3rd Quarter 2023

Data as of June 30, 2023

Nationwide Market Insights℠

Our perspective on the market and economic forces influencing investment planning and retirement

Nationwide Market Insights℠

One of the challenges of planning for a more secure financial future comes in understanding the market and economic forces that affect investment performance and influence investment decisions. With *Nationwide Market Insights*, we present insights and informative commentary about the economy and the financial markets from Nationwide's staff of economists. You can share *Nationwide Market Insights* with clients to help answer questions about investment performance and inspire greater confidence in the guidance you provide.

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Executive Summary

Risk assets were mixed in the second quarter as core inflation eased slightly, and the Federal Reserve took a pause from its aggressive monetary tightening. For the quarter, stocks and Treasury yields rose while credit spreads and commodity prices slipped. The dollar was little changed.

The economy showed mixed signs with employment gains healthy and manufacturing activity decidedly in recession territory. Risks remain elevated that a recession will grip the economy by the end of the year. Leading indicators continue to flash a red warning sign for the economy while financial strains are appearing for both households and businesses. Near the end of the quarter, elevated jobless claims showed the strong labor market is showing some cracks. An outright downturn still does not appear to be imminent, but it is a growing probability in the quarters ahead.

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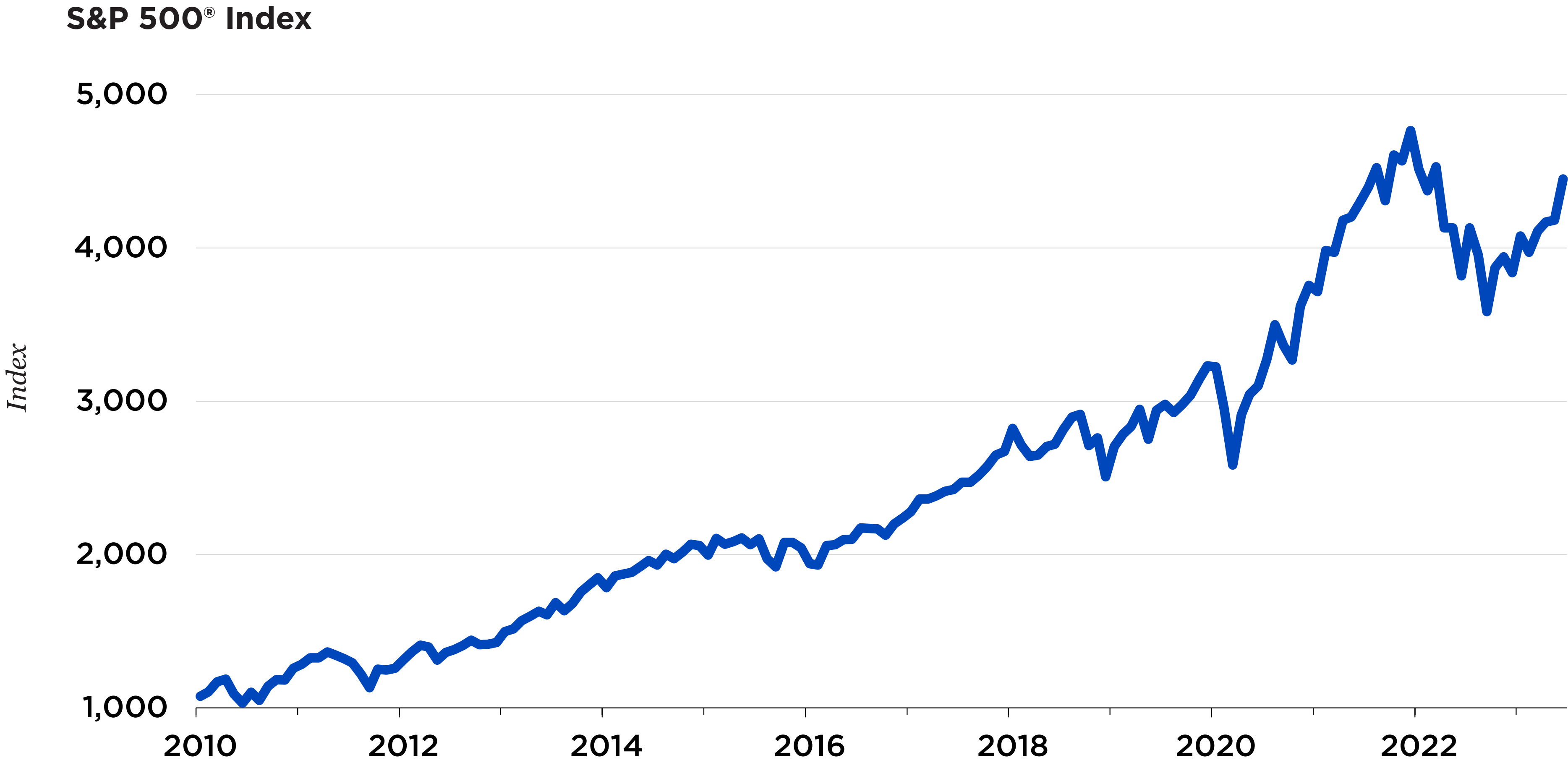
22 Natural gas prices stay under $3, giving businesses and households a break

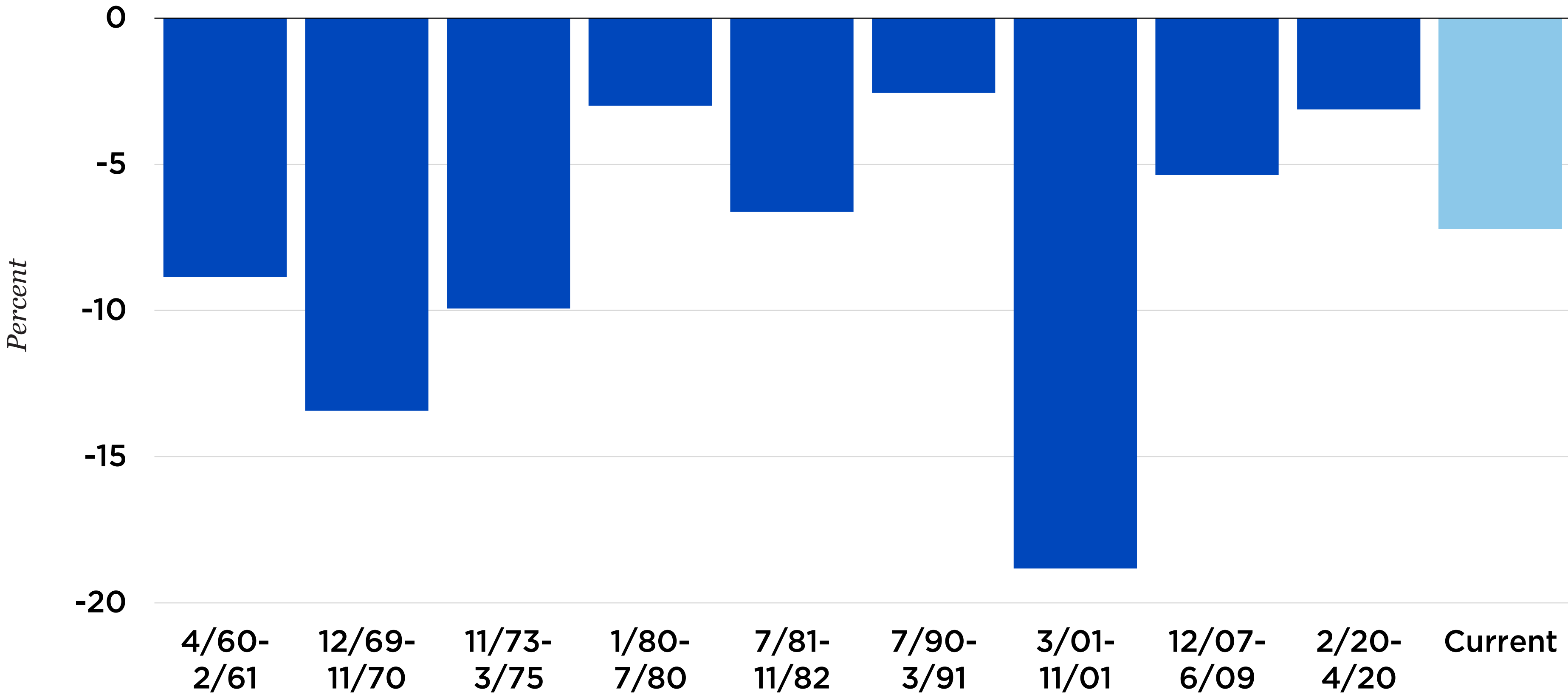
Stocks rise again

The S&P 500® moved higher for the third straight quarter even though the Fed continued to rise rates.



The decline has been unusually large

Even after the bounce back after the last three quarters, the decline in U.S. equities would still rank among the worst in a pre-recession period on record.

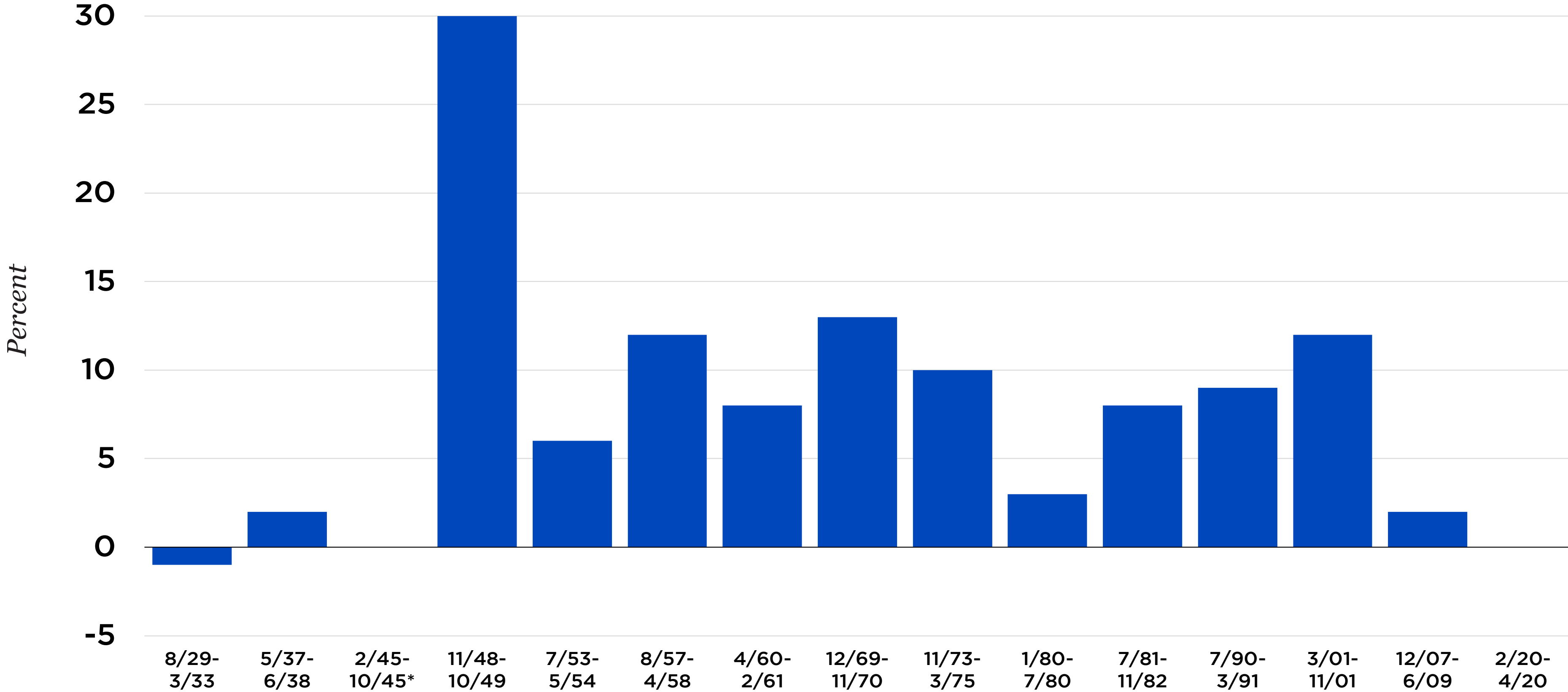


Source: Standard and Poor's

The pullback has come early

If a recession is in the cards for 2023, the stock market has flagged it much earlier than usual. The S&P 500®, which peaked in January of last year, usually has fallen into a bear market or correction a median of eight months prior to economic downturns.

Lag between the outset of S&P 500® bear markets or corrections and beginning of recessions

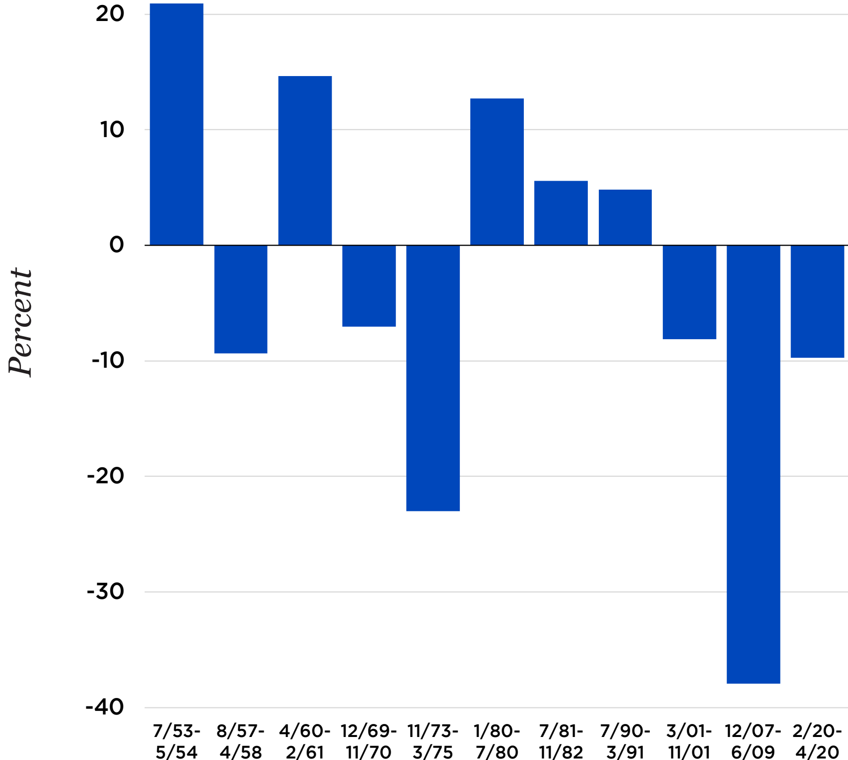


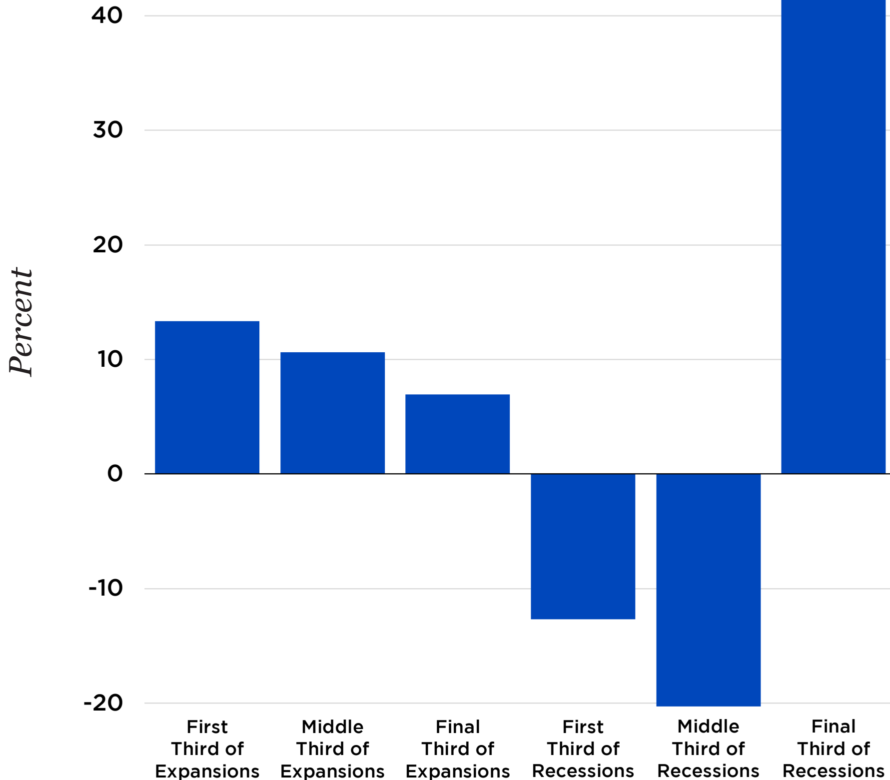
Source: Standard and Poor's and National Bureau of Economic Research

Market performance has been mixed within recessions

Equity market performance has varied widely across recessions, from deep declines in the 1973-75 and 2007-09 contractions to double-digit gains in the 1953-54, 1960-61, and 1980 downturns.

In most cases, however, stocks have performed poorly in the early and middle stages of economic contractions and robustly in the latter stages.

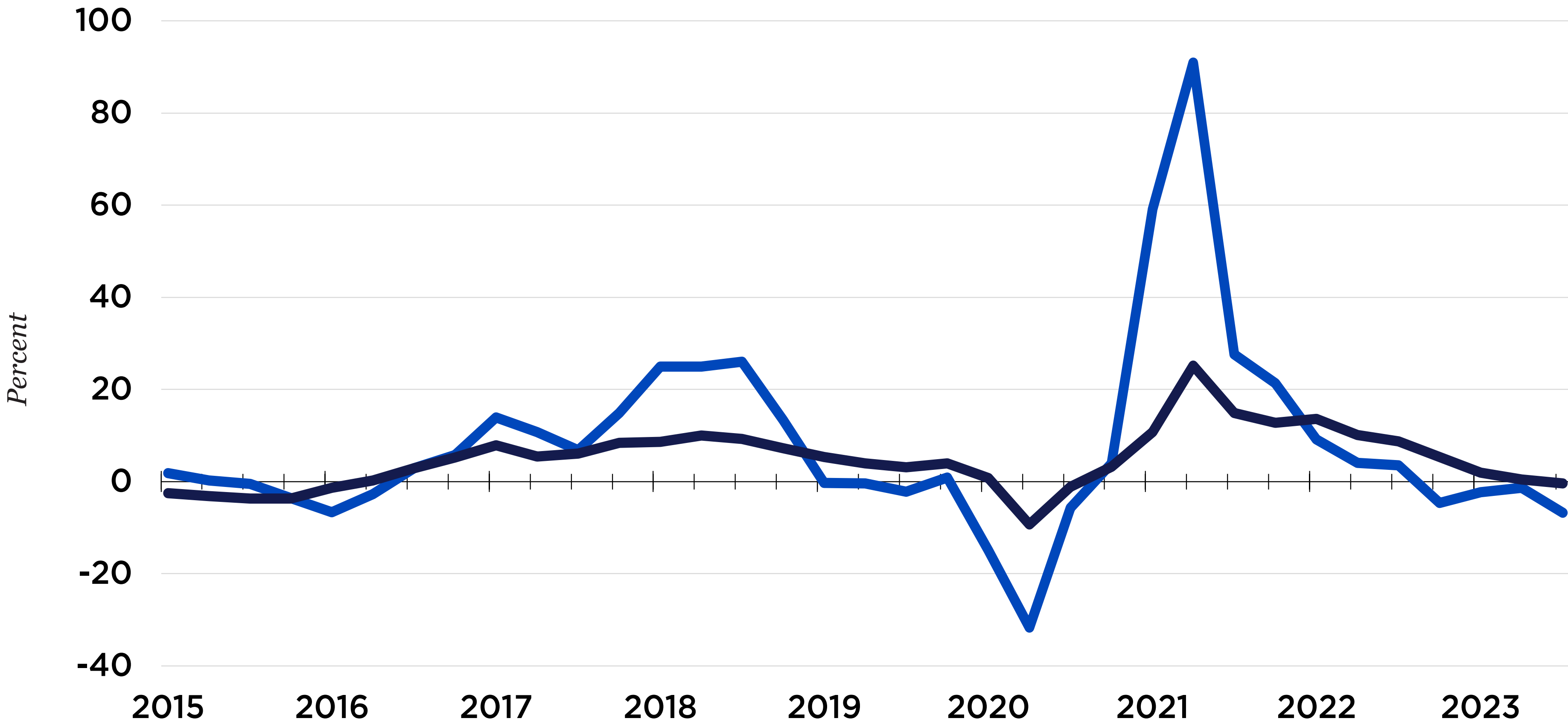




Source: Standard and Poor's

Earnings are contracting

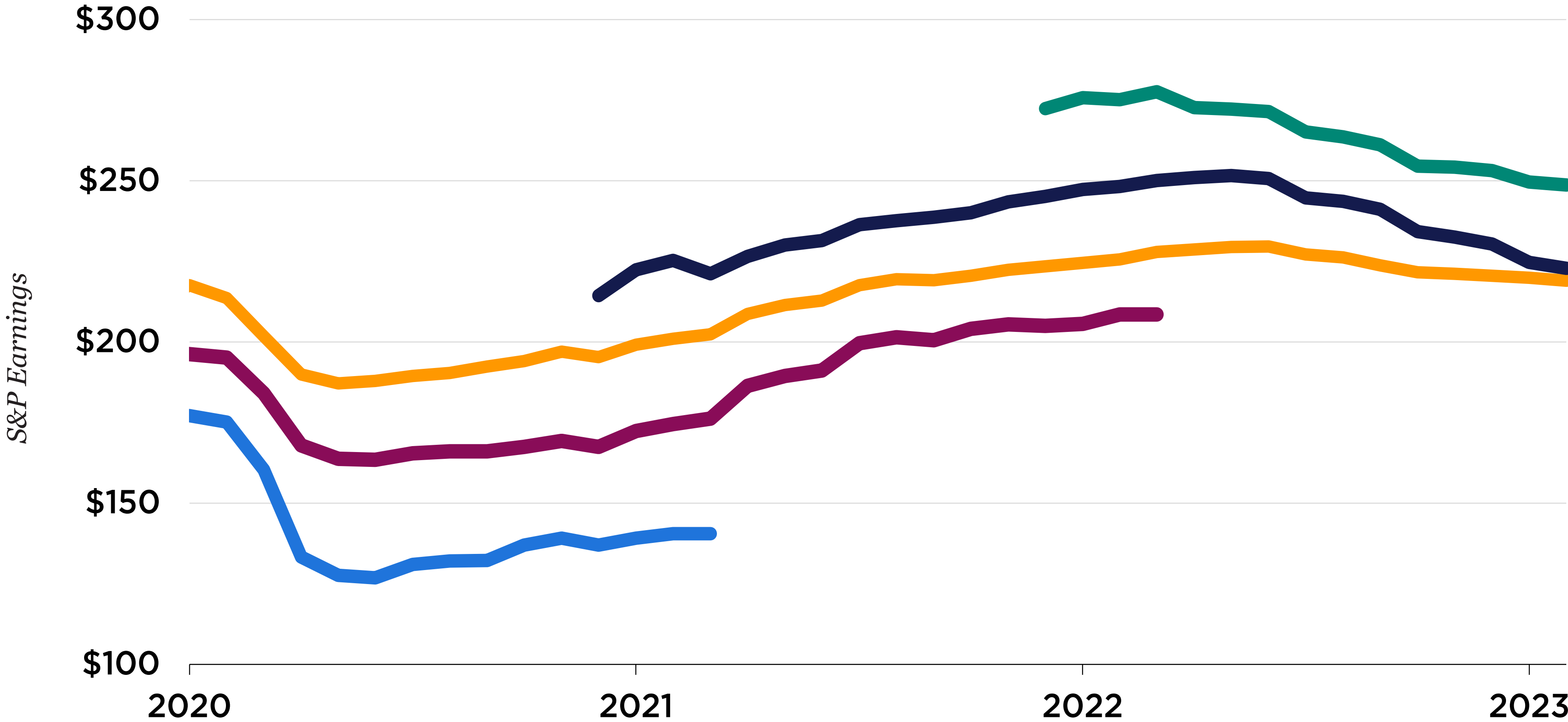
S&P 500® earnings fell for the first time in more than two years in Q4 and are expected to have continued to slide in the first half of 2023. Revenues are still growing.



Source: FactSet

Trend of sliding earnings expectations continue

The decline in earnings expectations for 2023 and 2024 marks a trend change from the prior dynamic of rising forecasts.

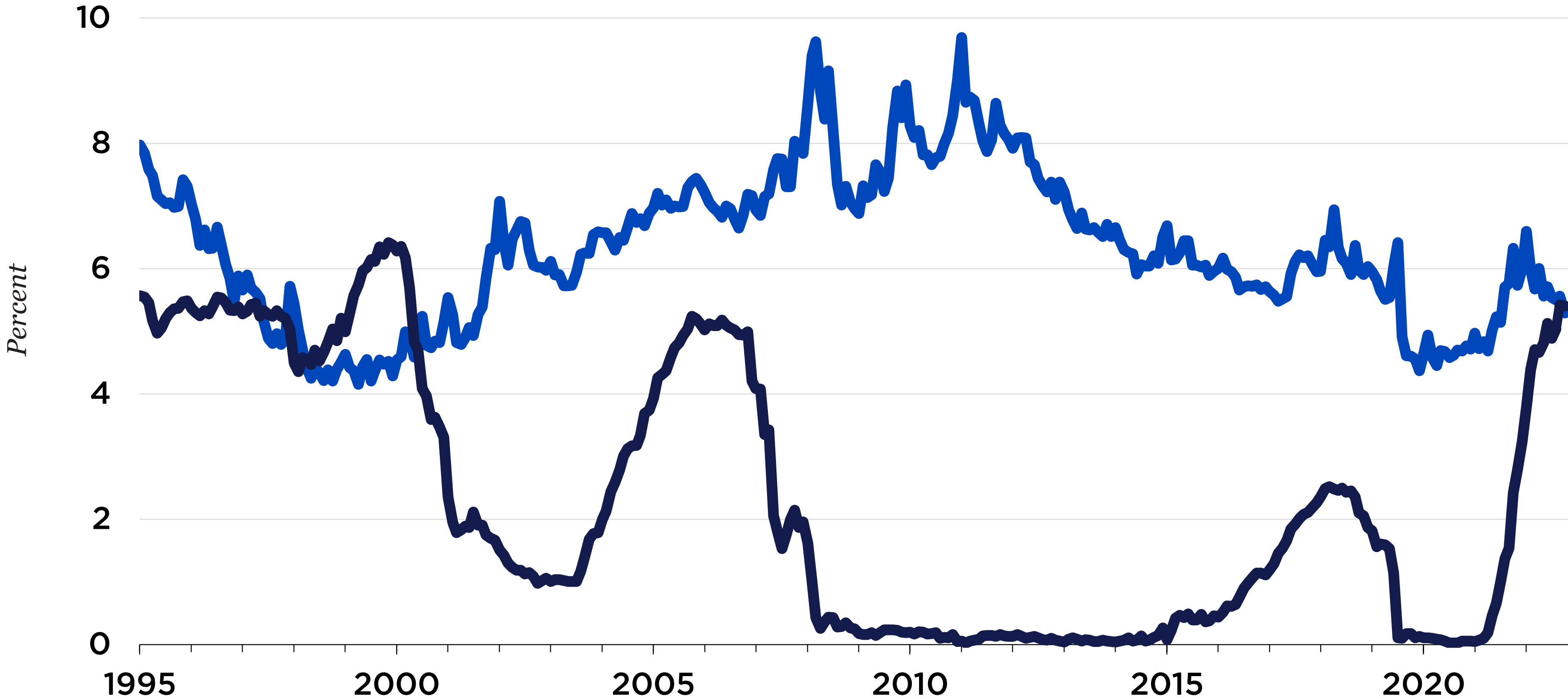


Source: FactSet

New competition for yield

Low interest rates over the last decade led investors to shift their focus to the earnings yield (the inverse of the P/E ratio) from equities to improve yield on their investments.

However, now the rapid rise of interest rates has leveled the playing field as the competition for yield between equities and fixed income is now a fierce battle.



Source: Standard & Poor's and Bloomberg

A bounce back in higher beta sectors

The higher beta sectors moved to the top of the table at the start of the year after largely underperforming in 2022.

Yearly changes in the S&P 500® sectors

Percent

2014	2015	2016	2017	2018	2019	2020	2021	2022	2023 YTD
Utilities 24%	Discretionary 8%	Energy 24%	Technology 37%	Health Care 5%	Technology 48%	Technology 42%	Energy 48%	Energy 59%	Technology 42%
Health Care 23%	Health Care 5%	Financials 20%	Materials 21%	Utilities 0%	Telecoms 31%	Discretionary 32%	Technology 33%	Utilities -1%	Telecoms 36%
Technology 18%	Technology 4%	Telecoms 18%	Discretionary 21%	Discretionary 0%	Financials 29%	Telecoms 22%	Financials 33%	Staples -3%	Discretionary 32%
Financials 13%	Staples 4%	Industrials 16%	Financials 20%	Technology -2%	S&P 500 29%	Materials 18%	S&P 500 27%	Health Care -4%	S&P 500 16%
Staples 13%	S&P 500 -1%	Materials 14%	Health Care 20%	S&P 500 -6%	Industrials 27%	S&P 500 16%	Materials 25%	Industrials -7%	Industrials 9%
S&P 500 11%	Telecoms -2%	Utilities 12%	S&P 500 19%	Staples -11%	Discretionary 26%	Health Care 11%	Health Care 24%	Financials -12%	Materials 7%
Discretionary 8%	Financials -3%	Technology 12%	Industrials 19%	Financials -15%	Staples 24%	Industrials 9%	Discretionary 24%	Materials -14%	Staples 0%
Industrials 8%	Industrials -5%	S&P 500 10%	Staples 10%	Industrials -15%	Utilities 22%	Staples 8%	Telecoms 21%	S&P 500 -19%	Financials -2%
Materials 5%	Utilities -8%	Discretionary 4%	Utilities 8%	Telecoms -16%	Materials 22%	Utilities -3%	Industrials 19%	Technology -29%	Health Care -2%
Telecoms -2%	Materials -10%	Staples 3%	Energy -4%	Materials -16%	Health Care 19%	Financials -4%	Staples 16%	Discretionary -38%	Utilities -7%
Energy -10%	Energy -24%	Health Care -4%	Telecoms -6%	Energy -20%	Energy 8%	Energy -37%	Utilities 14%	Telecoms -40%	Energy -7%

Source: Stamdard & Poor's

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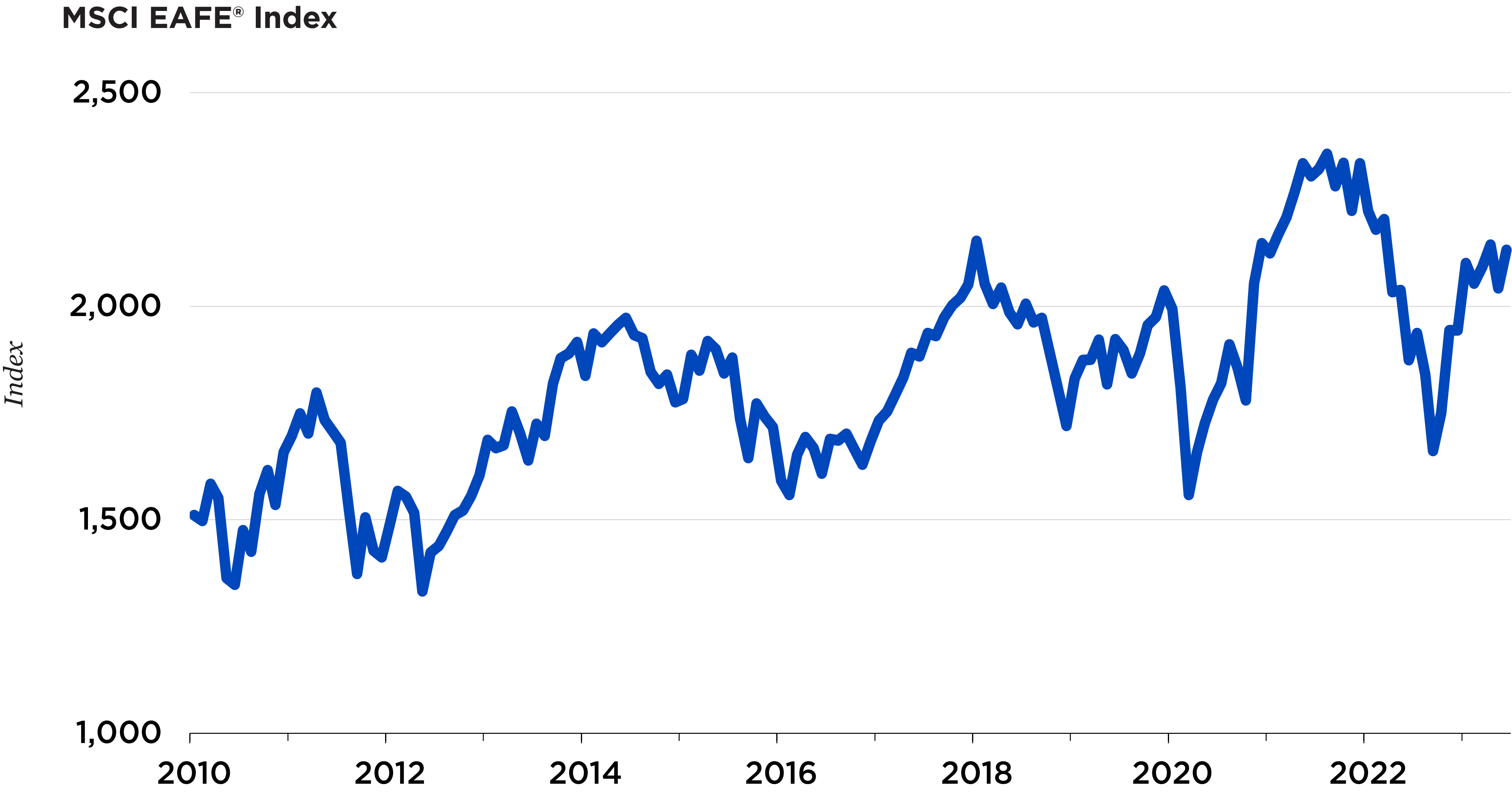
Global stocks climb further

Developed market stocks moved higher for a second straight quarter as economic growth proved more resilient than expected.



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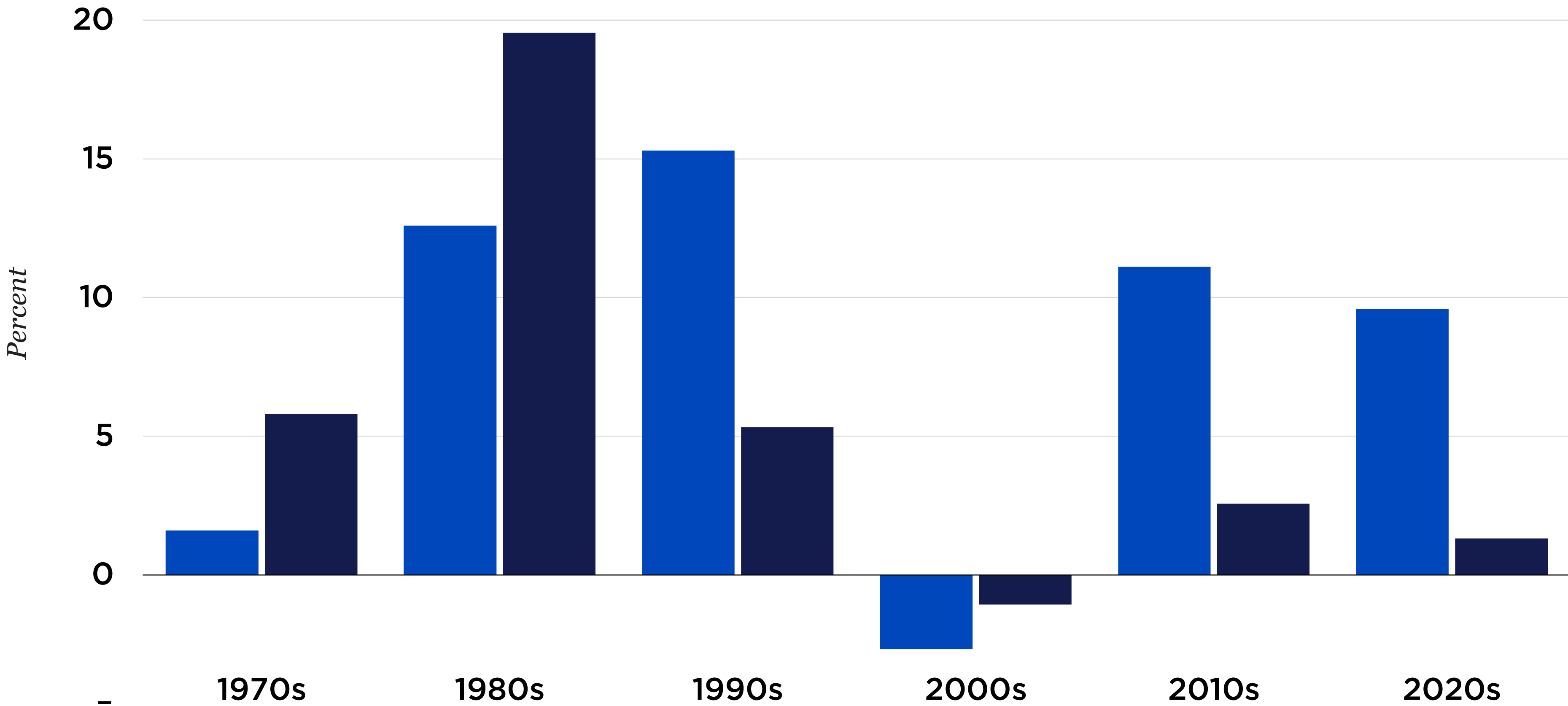
Global underperformance has continued in this decade

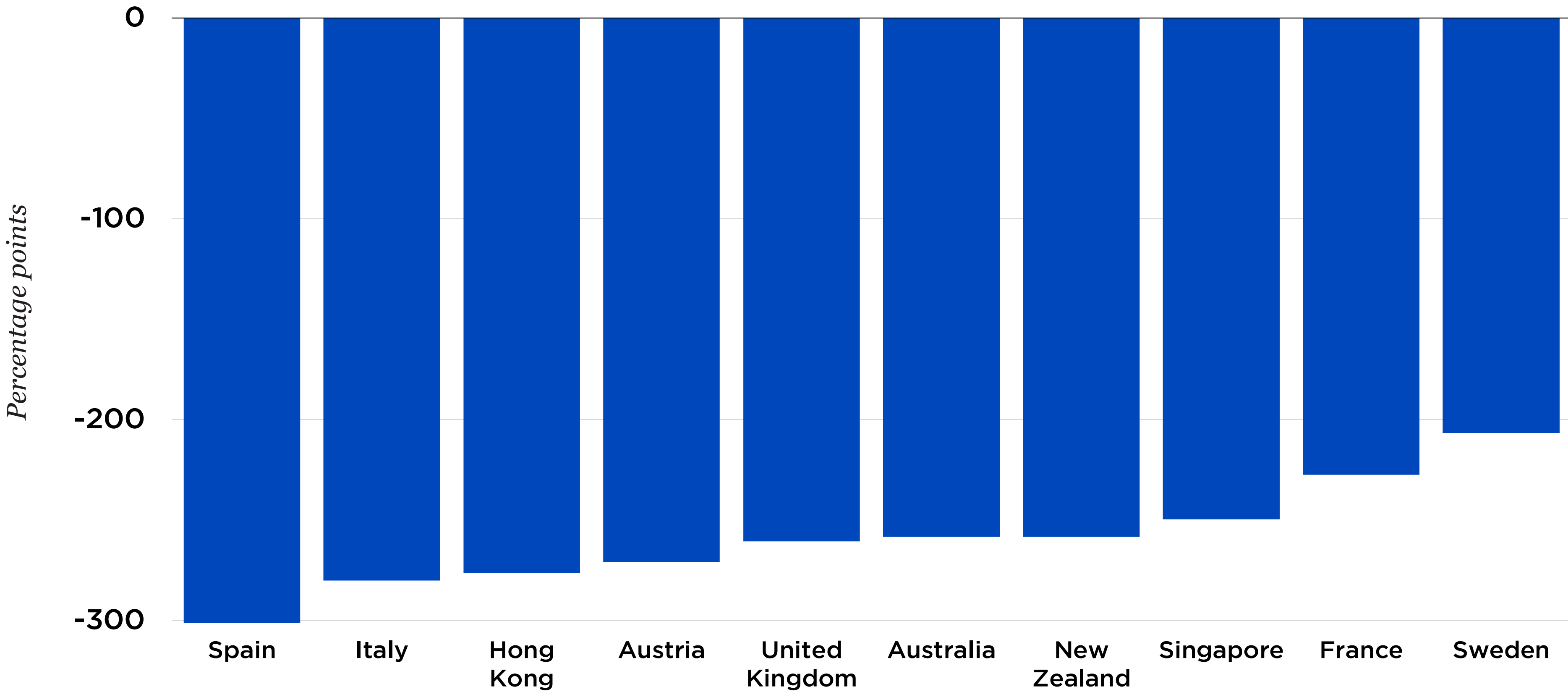
Global stocks outperformed the S&P 500® in the first six months of the year, but are still trailing the U.S. benchmark since the outset of the decade.



Source: Bloomberg

Many markets have underperformed substantially

The S&P has outpaced many markets significantly since the outset of the last decade. The benchmarks in nearly half of all EAFE countries have fallen short of the U.S. bellwether by more than 200 full percentage points over that time frame.



Source: Bloomberg

A promising start to the year

It was an especially healthy start to the year in Europe, as the energy shortages threatened by the war in Ukraine failed to materialize.

Yearly changes in benchmark equity indices

Percent

2014	2015	2016	2017	2018	2019	2020	2021	2022	2023 YTD
China 49%	Japan 8%	Brazil 69%	India 36%	Brazil -2%	Russia 45%	Japan 22%	US 27%	Brazil 10%	Russia 30%
India 27%	China 5%	Russia 52%	Italy 30%	India -3%	US 29%	China 21%	Canada 23%	India -6%	Japan 27%
US 11%	Italy 1%	Canada 21%	Germany 28%	US -6%	Brazil 27%	US 16%	France 20%	UK -10%	Italy 19%
Canada -2%	US -1%	US 10%	Brazil 25%	Russia -7%	Italy 26%	Germany 14%	India 20%	Canada -15%	Germany 16%
Japan -6%	Germany -2%	Japan 4%	France 25%	Japan -10%	Canada 25%	India 13%	Russia 15%	France -15%	US 16%
UK -8%	France -3%	Germany 3%	Japan 23%	France -15%	France 24%	Canada 4%	UK 13%	Germany -17%	France 14%
Germany -10%	Russia -4%	France 2%	US 19%	UK -18%	Germany 23%	Italy 4%	Italy 13%	Italy -18%	Brazil 8%
Italy -12%	India -9%	India -1%	UK 18%	Canada -19%	China 21%	France 1%	China 8%	US -19%	India 6%
France -13%	UK -10%	UK -4%	Canada 14%	Italy -20%	Japan 20%	Russia -10%	Germany 7%	Japan -20%	Canada 4%
Brazil -13%	Canada -25%	Italy -13%	China 14%	Germany -22%	UK 17%	UK -12%	Japan -6%	China -22%	China 4%
Russia -45%	Brazil -42%	China -18%	Russia 0%	China -29%	India 12%	Brazil -20%	Brazil -18%	Russia -39%	UK 1%

Source: Bloomberg

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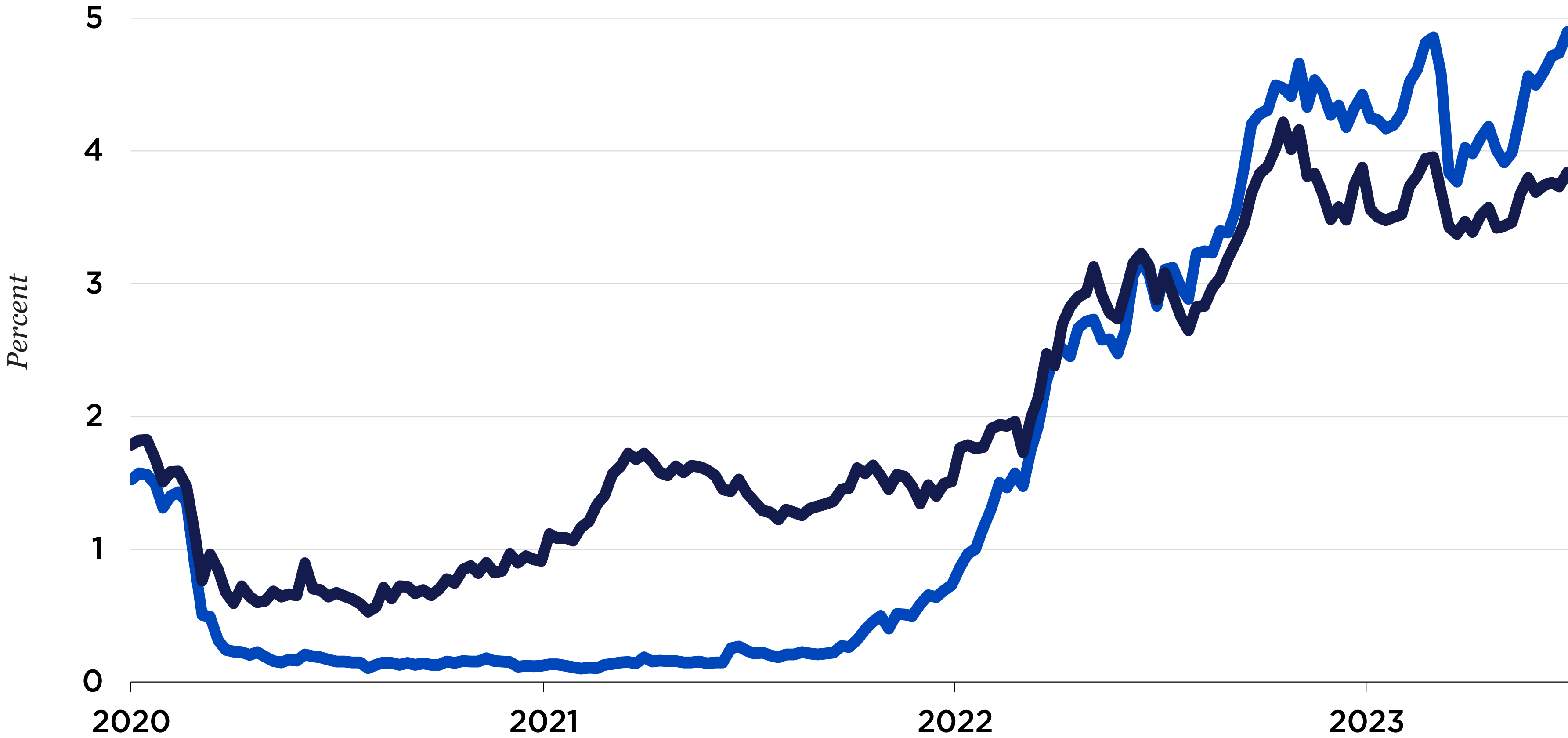
The bond inversion deepened

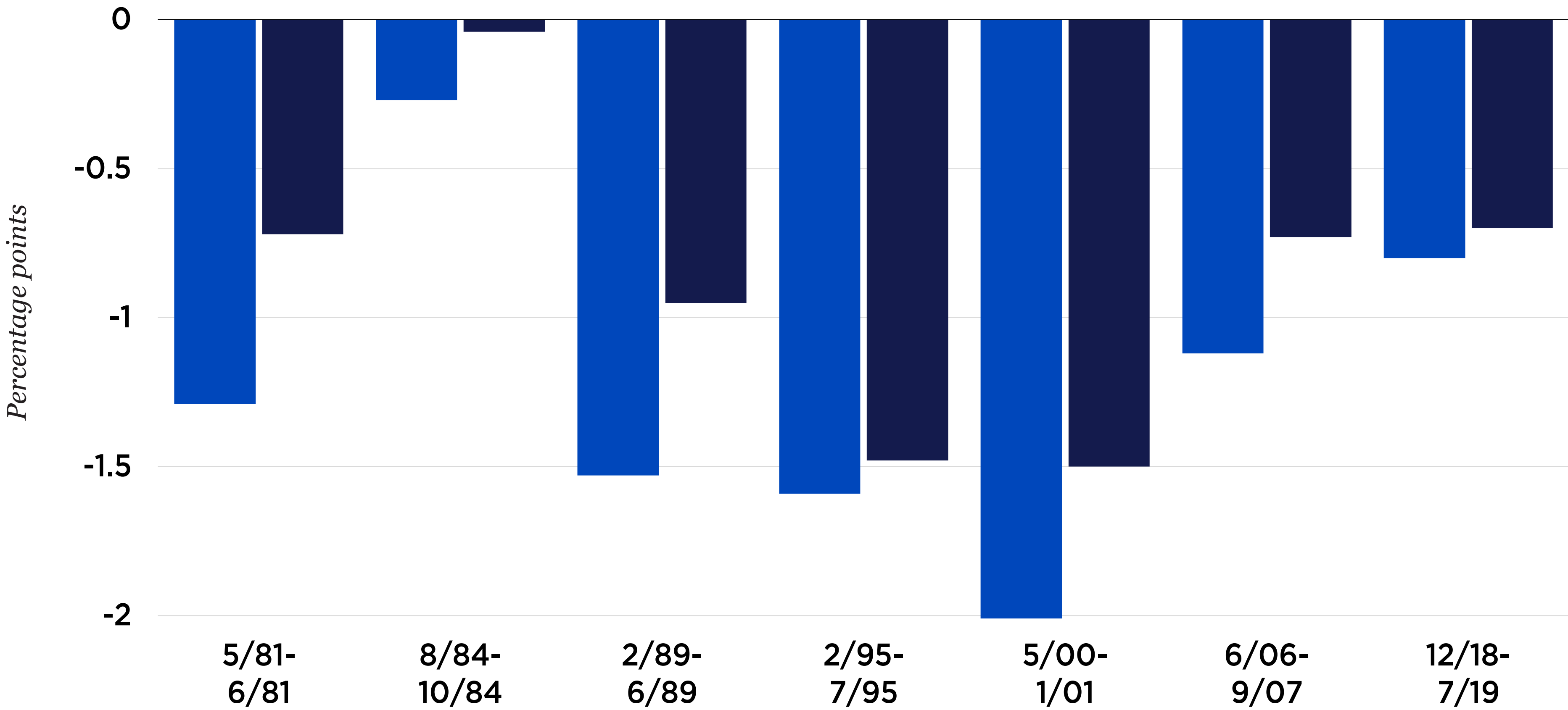
Yields on the 2-year and 10-year have moved more or less in lockstep after the Fed hiked rates in 2018 and for the first year and half after the start of the pandemic. Lately, the 2-year has reacted more than the Fed's tightening, pushing the yield curve to a meaningful inversion.



Source: Federal Reserve Board of Governors

Treasuries rally between tightening and easing cycles

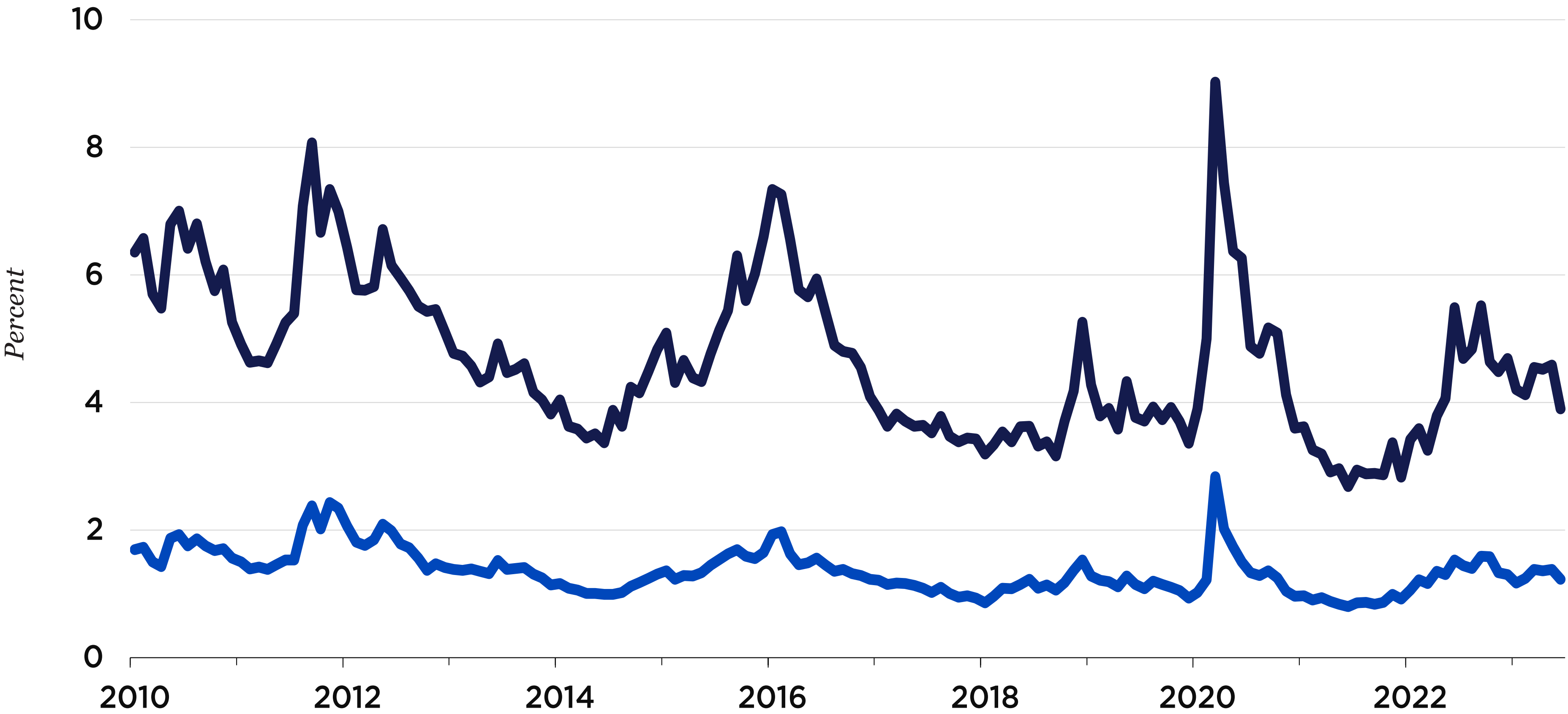
Historically, yields have fallen and the curve has steepened in between the last hike of a Fed tightening cycle and the first cut of the subsequent easing cycle.



Source: Federal Reserve Board of Governors

Credit spreads drop as confidence in corporate performance increases

Credit spreads reversed course by narrowing in Q2 as confidence in corporate performance rose. This drop was a meaningful change from the six quarterly increases in the previous seven quarters. The decline may be a head fake as recession fears loom and the manufacturing sector is already in contraction territory.



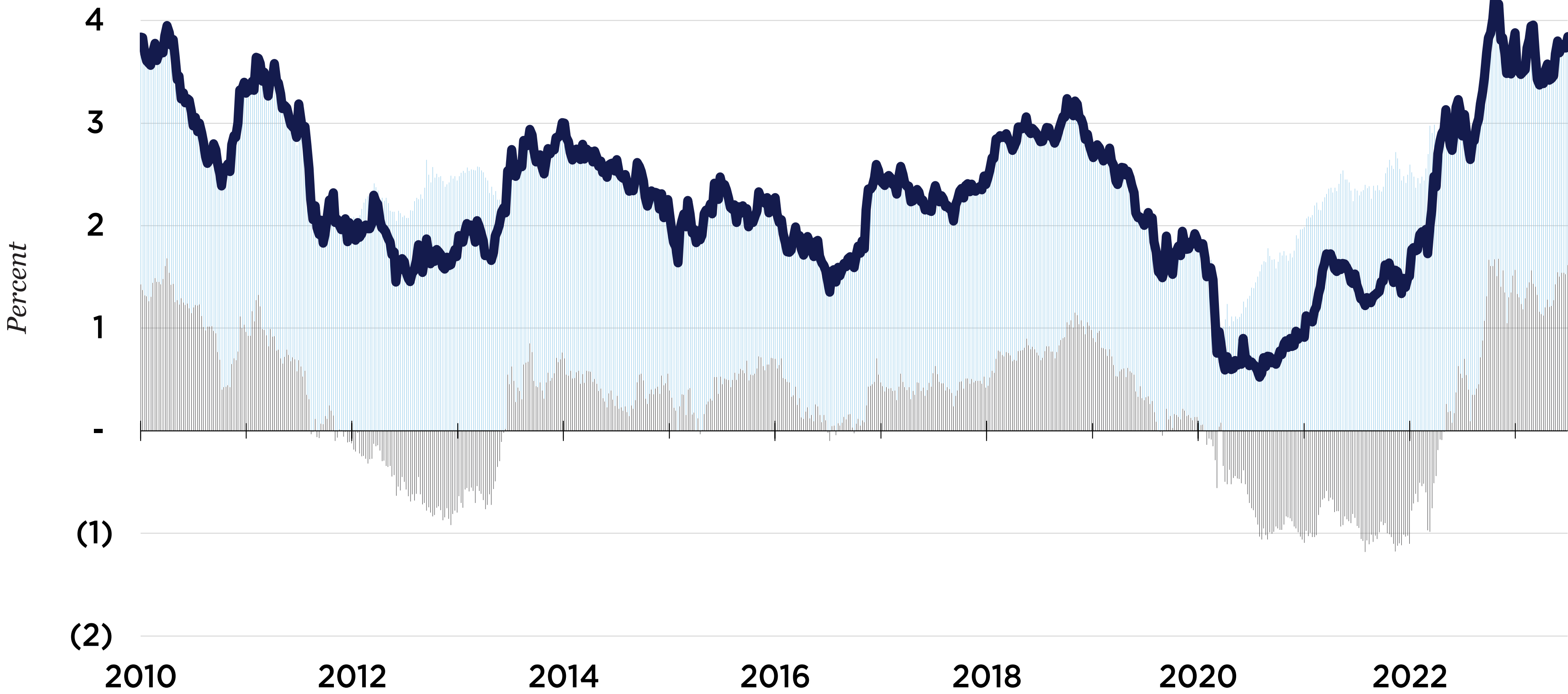
Source: Bloomberg

Inflation expectation disconnect

The seemingly tandem movement of the 10-year Treasury yield and inflation expectations disconnected in 2022, showing the resurgence of real interest rates.

- 10-year nominal Treasury yield
- 10-year inflation breakeven
- 10-year real TIPS yield

Nominal and real Treasury yields



Source: Bloomberg

Better fixed income performance in the first half of 2023

The fixed income asset classes were broadly improved in the first half of 2023 after a rough 2022.

Yearly changes by asset class

Percent

2014	2015	2016	2017	2018	2019	2020	2021	2022	2023 YTD
Treasuries 10.70%	Municipals 3.30%	High Yield 17.10%	High Yield 7.50%	Agencies 1.30%	Corporates 14.50%	TIPS 11.20%	TIPS 6.10%	Agencies -7.90%	High Yield 5.38%
Municipals 9.10%	MBS 1.50%	Corporates 6.10%	Corporates 6.40%	Municipals 1.30%	High Yield 14.30%	Treasuries 10.60%	High Yield 5.30%	Municipals -8.50%	Corporates 3.21%
Corporates 7.50%	Agencies 1.00%	TIPS 4.80%	Municipals 5.40%	MBS 1.00%	Treasuries 8.90%	Corporates 9.90%	Municipals 1.50%	MBS -11.80%	Municipals 2.67%
MBS 6.10%	Treasuries 0.90%	Bloomberg Agg 2.60%	Bloomberg Agg 3.50%	Bloomberg Agg 0.00%	TIPS 8.80%	Bloomberg Agg 7.50%	Corporates -1.00%	High Yield -11.90%	Bloomberg Agg 2.09%
Bloomberg Agg 6.00%	Bloomberg Agg 0.50%	MBS 1.70%	TIPS 3.30%	Treasuries 0.00%	Bloomberg Agg 8.70%	High Yield 7.10%	MBS -1.00%	TIPS -12.60%	TIPS 1.99%
TIPS 4.40%	Corporates -0.70%	Agencies 1.40%	MBS 2.50%	TIPS -1.50%	Municipals 7.50%	Agencies 5.50%	Agencies -1.30%	Bloomberg Agg -13.00%	MBS 1.87%
Agencies 3.60%	TIPS -1.70%	Municipals 0.20%	Treasuries 2.10%	High Yield -2.10%	MBS 6.40%	Municipals 5.20%	Bloomberg Agg -1.50%	Corporates -15.80%	Treasuries 1.78%
High Yield 2.50%	High Yield -4.50%	Treasuries -0.20%	Agencies 2.10%	Corporates -2.50%	Agencies 5.90%	MBS 3.90%	Treasuries -3.60%	Treasuries -16.30%	Agencies 1.64%

Source: Bloomberg

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Commodities are in a downward trend

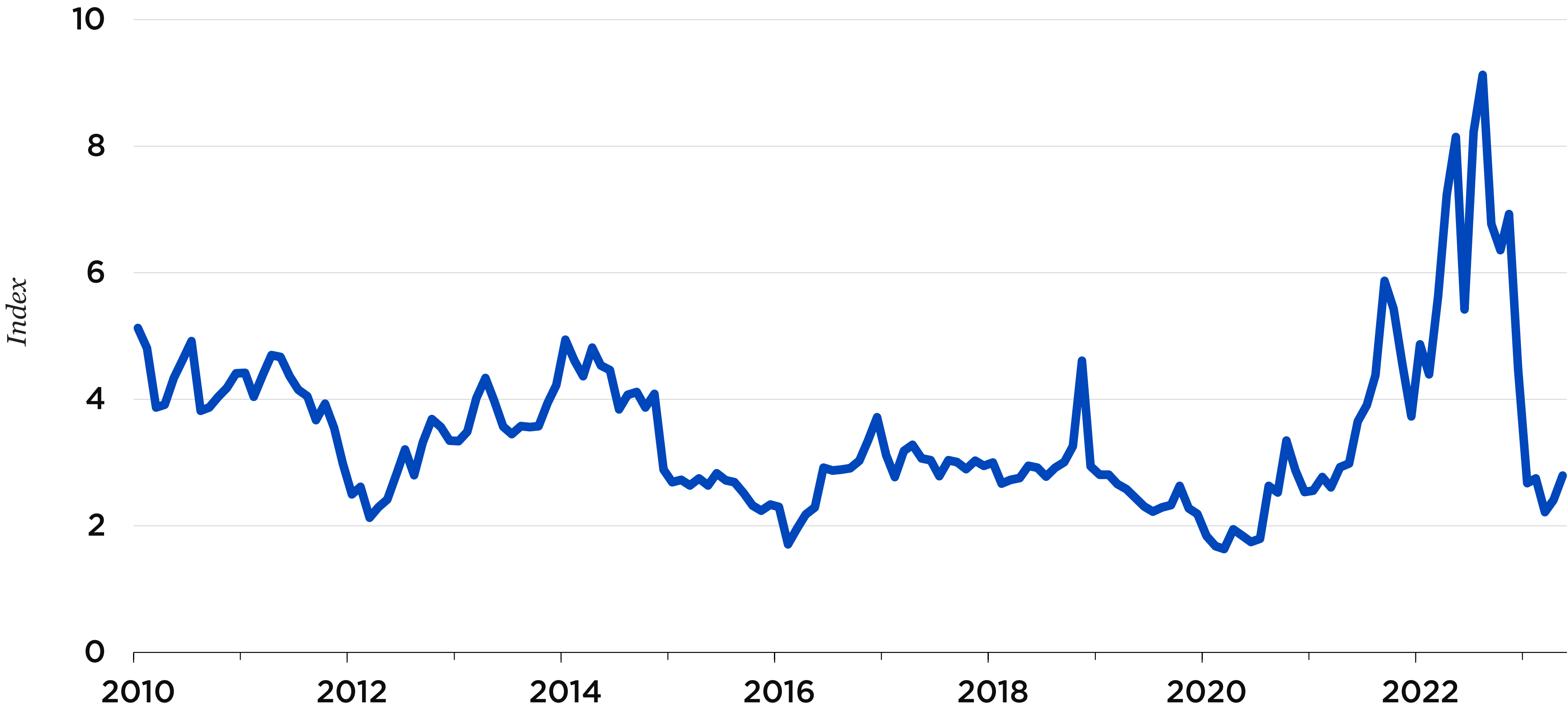
Commodity prices fell for the third time in the last four quarters.

Source: Commodity Research Bureau

Natural gas retreats

A surge in supply from the Permian region has stablized natural gas prices after a rough ride in 2022.

Energy prices shocked businesses and provided welcomed relief to consumers.



Source: New York Mercantile Exchange

A pullback in energy

Energy retreated in the first half of 2023 after big gains in 2022.

Yearly changes in commodity prices

Percent

2014	2015	2016	2017	2018	2019	2020	2021	2022	2023 YTD
Livestock 14%	Precious Metals -11%	Energy 18%	Industrials 29%	Livestock -1%	Energy 30%	Precious Metals 23%	Energy 61%	Energy 42%	Livestock 8%
Precious Metals -4%	Agriculture -17%	Industrials 18%	Precious Metals 12%	Precious Metals -4%	Precious Metals 18%	Agriculture 15%	Industrials 30%	Agriculture 12%	Precious Metals 4%
Industrials -7%	Livestock -18%	Precious Metals 8%	Livestock 8%	Agriculture -8%	Industrials 3%	Industrials 15%	Agriculture 25%	Livestock 5%	Agriculture -3%
Agriculture -11%	Industrials -25%	Agriculture -4%	Energy 6%	Energy -17%	Agriculture 0%	Livestock -22%	Livestock 8%	Precious Metals 0%	Industrials -8%
Energy -44%	Energy -42%	Livestock -7%	Agriculture -12%	Industrials -18%	Livestock -6%	Energy -46%	Precious Metals -5%	Industrials -8%	Energy -12%

Source: Goldman Sachs

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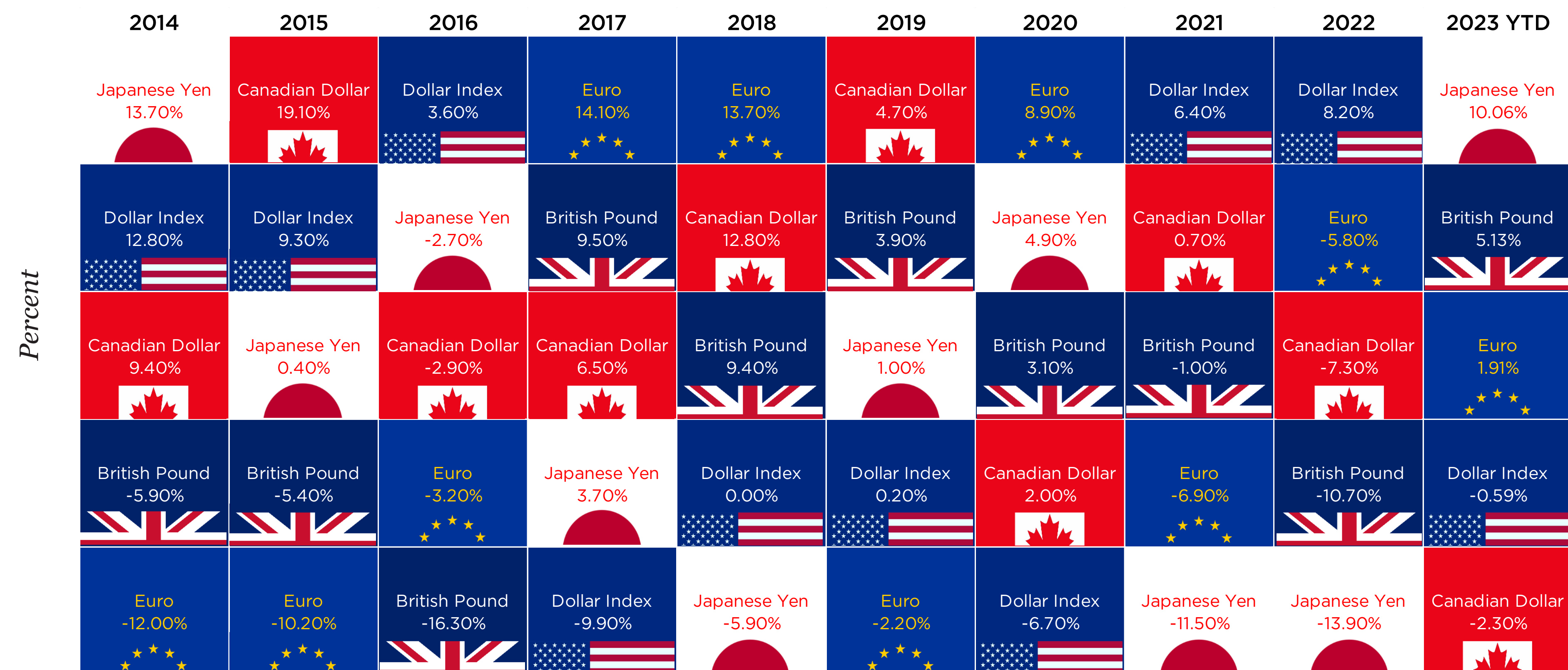
The dollar is off its high

The dollar was stable in the second quarter as the Fed wound down the pace of tightening.

A mixed quarter in FX

The dollar's performance was mixed.

Annual currency changes



Source: Bloomberg

U.S. Economy

Highlights

29 The Fed's aggressive tightening

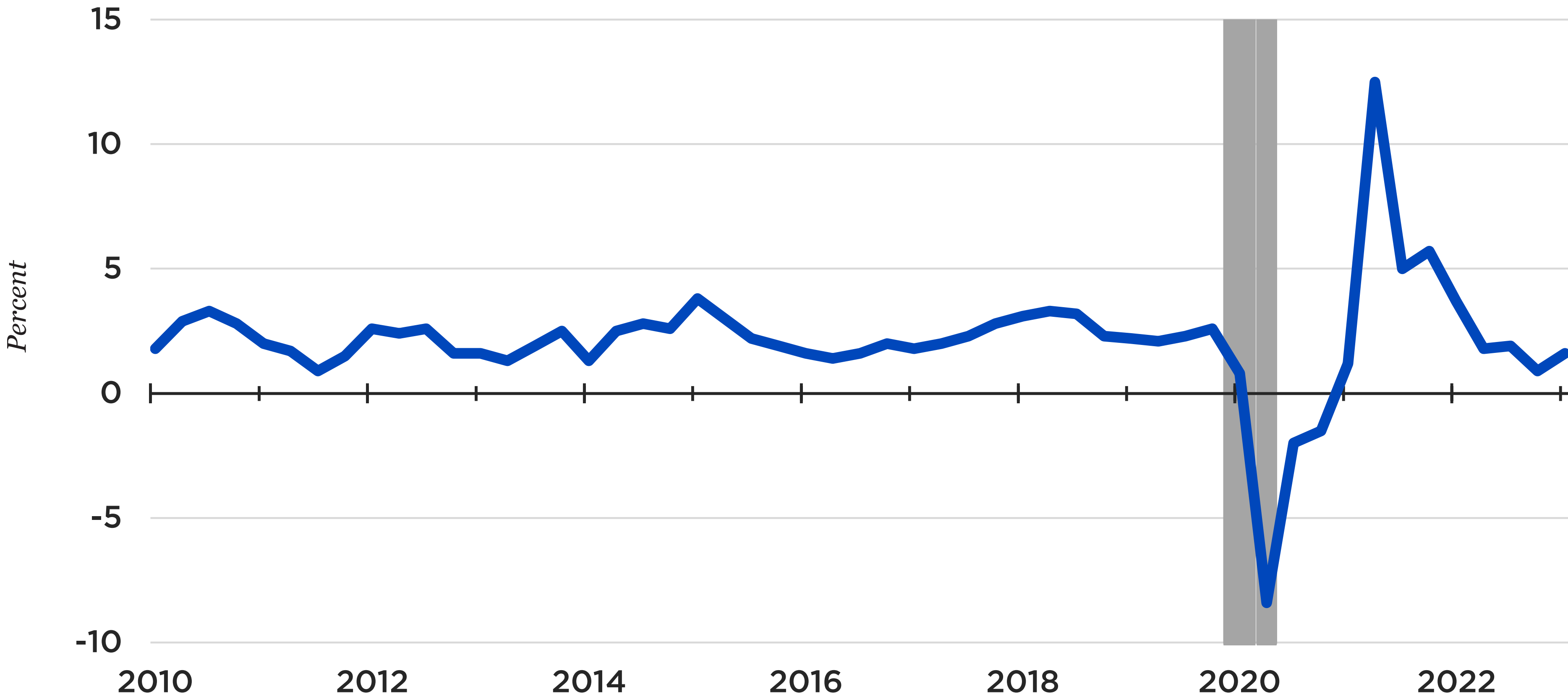
30 Yield curve inflection point

33 Employment growth regionally concentrated, economy vulnerable in others

37 Leading indicator index flashes red light for the economy

Growth nearly steady over the last few quarters

An increase in consumer and export demand has kept economic growth roughly stable even though the Fed has aggressively tightened.



Source: Bureau of Economic Analysis and National Bureau of Economic Research

Consumer and trade drives late cycle growth

Since 2013, most of the GDP components have remained in positive territory. As of 2022, the investment component has become a drag, weighed down by higher interest rates and stalled housing activity.

Yearly change in the real GDP components

Percent

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023Q1
Investment 9.3%	Imports 6.5%	Imports 3.3%	Consumption 2.3%	Exports 6.2%	Investment 4.8%	Government 4.0%	Investment 2.4%	Imports 10.1%	Exports 4.6%	Exports 7.2%
Exports 5.2%	Investment 3.5%	Consumption 2.6%	Imports 2.2%	Imports 5.3%	Imports 3.3%	Consumption 2.2%	Government 1.0%	Investment 8.6%	Imports 1.7%	Government 2.7%
Imports 2.9%	Consumption 5.3%	Investment 2.3%	Investment 1.8%	Investment 4.6%	Consumption 2.5%	Exports 0.8%	Imports 0.4%	Consumption 7.2%	Consumption 1.5%	Consumption 2.3%
Consumption 1.9%	Exports 0.3%	Government 2.2%	Government 1.6%	Consumption 2.8%	Government 1.6%	Investment 0.1%	Consumption -1.4%	Exports 6.5%	Government 0.9%	Imports -1.8%
Government -2.4%	Government 2.4%	Exports -1.5%	Exports 1.3%	Government 0.7%	Exports 0.2%	Imports -2.0%	Exports -10.0%	Government 0.5%	Investment -3.8%	Investment -7.9%

Source: Bureau of Economic Analysis

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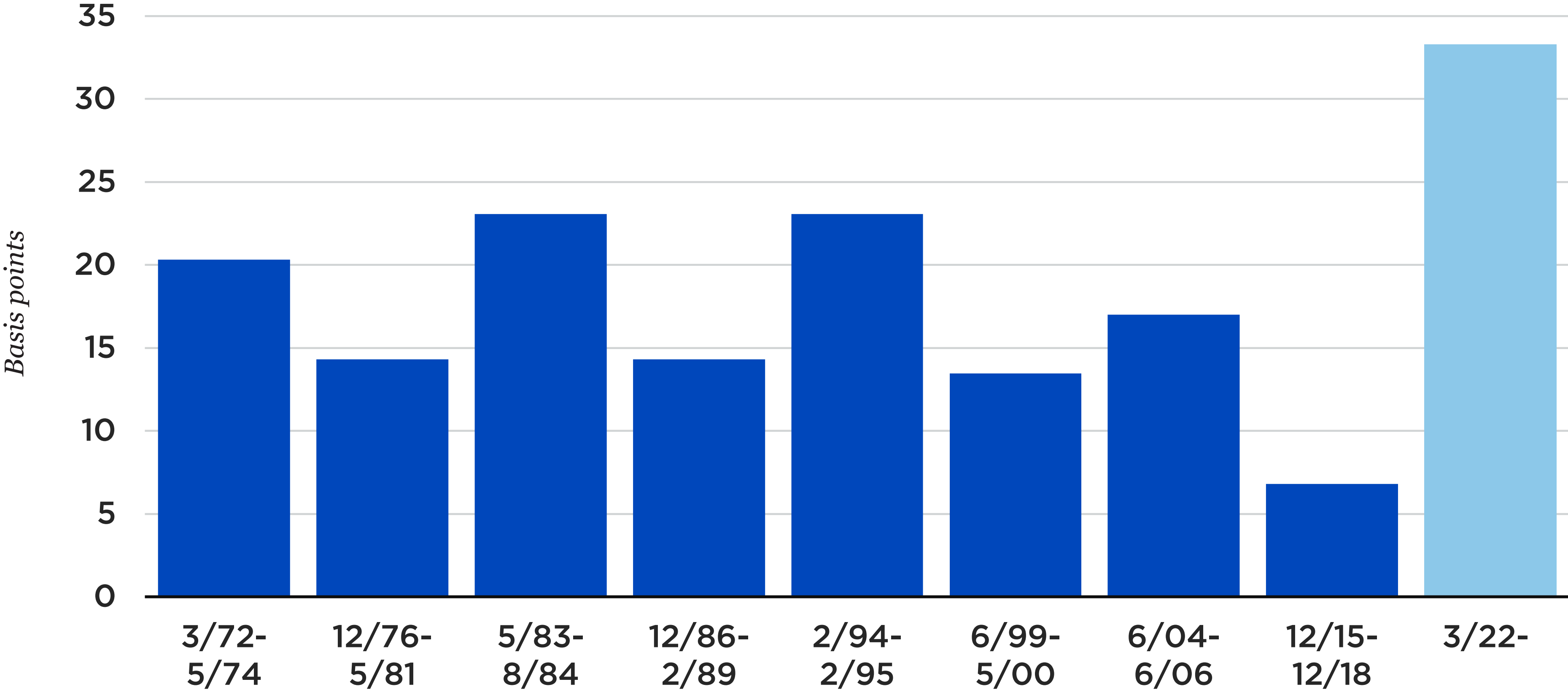
An aggressive Fed tightening cycle

The Federal Reserve has rapidly raised this tightening cycle which has seen the steepest interest rate increase of any completed tightening cycle in the last half century.



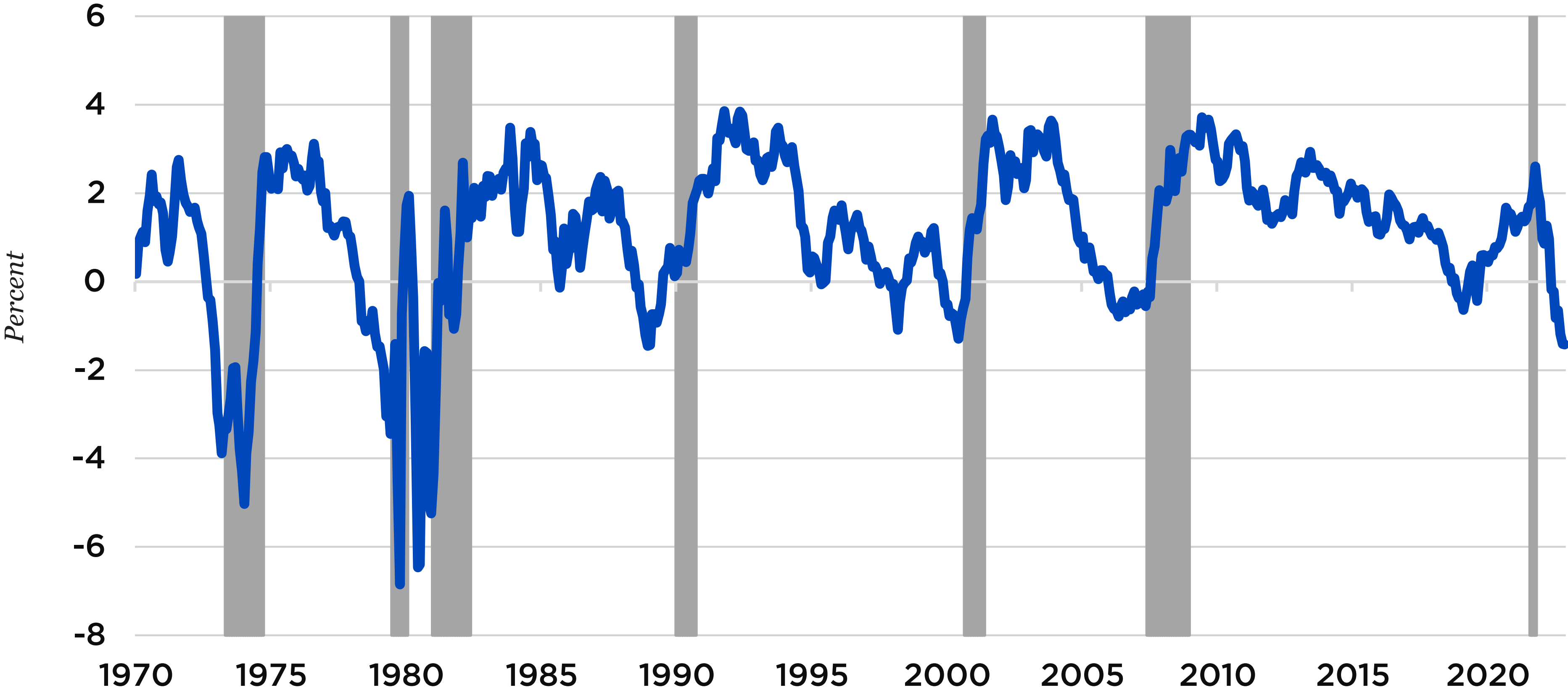
Source: Federal Reserve Board of Governors

The yield curve has hit a key inflection point

The yield curve, the spread between long and short-term interest rates, is the indicator that best encapsulates the stance of monetary policy relative to the state of the economy.

As this has been proven over time to be the most prescient signpost of a turn in the business cycle, the deepening inversion should be taken as a sign that the recession risks are rising.

Spread between the 10-year U.S. Treasury yield and the federal funds target rate



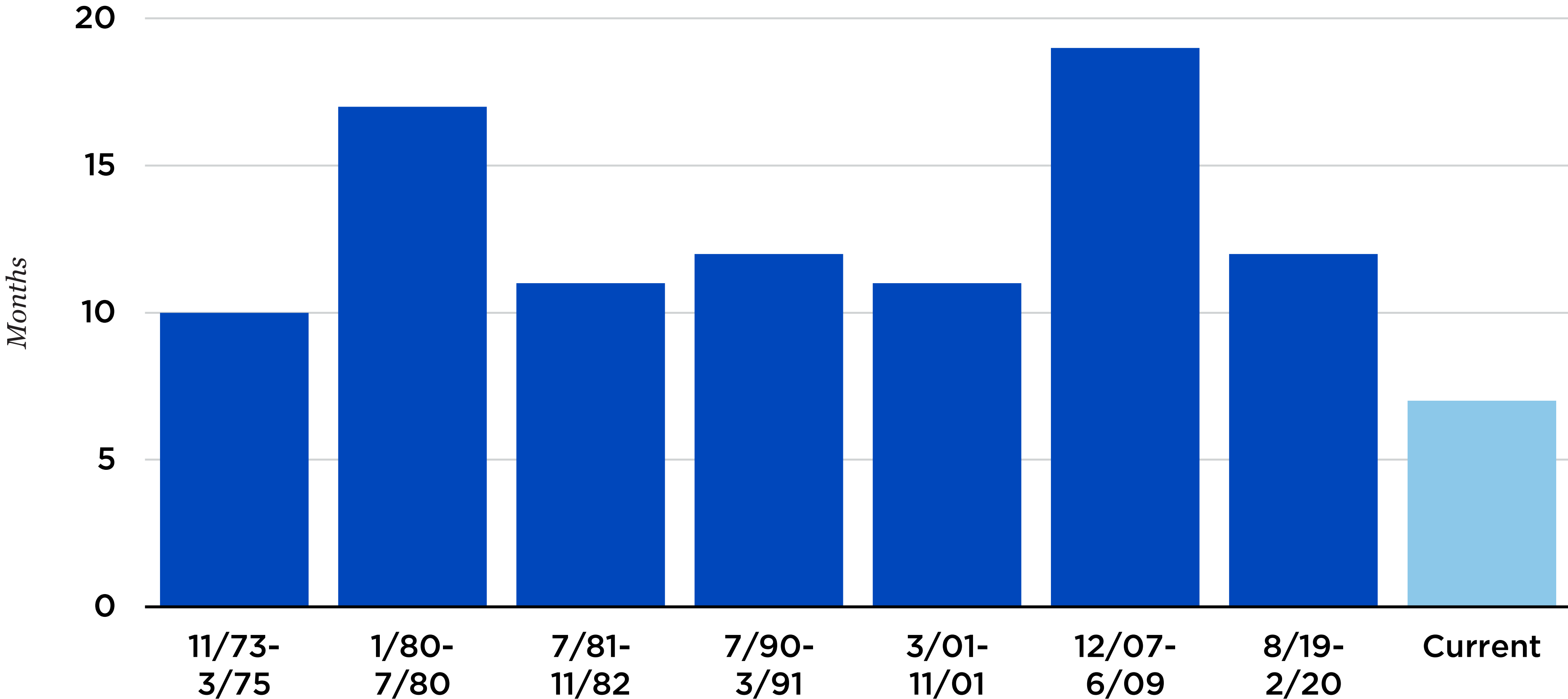
Shaded area depicts recessionary periods.
Source: Bloomberg

Yield curve inversion still modest by historical standards

Not all yield curve inversions lead directly into recessions. The gap between long- and short- interest rates typically flag a downturn when it has been deeply negative for a sustained period.

The recent inversion is an undeniable red flag, but it is not yet signaling that a contraction is inevitable.

Months in which the 10-year/federal funds spread has been negative prior to recessions

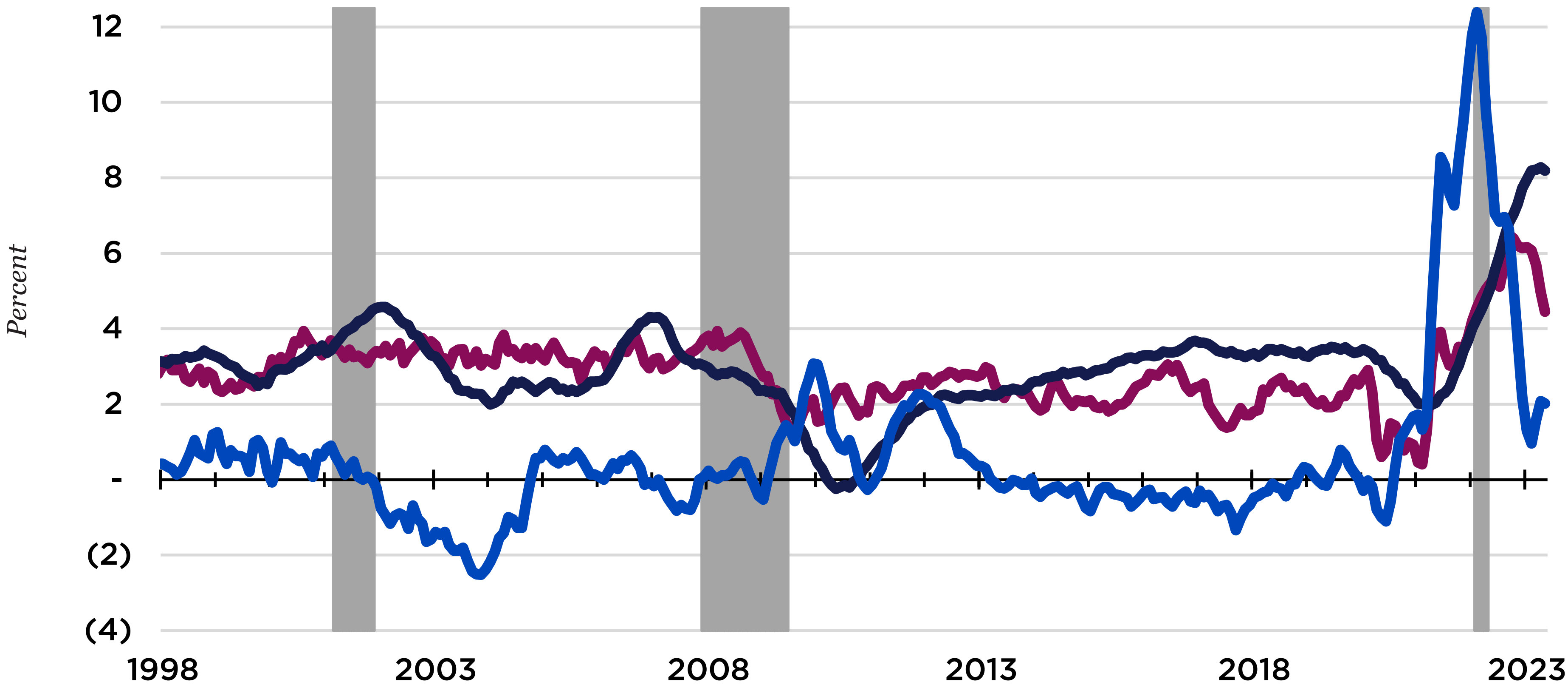


Source: Bloomberg

Core goods and service less rent retreats, housing inflation persists

Core goods and services less rents rapidly lifted inflation after the pandemic. Today, these readings have moderated under the weight of aggressive Fed tightening.

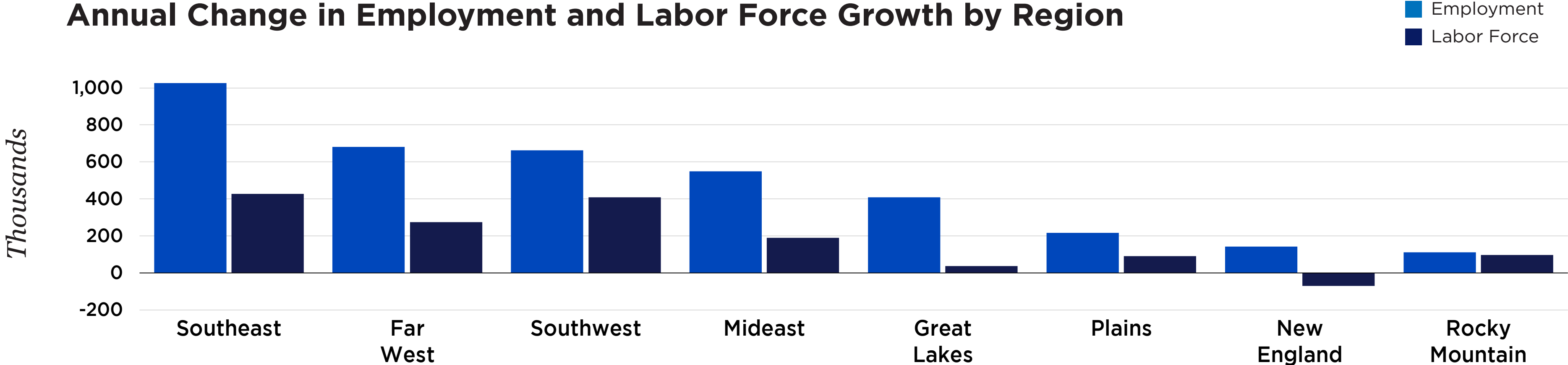
Rents inflation remains elevated causing affordability to plummet, holding back residential investment. A bright spot is that housing inflation typically moderates after a recession takes hold.

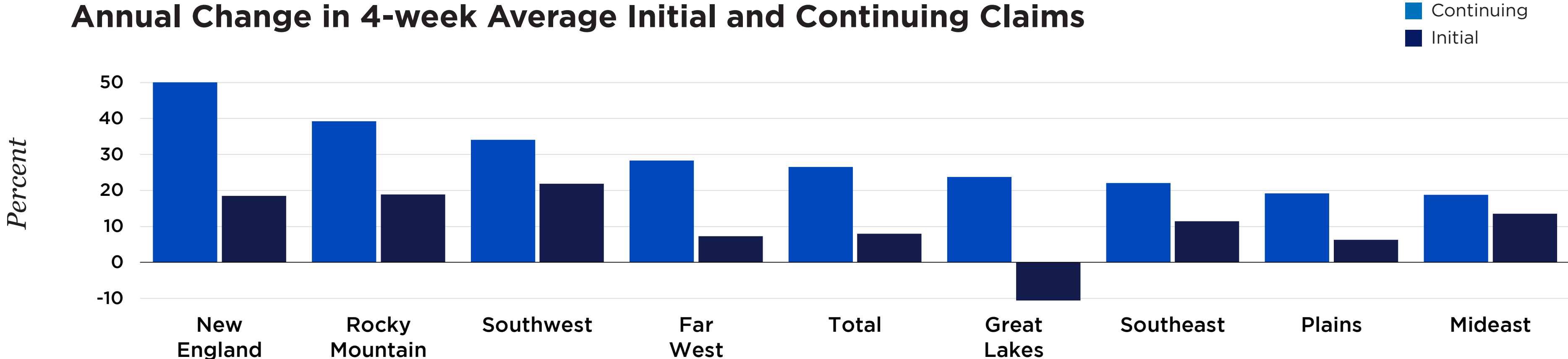


Shaded area depicts recessionary periods.
Sources: Bloomberg, Nationwide Economics

Regional Labor Market

Changes in work dynamics such as the transition to work-from-home and technology prevalence have created a wide division among regional economies. Southeast and Southwest show employment and labor force gains while weaker growth areas like New England and Rocky Mountains have seen a rise in jobless claims. The uptick in claims foretells the vulnerability of these regions to the expected economic downturn.

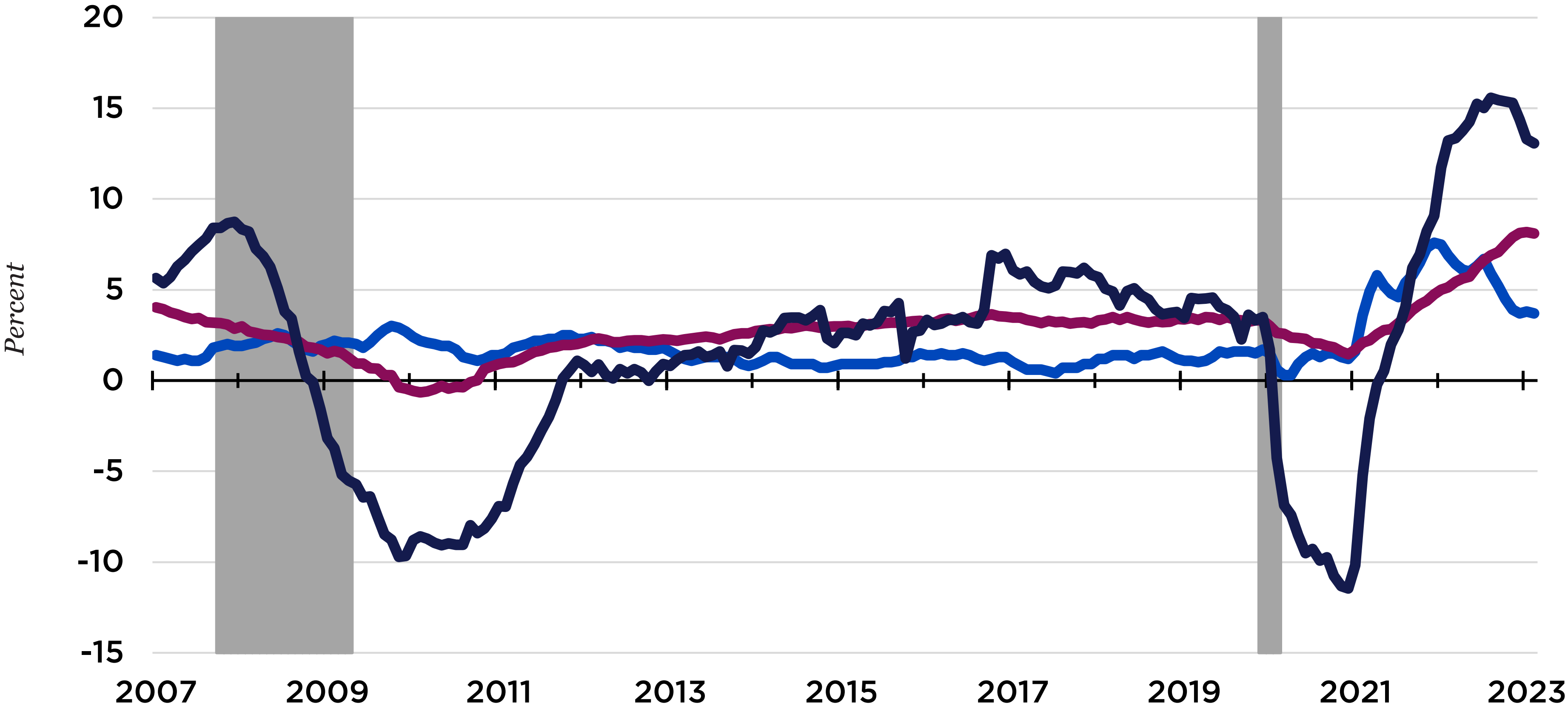




Source: Bureau of Labor Statistics

Revolving debt rising as inflation takes its toll on the consumer

Negative real wage growth has forced consumers to use an increasing amount of revolving debt.



Shaded area depicts recessionary periods.

Source: Bureau of Labor Statistics, New York Fed Reserve Bank

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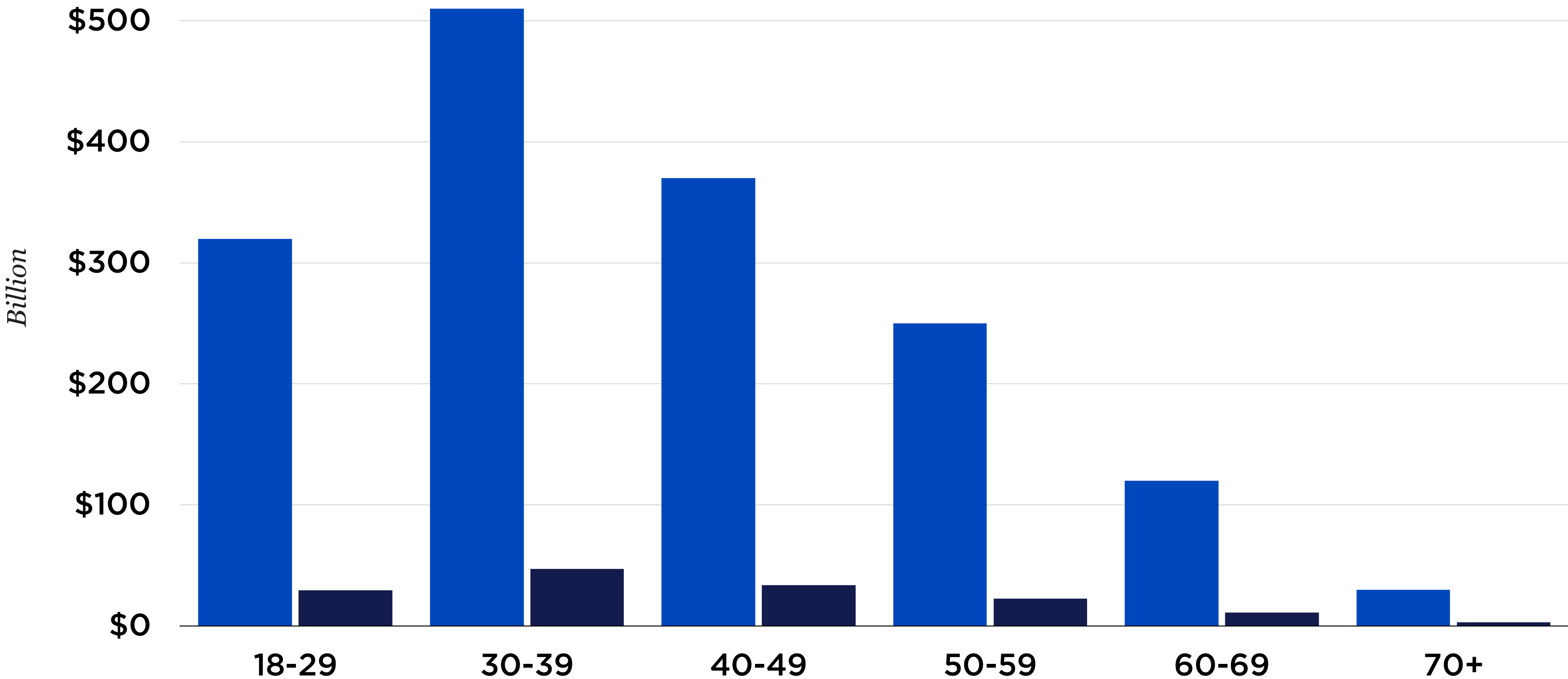
Resuming student loan payments should slow consumer spending

Student debt payments are expected to resume in the second half of 2023, with the 30- to-39-year-old spenders particularly vulnerable to the loss of this disposable income — bad news for businesses that cater to this primary spending group.



Payment assumption includes 10-year amortization, 5.80% annual interest rate, and 70% of loans in repayment

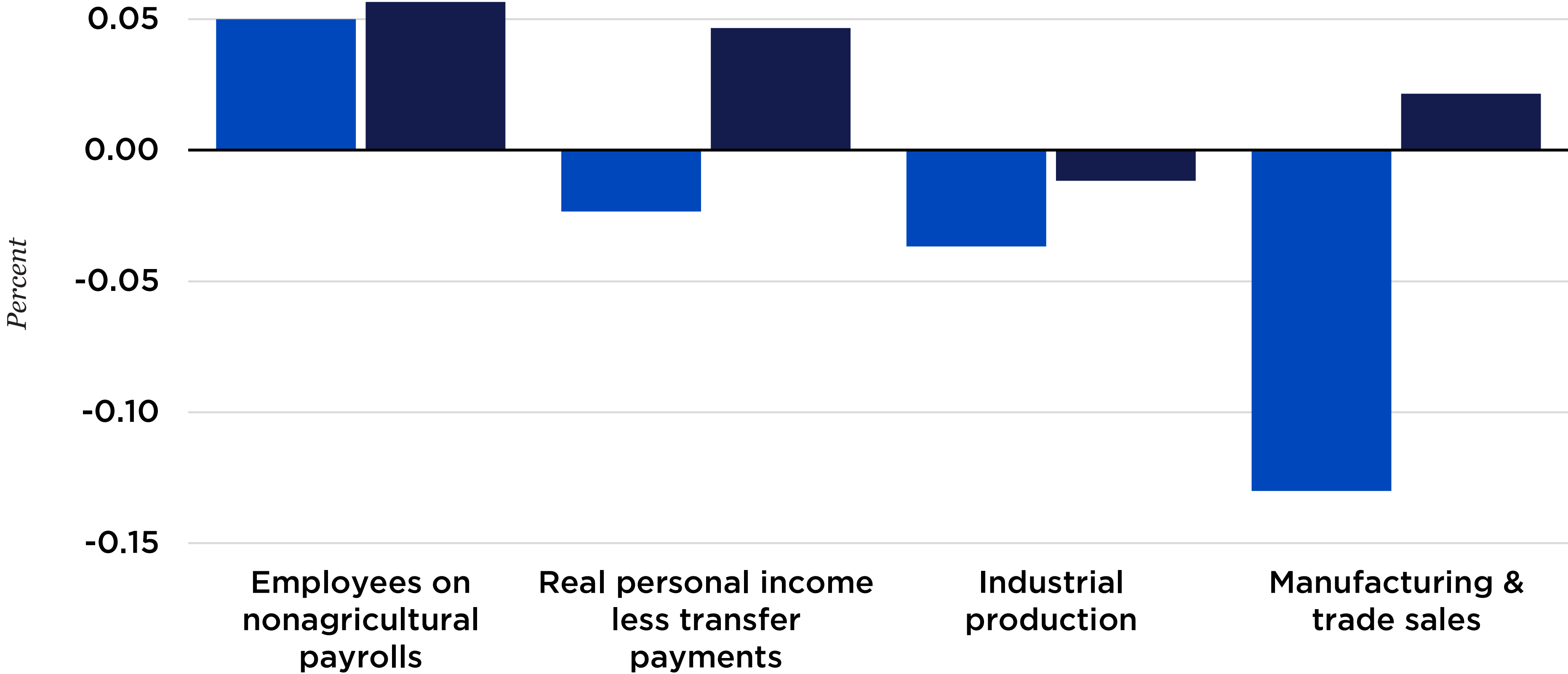
Sources: New York Fed Reserve Bank, Nationwide Economics

Coincident indicators

The monthly indicators used to determine the business cycle are modestly growing but at a slower pace, which is slowing the building of storm clouds for the next economic downturn.

Last six months
Six months prior to last recession

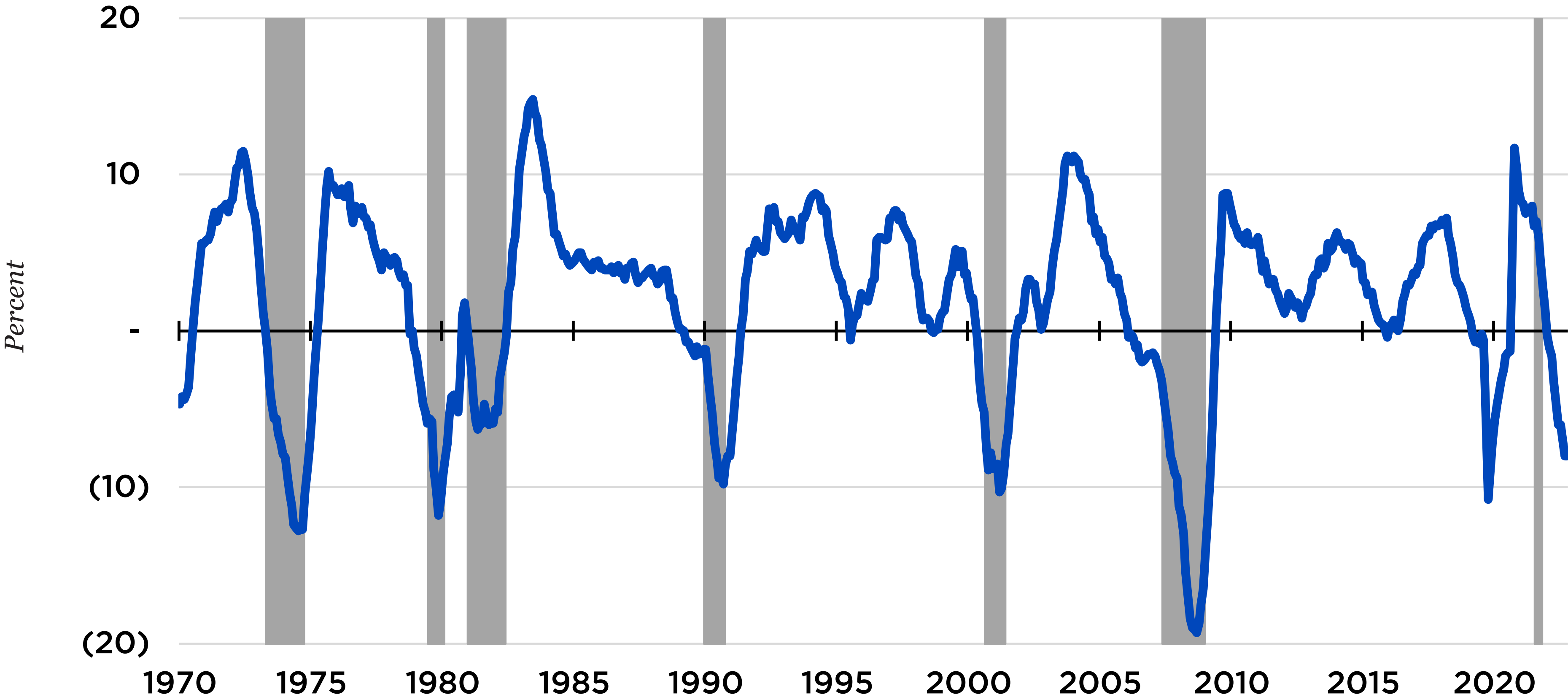
Average monthly changes in the key coincident economic indicators prior to recession



Source: Conference Board

Leading Indicators

The Conference Board's Leading Index is flashing a bright red warning sign for the U.S. economy, with weak readings in consumer expectations of business conditions and ISM new orders holding the index down the most.



Shaded area depicts recessionary periods.
Source: Conference Board

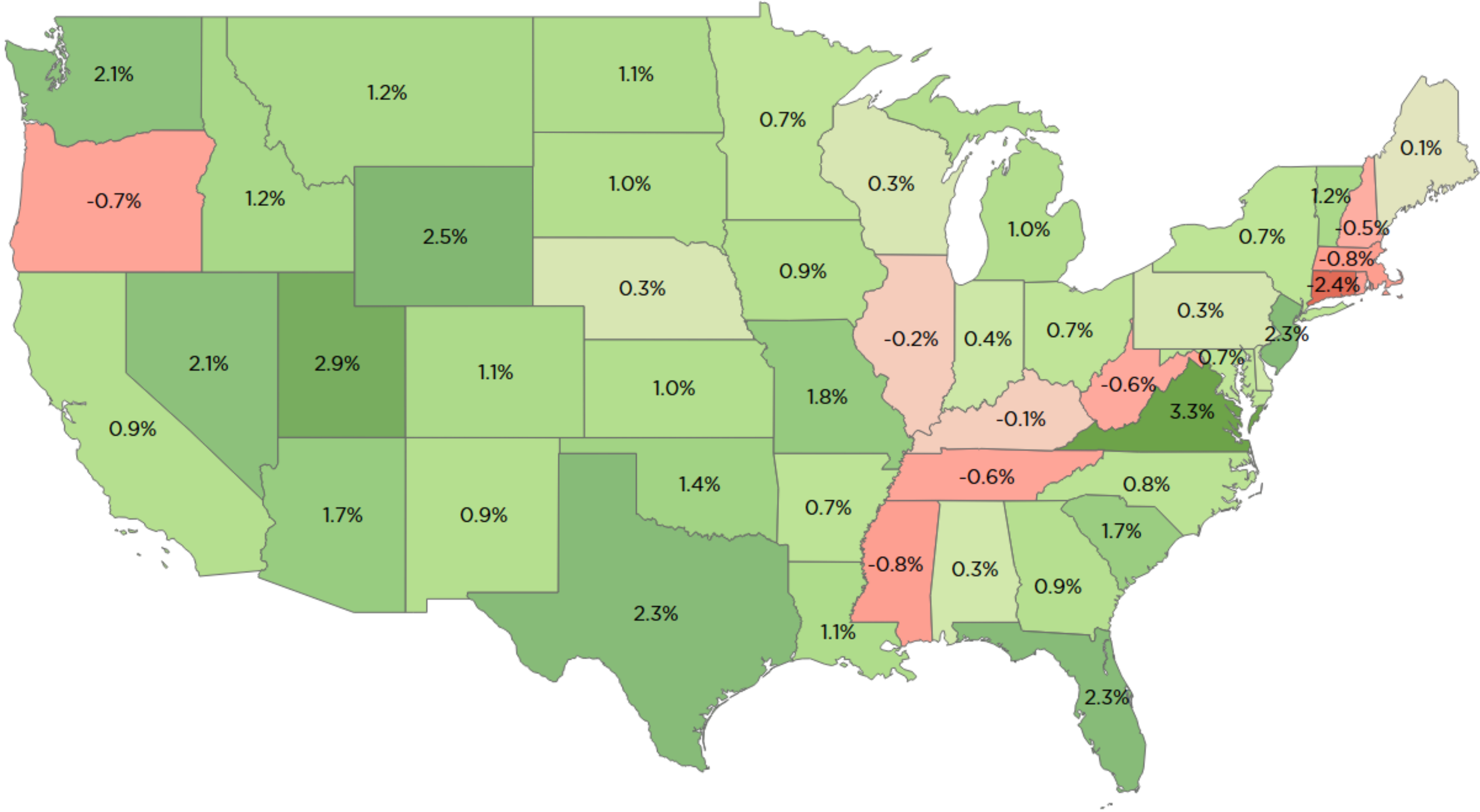
Where are we in the business cycle

Expansions and recessions are amplified through the labor market before being ended via changes in inflation and interest rates. The inversion in the yield curve late last year is an indication that this cycle may be nearing its conclusion.

Labor availability favors Southeast and Southwest

There has been healthy labor force growth in the overall southern region of the country. Though, worker scarcity persists in other areas of the country due to a shortage of skilled workers.

Yearly change in labor force by state



Source: Department of Labor and Bloomberg

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