Q3 2023

Quarterly Perspectives

MEEDER

MARKET PERFORMANCE UPDATE

The majority of the S&P 500 Index's year-to-date performance continues to be driven by a few technology stocks. Only a couple of years ago, investors coined the small number of large-cap technology drivers as the "FAANG" stocks. These included Facebook (Meta), Amazon, Apple, Netflix, and Google (Alphabet). Now, investors have chosen a new group of favorites they call the "Magnificent Seven." These include Apple, Alphabet, Amazon, Meta, Microsoft, Nvidia, and Tesla. These stocks are the primary reason for the year-to-date performance disparity between the S&P 500 Index (+13.1%) and the S&P 500 Equally Weighted Index (+1.8%). In addition, volatility increased throughout the quarter but remained below its long-term average. U.S. small-cap stocks gave up nearly all their 2023 gains in the third quarter, as a surge in interest rates and the Federal Reserve remained the primary focus of investors. Bond prices fell in the quarter, with the Bloomberg U.S. Aggregate Bond Index now in negative territory for the year.

FEDERAL RESERVE RAISES RATES

In July, the Federal Reserve raised the overnight lending rate by 0.25% to a target range of 5.25–5.50%, making it the 11th hike since March of 2022 and the highest Fed Funds rate level in over 20 years. The biggest surprise from the Fed meeting was that the Fed staff economists stated they are no longer forecasting a recession in the U.S. The main narrative from the September meeting was that the economy is still showing strength and, therefore, interest rates could remain "higher for longer." Fed Chair Jerome Powell stated that they will continue to allow more time between rate hike decisions to obtain as much data as possible to see how much impact restrictive monetary policy is having.

U.S. ECONOMY

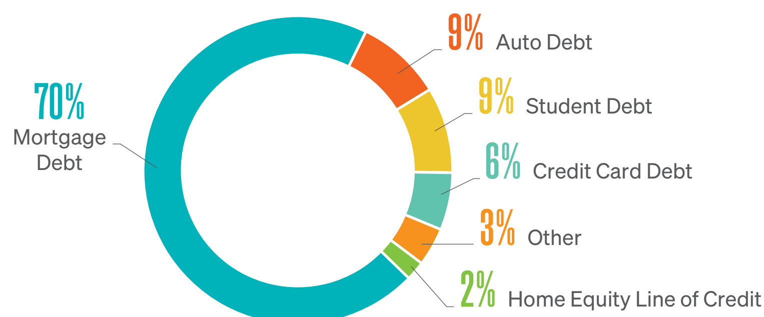
The U.S. economy expanded in the second quarter, with U.S. GDP exceeding expectations and growing at an annualized rate of 2.4%. While this quarter's reading was much higher than the first quarter's growth of 1.7%, investors fear the Fed's restrictive monetary policy may eventually push the economy into a recession. Longer-term interest rates continue to climb higher on this economic data. The 10-year Treasury yield reached nearly 4.8%, marking its highest since 2007. The move higher in rates also impacted the mortgage market, with the average U.S. 30-year mortgage up to almost 8%.

The U.S. labor market remains tight and is seemingly unfazed by the headwinds of higher interest rates. September's nonfarm payrolls report of 336,000 jobs easily exceeded analysts' expectations of 227,000. According to the Bureau of Labor Statistics, the labor force participation rate remained unchanged at 62.8% and is at its highest level since February 2020. September's unemployment level also remained steady from August at 3.8%.

STUDENT LOANS ARE BACK

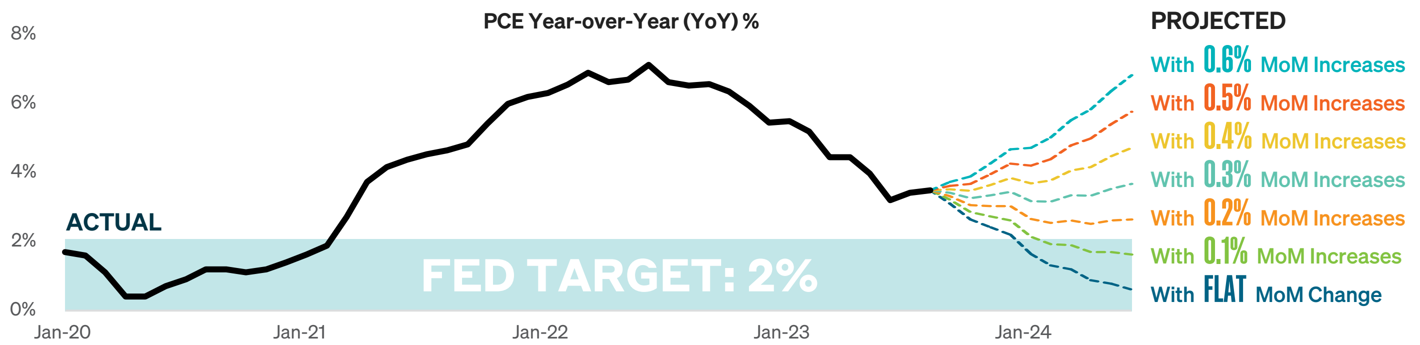
Since the beginning of the COVID-19 pandemic, the government suspended payments and interest on federal student loans. Now that the pandemic has ended, interest on these student loans began accruing on September 1st, and loan payments will restart at the beginning of October. **Figure 1** illustrates that student loan balances now make up the same percentage as auto debt, the second largest component of consumer debt. Student debt now exceeds total credit card debt. It will be interesting to see how the end of this emergency relief may impact consumer spending over the next year.

FIGURE 1
PERCENTAGE OF U.S. CONSUMER DEBT



SOURCE: FEDERAL RESERVE BANK OF NEW YORK

FIGURE 2
POTENTIAL PATHS FOR INFLATION
PCE YOY % AS OF 08/31/2023



SOURCE: BLOOMBERG

INFLATION REMAINS STICKY

After reaching a high in June of 2022, inflation has continued to trend downward. The black line in **Figure 2** illustrates the year-over-year PCE, which is the Fed's preferred measure of inflation. The dashed lines represent a range of different projected month-over-month inflation readings and how these would impact year-over-year inflation. Even if month-over-month inflation were zero, it would likely be 2024 before PCE year-over-year inflation reaches the Fed's 2% target.

U.S. LOSES AAA CREDIT RATING

Early in August, the rating agency Fitch lowered its credit rating of U.S. Treasuries from AAA to AA+, stating that the downgrade was due to its growing national debt and the fiscal struggles it projects the U.S. to have over the next three years. In 2022, the government deficit to GDP ratio was 3.7%, and Fitch's forecasts indicate an increase to 6.3% in 2023, 6.6% in 2024, and 6.9% in 2025. Additionally, Fitch projects the U.S. total debt-to-GDP ratio to rise to 118% by 2025, above this year's projected level of 113%.

The credit agency provided two positive factors that justified its stable outlook for the United States. The U.S. maintains the world's most powerful economy, with an output of more than $20 trillion in GDP. The second factor is that the U.S. dollar remains the world's primary reserve currency. This status allows the U.S. government exceptional flexibility to finance its activities.

HOW IS THIS IMPACTING PORTFOLIOS?

Meeder manages investment strategies utilizing a multi-discipline and multi-factor investment approach that guides us in allocating our portfolios. We manage investment solutions across an array of risk profiles and time horizons. Many of these solutions employ one or more of our core investment strategies: Growth, Defensive Equity, and Fixed Income.

GROWTH STRATEGY

Investment portfolios utilizing the Meeder Growth Strategy maintain a more aggressive objective and typically remain invested in the stock market. The stock market continued to provide mixed performance results in the third quarter. Companies that were larger and more growth-oriented provided stronger results than those that were smaller and more value-oriented. Volatility increased throughout the quarter but remained below its long-term average.

Investors in the Meeder Growth Strategy have captured much of the upside of the stock market's year-to-date performance despite near-continual headlines surrounding inflation and the Federal Reserve. Investors who remained invested in portfolios employing the Growth Strategy in the third quarter experienced more volatility in our suite of risk-based portfolios.

DEFENSIVE EQUITY STRATEGY

Portfolios that utilize the Meeder Defensive Equity Strategy follow a quantitative rules-based and data-driven approach using the Meeder Investment Positioning System (IPS) model. This investment model determines the risk relative to the reward present in the marketplace and identifies when we should increase or decrease the portfolio's target equity exposure.

We began the third quarter with a target equity exposure of 90%. The short-term model score was strong as all ten trend and momentum indicators in the IPS model were positive. Meanwhile, the long-term model score weakened as elevated valuations in the U.S. equity market weighed on the long-term model's score.

Near the end of July, the Federal Reserve announced it would raise interest rates by 0.25% to its highest level in over 20 years after seeing stronger-than-expected economic growth. The number of advancing vs. declining stocks reached extremely bullish levels as more than 1.7 times as many advancing as declining stocks. Near this time, the long-term model score weakened as inflation and elevated valuations remained a focus for investors.

In early August, market risk levels increased when Fitch Ratings downgraded the U.S. government's credit rating from AAA to AA+ due to concerns about the country's rising debt load. The long-term model score deteriorated because of elevated valuations, inflationary pressures, and weakening market breadth. The intermediate-term model score strengthened as a resurgence in bearish investor sentiment occurred, which we view from a contrarian perspective. The short-term model score softened in August but remained additive, as 7 of 10 trend and momentum

indicators were positive. The extreme improvement in the intermediate-term model score offset the weakening in the long and short-term model scores, and the combination of these model changes resulted in keeping the net equity exposure at 90% through the end of the third quarter.

FIXED INCOME STRATEGY

The Meeder Fixed Income Strategy tactically shifts portfolio exposure utilizing our proprietary investment models. These models actively monitor economic and market-related factors to guide us in determining the credit quality, emerging market debt exposure, and the portfolio's U.S. Treasury duration.

Interest rates surged during the third quarter, with the U.S. 10-year Treasury yield increasing from 3.8% to above 4.8% in early October. While economic data was very strong during the quarter and inflation remained above the Fed's long-term goal of 2%, the "higher for longer' narrative firmly took stage as risky assets experienced negative returns. While investment-grade bonds experienced losses during the month of September, short-duration U.S. Treasuries generated gains of more than 1% during the month and U.S. high yield finished just above breakeven.

The duration of the Tactical fixed-income strategy remained shorter than its respective benchmark, finishing the month of October with an effective duration of less than three years. This positioning was a positive contributor to its relative performance during September. The strategy also employed an overweight to U.S. high yield and increased exposure to this fixed-income sector during the first week of September. On a relative basis, this high yield position positively contributed to the strategy relative to holding U.S. investment grade bonds, which was more negatively impacted by the surge in interest rates toward the end of the third quarter.

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