STRAIGHT TALK

2nd Quarter 2022

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2022
Market Returns

Domestic Large
S&P 500
-19.96%

Domestic Small
Russell 2000
-23.43%

Intl Developed
MSCI EAFE
-19.57%

Emerging Markets
MSCI EM
-17.63%

Fixed Income
Bloomberg US
Aggregate Bond
-10.35%

**Returns are from Morningstar, with dividends reinvested, and are through 06/30/22*

The blows kept coming in the second quarter as investors faced one of the worst starts to a year in history. With stock markets officially moving into bear market territory during the quarter, any hope for a quick rebound from first quarter selling was dashed. To make matters worse, bonds have failed to live up to their often perceived safe status, and have only added to the pain. Meanwhile, inflation continues to be stubbornly high, and after being late to the party, the Fed is entrenched in its policy tightening stance, regardless of any pain inflicted on financial markets. We wish we had some better news, but unfortunately in the short-term, things are unlikely to change drastically. Markets will likely remain volatile, as higher inflation persists, and the Fed remains in tightening mode. However, despite the miserable mood of investors, consumers, and just about everyone else, we have an economy that is doing surprisingly well and we expect a gradual easing of pressures on the markets over the second half of the year.

Eventually, the rapid tightening of monetary policy over the first half of this year will work its way through the economy and do its job in helping slow inflation. In our view, the Fed is going to do what they often do: overcorrect and slow down the economy as they play catch up. Whether this results in a recession or not is a big question right now, but from a market perspective, it is unlikely to have a major impact beyond what has already happened. Historically, the difference in market declines in bear markets with or without a recession is minimal, either way you are looking at drops of roughly 30% on average - meaning it is quite possible that we have already seen much of the damage. However, the bigger difference comes in the length of the bear market. Recessions can prolong the pain, with sentiment remaining negative for longer. Either way, we are looking at more volatility in the coming months. Inflation figures may moderate, but they are unlikely to fall rapidly, and the looming mid-term elections will likely only add uncertainty for investors.

We do not want to project a picture of complete doom and gloom. Yes, the world does seem especially chaotic these days, but under the surface, good things are happening. The current inflationary period is the latest ripple that proceeded from the Covid shockwave. Ultimately though we expect that things will calm down somewhat. As we have said before, this era of disruption creates new risks and opportunities for investors. We continue to see a mini-manufacturing renaissance in the US as companies look to onshore some production. In the coming quarters, the market environment should be more favorable for companies that invest in efficiency and capacity.

In equities, we continue to advocate for a mix of both traditional value stocks and quality growth companies. The selling in stocks has been broad-based, but higher growth names, such those with little to no earnings and high multiples have been hit the hardest. We would caution against loading up on the stocks that did the best pre-pandemic. This is a very different environment and should be treated as such. On the fixed income side, the picture is a little rosier. For years investors have complained about low yields as the Fed has maintained an easy policy stance. The last 18 months have been ugly in bond markets, but now investors can buy bonds and earn some attractive levels of income. It is why we have been buying treasury bonds where possible. Elsewhere, bond mutual funds will be able to reinvest money at higher yields and set the stage for a period of much better returns going forward.

There is no doubt that it has been a challenging start to the year. It certainly does not feel good to look at monthly statements and see continued losses, but if history is any guide, things are setting up for another good run in markets that will reward patient investors. Please enjoy the summer and hopefully we will have some better news to report next quarter. As always, please reach out with any question or concerns.

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