Financial Markets Review

Q3 2023

Stocks and bonds fell during the third quarter as rising interest rates and tighter Federal Reserve ("the Fed") policy added pressure on risk assets. The S&P 500® Index reached a peak in July, up 20.65% through the first seven months of the year. Two consecutive negative months followed, reducing the year-to-date gain to 13.07% through the end of September. The Bloomberg U.S. Aggregate Bond Index, a broad gauge of U.S. bond market performance, slipped into negative territory with a -1.21% year-to-date return through the end of the quarter. The recent down trend came alongside a seasonally weak period for markets and a backdrop of better-than-expected economic reports that has emboldened the Fed to maintain its higher-for-longer interest rate policy. While the Fed paused interest rate hikes in September, it reduced the number of expected rate cuts in its 2024 projections and kept on the table the potential for one more hike in 2023 amid sticky inflation, stronger economic growth, and a tight labor market. Entering the final quarter of the year, investors remain optimistic that the Fed will soon reach peak interest rate policy and sustain what has been so far a very resilient economy.

The Consumer Price Index ("CPI") reversed its downward trend during the quarter, accelerating to a 3.7% annual increase in August, driven in part by a spike in gasoline prices.[1] Core CPI (excluding volatile food and energy prices) continued to fall, but remains well above the Fed's 2.0% target with a reported annual increase of 4.4%. The U.S. economy expanded at a 2.1% annualized pace according to the Commerce Department's report on second quarter GDP growth,[2] continuing its advance in the face of tighter monetary policy. The economy added an average of 266,000 new jobs each month during the quarter, far exceeding expectations, and the unemployment rate ticked only slightly higher to 3.8% during the period. The ISM PMI Manufacturing Index reading showed improvement, rising to 49 in September, while the non-manufacturing sector remained above 50 (readings above 50 indicate economic expansion and below 50 indicate contraction).[3] According to data from FactSet, corporate earnings declined by -4.1% year-over-year during the second quarter, marking the third straight quarter of declines. Earnings were better than expected, however, with nearly 80% of S&P 500 companies beating analyst estimates. Earnings are expected to decline by only -0.1% for the third quarter, marking a significant improvement from the past three quarters.

Stocks

Most broad global equity market indexes registered declines during the third quarter. In the U.S., the S&P 500 Index fell -3.27%, while foreign developed markets outside the U.S. sank -4.11% as measured by the MSCI EAFE Index. Nine S&P 500 sectors were negative, with the lowest returns from utilities (-9.25%) and real estate (-8.90%). Energy outperformed with a 12.22% return on the back of a 28% increase in oil prices.[4] Communication services also delivered a modestly positive 3.07% gain. Shares of the "Magnificent Seven" group of stocks (Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta Platforms, and Tesla), representing a large and concentrated portion of the S&P 500, delivered mixed performance during the quarter with an average return of 0.02% for the group. This followed the first half of the year when the Magnificent Seven contributed nearly three-quarters of the market's advance. Small caps underperformed large caps with a -5.13% return for the Russell 2000® Index compared to the -3.15% return for the Russell 1000® Index. Large cap growth and value stocks fell by roughly equal amounts, with the Russell 1000® Growth Index losing -3.13% and the Russell 1000® Value losing -3.16%.

Bonds

Bond investors faced a second consecutive quarter of difficult performance as sharply rising rates and a steepening yield curve impacted returns. The 10 Year U.S. Treasury yield increased nearly 80 basis points to end the quarter yielding 4.59%, the highest in 16 years. The yield curve became less inverted as yields for longer

[1] Dept. of Labor, FactSet.
[2] U.S. Bureau of Economic Analysis, FactSet.
[3] ISM, FactSet.
[4] Crude Oil $/bbl, WTI, FactSet

maturities climbed higher than shorter maturities with the spread between 2-year and 1-10-year Treasury yields narrowing significantly from -1.08% to -0.44% during the quarter. Amid this backdrop the Bloomberg Barclays U.S. Aggregate Index returned -3.23% during this period. Investment grade credit spreads remained relatively unchanged within the corporate bond sector, driving a wide margin of outperformance from higher-yielding lower quality bonds. BBB-rated U.S. Corporates returned -2.71% for the quarter compared to -6.31% for their AAA-rated counterparts. High yield bonds were slightly positive with a 0.46% return for the Bloomberg U.S. Corporate High Yield Index. Agency Mortgage-Backed Securities underperformed the broader market with a -4.05% return. Municipal Bonds also suffered underperformance with a -3.95% return for the Bloomberg Municipal Bond Index.

Each of us at AMG Funds appreciates the continued opportunity to assist you with your investing needs.

Disclosures

All investments are subject to risk including possible loss of principal. Past performance is no guarantee of future results.

Please note that all performance data and comments are for the period from April 1, 2023 through June 30, 2023. Any sectors, industries, or securities discussed should not be perceived as investment recommendations. The views expressed represent the opinions of AMG Funds and are not intended as a forecast or guarantee of future results. The information and opinions contained herein are current as of June 30, 2023 and are subject to change without notice. Information has been obtained from sources believed to be reliable, but its accuracy, completeness, and interpretation are not guaranteed. The Russell 1000® Index measures the performance of approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000® represents approximately 92% of the U.S. market. The Russell 1000® Value Index is a large-cap value index measuring the performance of the largest 1,000 U.S. incorporated companies with lower price-to-book ratios and lower forecasted growth values. The Russell 1000® Growth Index is a market capitalization weighted index that measures the performance of those Russell 1000® companies with higher price-to-book ratios and higher forecasted growth values. The Russell 2000® Index is composed of the 2000 smallest stocks in the Russell 3000® Index and is widely regarded in the industry as the premier measure of small-cap stock performance. The Russell 2000® Value Index is an unmanaged, market-value weighted, value-oriented index comprised of small stocks that have relatively low price-to-book ratios and lower forecasted growth values. The Russell 2000® Growth Index measures the performance of the Russell 2000® companies with higher price-to-book ratios and higher forecasted growth values. The Russell Midcap® Index measures the performance of the 800 smallest companies in the Russell 1000® Index, which represent approximately 25% of the total market capitalization of the Russell 1000® Index. The S&P 500 Index is a capitalization-weighted index of 500 stocks. The S&P 500 Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. U.S. Long Government Bond Index tracks the market for U.S. dollar-denominated, fixed-rate, nominal U.S. Treasuries and U.S. agency debentures. The MSCI World ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries excluding the United States. The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. & Canada. Please go to msci.com for most current list of countries represented by the index. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The MSCI China Index captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). Please go to msci.com for the most current list of countries represented by the MSCI indices. The Bloomberg Global Aggregate ex USD Index is a measure of investment grade debt from 24 local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers. Bonds issued in USD are excluded. The Bloomberg U.S. Corporate High Yield Bond Index is a total return performance benchmark for USD-denominated, high yield, fixed-rate corporate bonds having a maximum quality rating of Ba1/BB+/BB+ or below, as determined by the middle of the Moody's, Fitch, and S&P ratings. The Bloomberg U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds. The Bloomberg U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds. The Bloomberg U.S. Corporate Bond Index is an unmanaged index representative of publicly issued, SEC-registered U.S. corporate and specified foreign debentures and secured notes The Bloomberg US Mortgage Backed Securities (MBS) Index tracks fixed-rate agency mortgage backed pass-through securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

The Indices are unmanaged, are not available for investment and do not incur expenses.

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