY) increase of 3.7% in September which was the lowest reading since September 2021. Despite the Fed holding rates steady in September, the key Treasury rates of 2, 5, 10 and 30-years increased by an average of 48bps, which was the primary driver of broadly negative fixed income returns for the quarter. It was a quarter of relative extremes as the 10-year Treasury yield rose by almost 90bps to 4.61%, which is its highest level since pre-Financial Crisis. The two-year Treasury rate was up by less than 20bps to 5.12% but reached its highest point since 2006 intra-quarter. The overall yield curve remained inverted as of quarter-end, but the 2Y/10Y spread narrowed to 50bps from 100bps as of June 30, 2023.

After a positive performance of 4.5% in the first half of 2023, long-duration Treasury STRIPS lagged all fixed income sectors in the third quarter with a return of -17.7%[14]. The index representing longer duration government and credit bonds generated returns of -8.5%[15] for the quarter. Corporate bonds produced negative returns for the quarter with US long corporates returning -6.2%[16] and intermediate corporates returning -2.3%.[17] Short-term US corporate bonds returned 0.4%[18] and high-yield bonds returned 1.5%[19] making these the only positive fixed income sectors. Fixed income returns were largely impacted this quarter by a shift in consensus expectations for future rate cuts. The market repriced downward, embracing the "higher for longer" narrative from the Fed which negatively impacted the long end of the yield curve relative to the short end.

International bond sectors suffered similar declines amidst rate increases by the European Central Bank (ECB) and the Bank of England (BoE), as well as persistent inflation and growth concerns in China. The 10-year rates in Japan (+37bps), Germany (+41bps), Australia (+47bps) and Canada (+77bps) all showed significant gains, while rates in China (+3bps) and the United Kingdom (-1bps) were relatively flat. Unhedged international bonds (-3.9%)[20] underperformed U.S. bonds (-2.9%)[21] for the quarter, mostly due to the relative strength of the dollar.

Market commentary (continued)

For the quarter ended September 30, 2023

Economic Outlook

The recent progress in bringing inflation down stalled in September, offering more evidence that the path to fully extinguishing price pressures could be bumpy. Headline CPI rose 0.4% in September from the prior month and 3.7% from a year earlier according to the latest data from the Labor Department. The monthly gain represents a cooling from August's 0.6% increase which was driven by higher energy prices. When excluding volatile food and energy items, core CPI increased 0.3% in September, the same as the prior month in a continuation of mild readings through the summer months. On a 12-month basis, core prices rose 4.1% in September, down from the August result of 4.3%. Within core inflation, goods remained deflationary at -0.4% month-over-month and services inflation came in firmer than expectations at 0.6% month-over-month. The upside surprise was primarily attributable to shelter, recreational and medical services.

According to the latest monthly data from the Labor Department, the U.S. economy added 336,000 jobs in September, the highest number since January and greatly exceeding the forecast. The average monthly new employment opportunities in the 3rd quarter stood at 266,000 – an increase of 32% over the 2nd quarter. Industries with unusually strong job gains included retail, construction, and air transportation. Public education employment also jumped as most schools in the U.S. returned to session. The unemployment rate held steady at 3.8%, near a historical low, as the number of people without jobs increased from 6.0 to 6.4 million between July and September. Initial jobless claims have been decreasing steadily through the past quarter with the weekly figures hovering at just over 200,000 in September after reaching a recent high of 265,000 in the middle of June.

The S&P Global U.S. Manufacturing Purchasing Manager's Index ticked up higher to 49.8 in September, exceeding August's final reading of 47.9. The latest figure pointed to a fifth consecutive month of contraction in the manufacturing sector, however the production component at 52.5 and the employment subindex at 51.2 were still indicating growth. The developing United Auto Workers strike could prevent the index from climbing into expansionary territory. Consumer sentiment, on the other hand, registered its three best monthly results since December of 2021, showing the consumer is less worried about an economic downturn.

The Euro Area, reporting on a one-quarter delay, continued to exhibit very slow economic growth. GDP increased only 0.1% in the 2nd quarter, matching the results for the first three months of this year. Considering the sluggish outlook for the German economy, investors' concerns about the ability of the Eurozone to avoid recession keep mounting. According to the latest forecast by the European Commission from September, Germany's economy is expected to contract in 2023 by -0.4%.

In the UK, the inflation rate fell during August to 6.7% from 6.8% in July, despite climbing energy prices. Economic growth was confirmed at 0.2% during the second quarter of 2023, following an upwardly revised expansion of 0.3% in the previous three-month period. Household spending, business investment and government consumption positively impacted the marginal increase of GDP in Q2 whereas net international trade was a detractor to growth.

China's August activity data presented a broad stabilization, following stronger than expected manufacturing PMI, trade, inflation, and credit data. Retail sales growth ramped up to 4.6% YoY in August from July's 2.5%, with a meaningful uptick in the monthly growth rate of 0.3% compared to last month's -0.1% result. The property sector, however, continued to remain deeply negative with property sales plunging by -23.7% in August on a year-over-year basis. The impact from the monetary and fiscal policy easing is yet to show up in the data, and the property sector is not yet out of the woods.

Monetary Policy Highlights

The Fed continued raising interest rates in July by 25bps, aligning with market expectations. Their decision to hold rates steady at the September meeting was also consistent with market forecasts. This brought the federal funds rate to a range of 5.25-5.50%. At this time, Vanguard expects Fed policy to remain restrictive well into next year as rate cuts are not expected until the second half of 2024.

Market commentary (continued)

For the quarter ended September 30, 2023

The ECB raised interest rates twice by 25bps during Q3. The latest hike increased the ECB's Deposit Facility rate to 4%, which is an all-time high. The Governing Council's decision was based on their assessment that despite slowing inflation, inflation is still expected to remain "too high for too long." In Vanguard's view, the Governing Council has now reached their terminal rate of 4% and are not expected to cut rates until at least the second half of 2024.

The Monetary Policy Committee (MPC) of the BoE voted to continue raising interest rates to 5.25% at the end of August. However, the MPC left rates unchanged in September, which is the first-time rates were kept steady since November 2021. The latter decision was based on a loosening labor market and declining headline, services, and core inflation measures. Four of the nine members of the Committee still believe that rate hikes are warranted due to rising household incomes. The MPC remains data-dependent in their approach and Vanguard maintains a forecast for their terminal rate in the range of 5.50-5.75%.

References (Index Returns)

1. CRSP U.S. Total Stock Market Index
2. CRSP U.S. Large Cap Index
3. CRSP U.S. Small Cap Index
4. CRSP U.S. Mid Cap Index
5. Russell 3000 Growth Index
6. Russell 3000 Value Index
7. MSCI U.S. IMI Energy 25/50
8. MSCI U.S. IMI Communication Services 25/50
9. MSCI U.S. IMI Utilities 25/50
10. MSCI U.S. IMI Real Estate 25/50
11. FTSE Global All Cap ex U.S. Index
12. FTSE Developed All Cap ex U.S. Index
13. FTSE Emerging Index
14. Bloomberg U.S. Treasury STRIPS 20–30 Year Equal Par Bond Index
15. Bloomberg US Aggregate Government & Credit – Long Index
16. Bloomberg US Corporate Long Index
17. Bloomberg US Aggregate Credit - Corporate (5-10 Y)
18. Bloomberg US Corporate (1-5 Y) Index
19. Bloomberg US Corp High Yield Index
20. Bloomberg Global Agg Index ex USD
21. Bloomberg US Agg Float Adjusted Index

Sources:
Vanguard, U.S. Treasury, Trading Economics, FactSet, Bureau of Economic Analysis, Department of Labor, Wall Street Journal, Nuveen, Goldman Sachs, JP Morgan, St. Louis Fed Economic Database, Morningstar, FactSet

Past performance is not a guarantee of future returns. Indexes are unmanaged; therefore direct investment is not possible.

Client and investment activity

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For the quarter ended September 30, 2023

Beginning and ending portfolio market values are net of all advisory fees and trading expenses. Purchases represent all new purchases and exchanges to securities within the plan, less any trading expenses. Sales represent all new sales and exchanges from securities, less any advisory fees and trading expenses.

Performance attribution by sub-asset class

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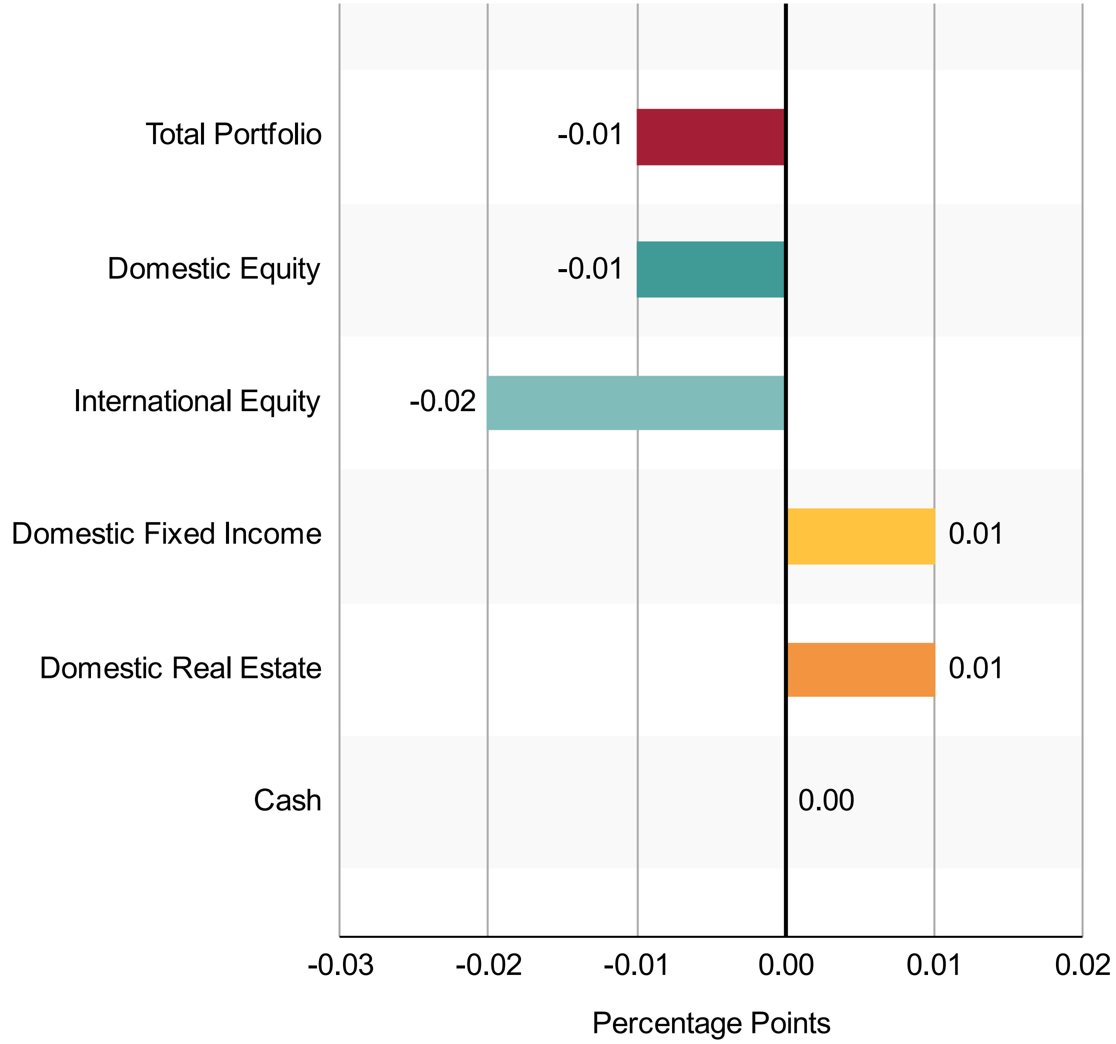
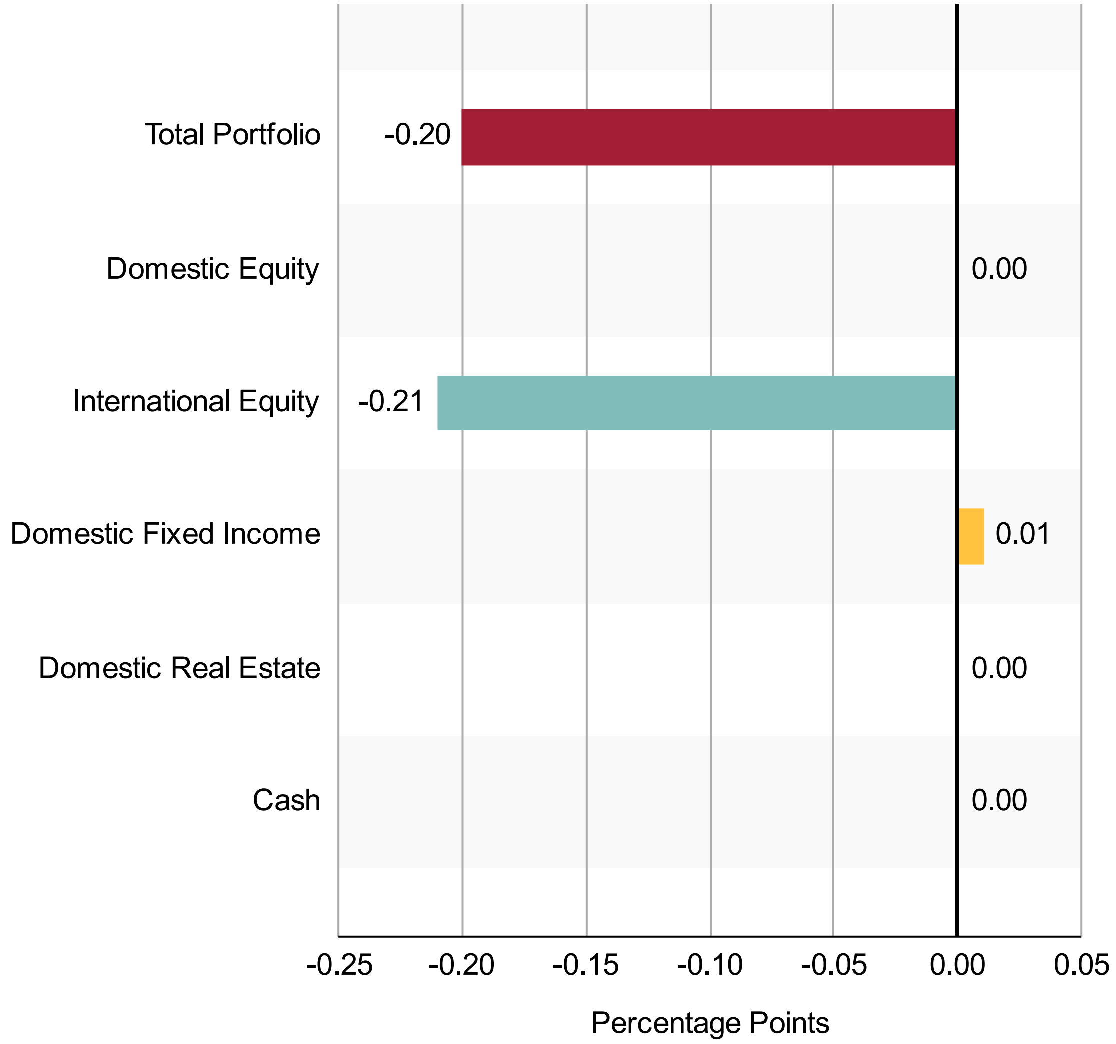
Broad Allocation Impact



Fund Selection Impact



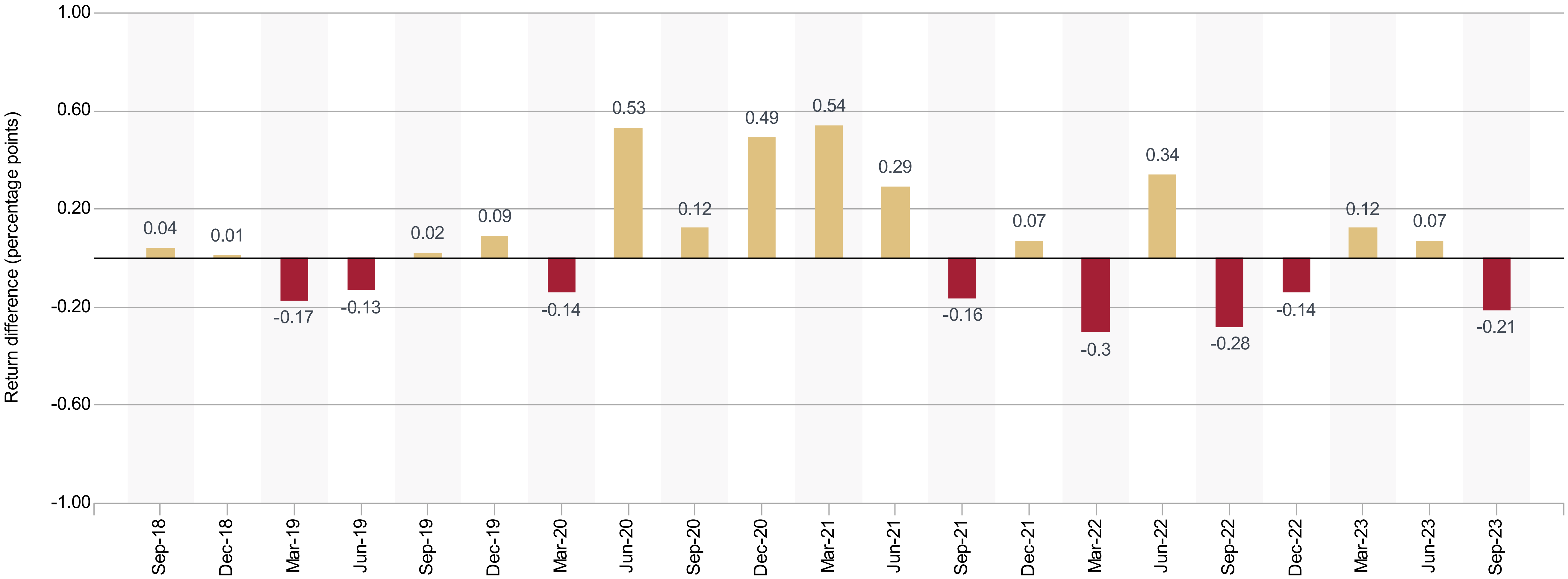
The standard Brinson-Fachler method is used, and explains portfolio performance against its overall benchmark. See Benchmark allocation history for description of what the policy benchmark represents. Returns used are gross of advisory fees and are time-weighted. **Past performance is not a guarantee of future results.** Diversification and asset allocation can not ensure profit or prevent loss.

Excess returns by time periods

Community Foundation For Muskegon County - Vanguard

For the periods ended September 30, 2023

Quarterly calendar excess returns



Each time period in the Quarterly calendar returns chart represents one quarter of performance as of that date. Each time period in the Quarterly rolling 5-year returns chart represents 60 quarters of annualized performance as of that date. Returns used are gross of advisory fees and are time-weighted. Excess returns are the arithmetic return difference between the Total Plan versus Policy Benchmark. See Benchmark allocation history for description of what the policy benchmark represents. **Past performance is not a guarantee of future results.**

Excess returns by time periods

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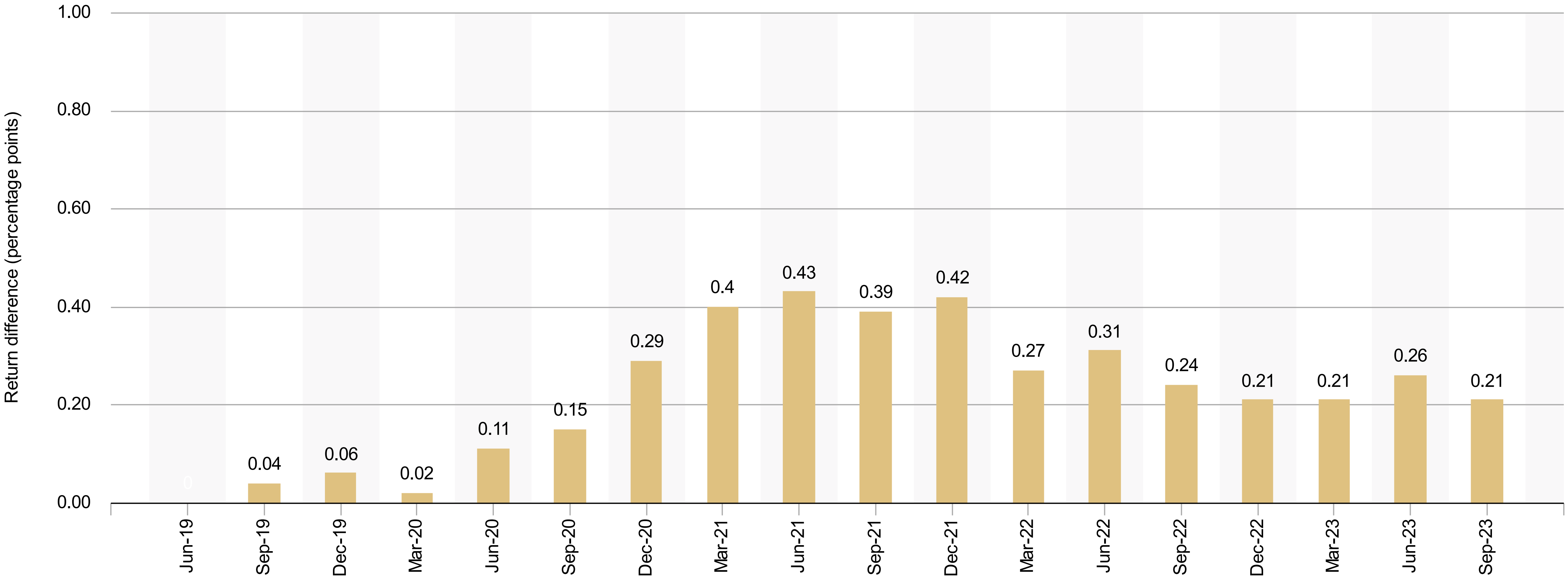
For the periods ended September 30, 2023

Quarterly rolling 5-year annualized excess returns



Each time period in the Quarterly calendar returns chart represents one quarter of performance as of that date. Each time period in the Quarterly rolling 5-year returns chart represents 60 quarters of annualized performance as of that date. Returns used are gross of advisory fees and are time-weighted. Excess returns are the arithmetic return difference between the Total Plan versus Policy Benchmark. See Benchmark allocation history for description of what the policy benchmark represents. **Past performance is not a guarantee of future results.**

Risk control - rolling quarter returns

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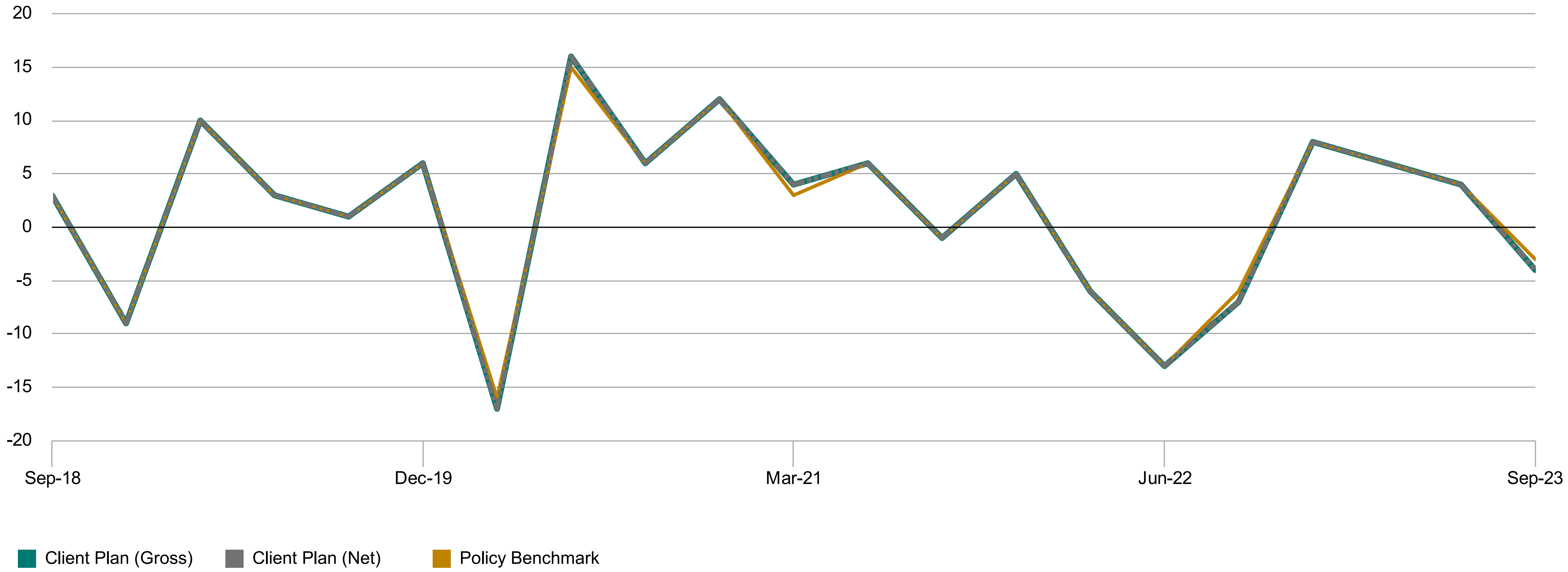
For the periods ended September 30, 2023

Client plan versus policy benchmark



This charts show how the portfolio has performed against its benchmark in up and down markets. See Benchmark allocation history for description of what the policy benchmark represents. Returns included on this page are Time-Weighted Returns (TWR) and net of Vanguard Institutional Advisory Services (VIAS) advisory fees, fund expense ratios, and other expenses unless otherwise indicated. A client cannot invest directly in a benchmark. **Past performance is not a guarantee of future results.**

Benchmark allocation history

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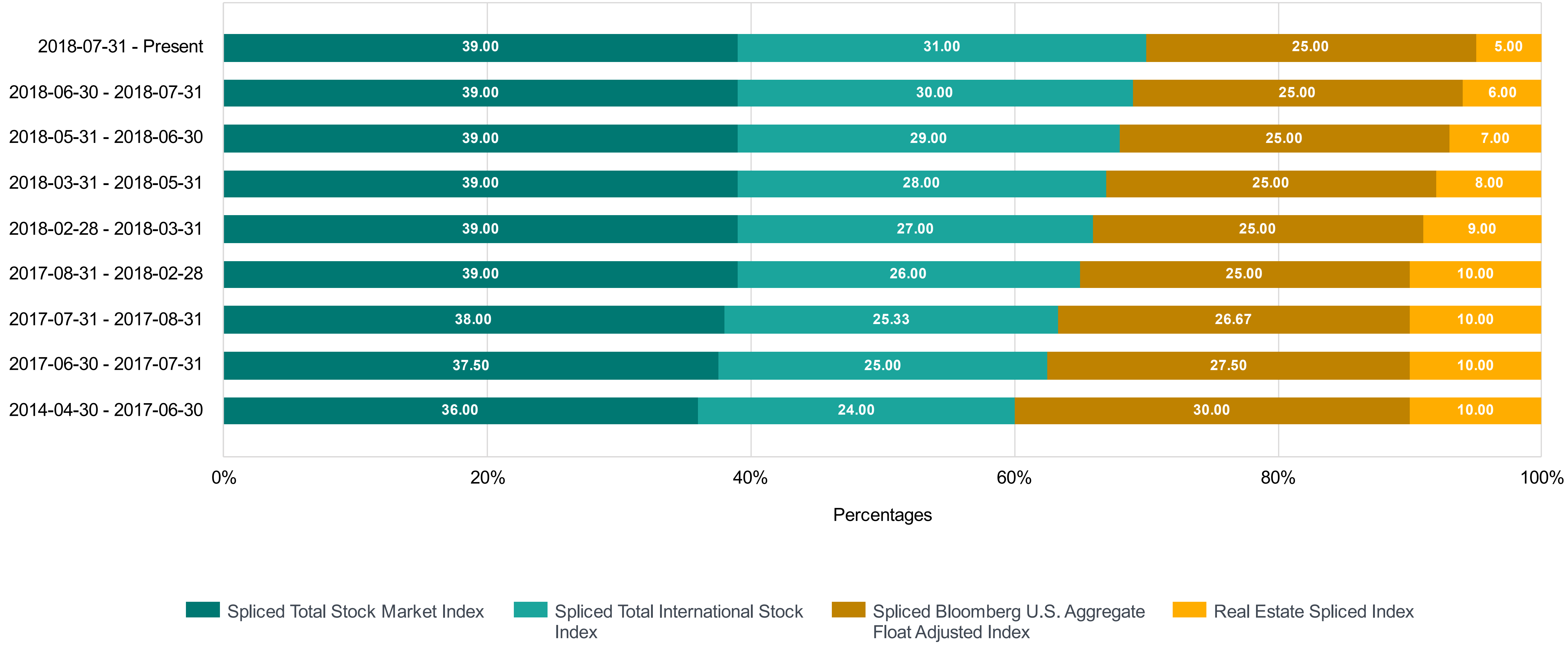
Policy benchmark allocations up to September 30, 2023



Policy Benchmark is a weighted set of indices that align to the Investment Management Agreement Schedule B which sets forth the strategic asset allocation for the client portfolio. The Policy Benchmark is rebalanced monthly. Allocations may change overtime as the investment strategy changes. The most recently policy benchmark composition is in the top row. Neither asset allocation nor diversification can guarantee a profit or prevent loss. Indexes are unmanaged; direct investment is not possible. **Please read additional information in Benchmark and Disclosure sections.**

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