

Morningstar ETF Allocation Series

Commentary | September 30, 2023

Summary

Stocks and bonds both declined in the third quarter, taking back some of the gains from the first half of 2023.

The US Federal Reserve raised its interest rate target by another quarter point at its July meeting (to a range of 5.25% to 5.50%), and then left rates unchanged at its September meeting. While upward pressure on wage hikes moderated in the quarter, oil prices rose significantly and consumer spending remained resilient. Given these developments, market participants that believed the Federal Reserve (Fed) would start lowering interest rates by now may have been extra disappointed with the negative equity returns during the quarter.

The Morningstar US Market Index fell 3.2% for the quarter, following its 16.5% gain in the first half of 2023. This reduced its year-to-date return to 12.8% which is still relatively high by historical standards. Europe, Japan and emerging markets posted stronger returns in their local currency during the quarter than US equities. The US dollar appreciated relative to most foreign currencies during the quarter which lowered the returns on foreign dollar-denominated assets. The Morningstar Global Markets ex-US Index recorded a 3.3% loss for the quarter which reduced its year-to-date return to 5.4%.

Mega-cap growth stocks like NVIDIA, Apple, Microsoft, Amazon, Alphabet and Meta, drove market returns in the first half of 2023 due to investor's preference for the higher quality stocks and excitement for the potential benefits from artificial intelligence. However, investor enthusiasm for some of the same stocks soured, especially within technology and consumer discretionary, during the third quarter. The value style of investing significantly lagged the growth style during the first half of 2023. The strong momentum within US growth stocks reversed to favor value stocks in October. Broad growth indexes ended the quarter with larger losses than value indexes. The Morningstar US Value Index declined by 1.9% while the Morningstar US Growth Index lost 5.9% during the quarter. The energy sector was the largest contributor to value index performance during the quarter.

Many fixed income indexes reflected losses at the end of quarter which was primarily driven by the increase in interest rates. The Bloomberg US Aggregate Bond Index declined by 3.2% during the quarter. Long-term bonds underperformed short-term bonds while US Government bonds underperformed investment grade corporate bonds at similar maturities. During the quarter, the Bloomberg US Government Long Index declined by 11.8% while the Bloomberg US Government 1-3 Year Index gained 0.7%.

Broad commodities, as represented by the Bloomberg Commodity Index, returned 4.7% in the third quarter as oil prices trended higher.

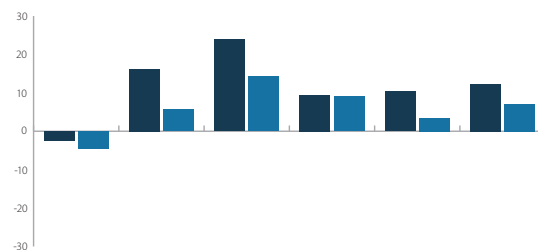
Returns of Key Indexes

| | 3 M | YTD | 1 Y | 3 Y | 5 Y | 10 Y |
|--------------------------------|--------|-------|-------|--------|-------|-------|
| Domestic Stock | | | | | | |
| S&P 500 | -3.27 | 13.07 | 21.62 | 10.15 | 9.92 | 11.91 |
| Morningstar US Market TR USD | -3.19 | 12.81 | 21.00 | 9.30 | 9.28 | 11.40 |
| NASDAQ Composite | -3.94 | 27.11 | 26.11 | 6.60 | 11.41 | 14.52 |
| International Stock | | | | | | |
| Morningstar DM xUS NR USD | -3.93 | 6.10 | 23.25 | 5.35 | 3.12 | 3.88 |
| Morningstar EM NR USD | -1.66 | 3.47 | 13.10 | 0.56 | 2.02 | 2.96 |
| Fixed Income | | | | | | |
| Bloomberg Aggregate | -3.23 | -1.21 | 0.64 | -5.21 | 0.10 | 1.13 |
| Bloomberg High Yield Corporate | 0.46 | 5.86 | 10.28 | 1.76 | 2.96 | 4.24 |
| Bloomberg Credit | -3.01 | 0.03 | 3.47 | -4.83 | 0.86 | 2.12 |
| Bloomberg Government Bond | -2.99 | -1.45 | -0.74 | -5.73 | -0.03 | 0.65 |
| Bloomberg Long Term Treasury | -11.83 | -8.55 | -9.09 | -15.73 | -2.78 | 0.75 |

Past performance is no guarantee of future results. Index performance is not indicative of fund performance. One may not invest directly in an index.

Morningstar Index Returns %

Large vs. Small

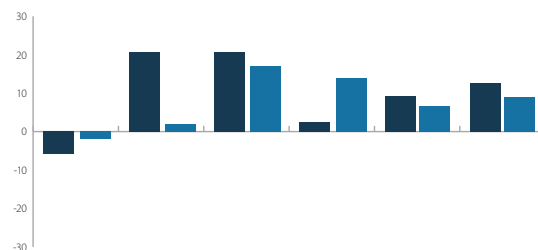


| | 3 M | YTD | 1 Y | 3 Y | 5 Y | 10 Y |
|-----------|-------|-------|-------|------|-------|-------|
| Large Cap | -2.55 | 16.22 | 23.86 | 9.43 | 10.35 | 12.26 |
| Small Cap | -4.56 | 5.71 | 14.22 | 9.01 | 3.40 | 7.06 |

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Both US large and small cap stocks ended the third quarter with negative returns. US small cap stocks declined more than large and mid-cap stocks during the third quarter of 2023.

Growth vs. Value



| | 3 M | YTD | 1 Y | 3 Y | 5 Y | 10 Y |
|--------|-------|-------|-------|-------|------|-------|
| Growth | -5.92 | 20.56 | 20.73 | 2.38 | 9.21 | 12.65 |
| Value | -1.91 | 2.06 | 17.04 | 13.79 | 6.66 | 8.91 |

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Many equity indexes reflected losses during the quarter. The US growth style reflected larger declines than the US value style. The Morningstar US Growth Index declined by 5.9% during the third quarter but still reflects a 20.6% gain for the YTD period. US value stocks fared better than growth thanks to energy stocks which led US sector returns during the third quarter. The Morningstar US Value Index declined by 1.9% during the third quarter.

Index Definitions

Bloomberg US Aggregate Bond Index: The US Aggregate Bond Index is the market-value-weighted performance benchmark for investment-grade fixed-rate debt issues, including government, corporate, asset-backed and mortgage-backed securities, with maturities of at least one year.

Bloomberg Commodity Index: An unmanaged index used as a measurement of change in commodity market conditions based on the performance of a basket of different commodities.

Bloomberg Credit Index: The US Credit Index comprises the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supnationals and local authorities. The US Credit Index was called the US Corporate Investment Grade Index until July 2000, when it was renamed to reflect its inclusion of both corporate and non-corporate issuers. Index history is available back to 1973. The US Credit Index is a subset of the US Government/Credit Index and the US Aggregate Index.

Bloomberg Government Bond Index: Securities issued by the US Government (i.e., securities in the Treasury and Agency Indices). Inclusions: Public obligations of the US Treasury with a remaining maturity of one year or more. Publicly issued debt of US Government agencies, quasi-federal corporations and corporate or foreign debt guaranteed by the US Government.

Bloomberg Long Term Treasury Index: Securities in the long maturity range of the US Treasury Index. The US Treasury Index represents the public obligations of the US Treasury with a remaining maturity of one year or more.

Bloomberg US Corporate High Yield Index: The US Corporate High-Yield Index measures the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB/BB or below, excluding emerging market debt. The US Corporate High-Yield Index was created in 1986, with history backfilled to July 1, 1983, and rolls up into the Bloomberg US Universal and Global High-Yield Indices.

Morningstar Large Cap Index: The Morningstar Large Cap Index tracks the performance of US large-cap stocks. These stocks represent the largest 70 percent capitalization of the investable universe.

Morningstar Small Cap Index: The Morningstar Small Cap Index tracks the performance of US small-cap stocks. These stocks fall between the 90th and 97th percentile in market capitalization of the investable universe. In aggregate, the Small Cap Index represents seven percent of the investable universe.

Morningstar US Growth Index: The Morningstar US Growth Index tracks the performance of stocks that are expected to grow at a faster pace than the rest of the market as measured by forward earnings, historical earnings, book value, cash flow and sales.

Morningstar US Market Index: The index measures the performance of US securities and targets 97% market capitalization coverage of the investable universe. It is a diversified broad market index.

Morningstar US Value Index: The Morningstar US Value Index tracks the performance of stocks with relatively low prices given anticipated per-share earnings, book value, cash flow, sales and dividends.

NASDAQ Composite Index: Measures the performance of all issues listed in the NASDAQ Stock Market, except for rights, warrants, units and convertible debentures. Morningstar reports the NASDAQ Composite as a price return.

Standard & Poor's 500 Index: Market-capitalization-weighted index of 500 widely held stocks. Member companies are chosen based on market size, liquidity and industry group representation. Included are the stocks of industrial, financial, utility and transportation companies.

Morningstar Emerging Markets Index: The index tracks emerging markets targeting the top 97% of stocks by market capitalization.

Morningstar DM ex-US Index: The index tracks developed markets ex-US targeting the top 97% of stocks by market capitalization.

One may not invest directly in an index.

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