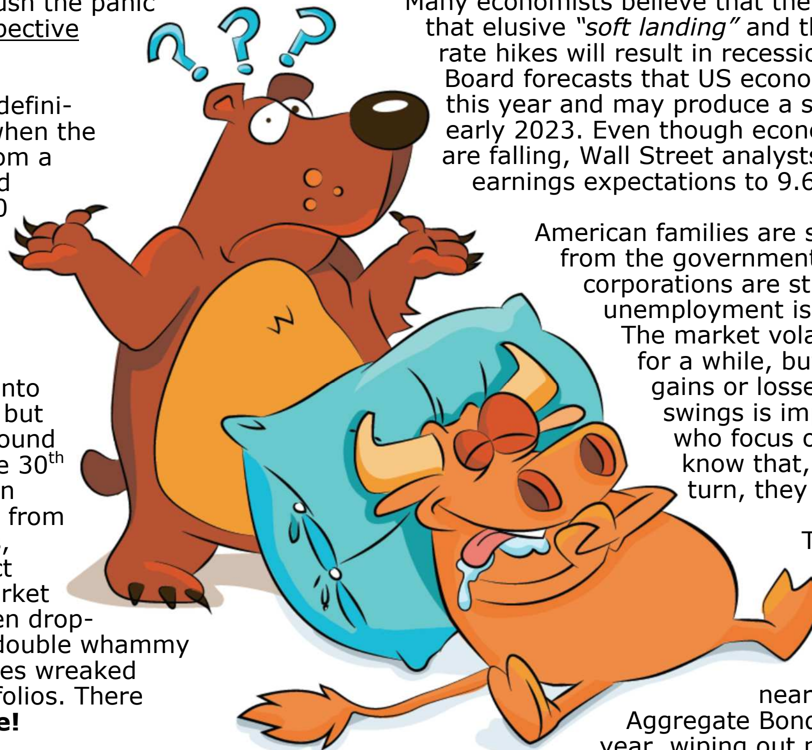
Investment Watch

2nd Quarter, 2022

No Place to Hide

Accelerating inflation, rising interest rates, and the Ukraine war drove the stock market to the worst start in 50 years while bonds offered no protection. The S&P 500 dropped nearly 20% this year, similarly bonds lost over 10% of their value. There was **no place to hide**. The carnage was so widespread that commodities and stable asset funds were the only two asset classes that had any gains. The surge in commodity prices fueled inflation, with oil prices topping $100 a barrel sending gas prices to record levels, and propelling food prices skyward. This rapid downturn has shaken our confidence, but don't push the panic button! A longer-term perspective may well ease our anxiety.



What is a Bear Market? By definition a Bear Market occurs when the stock market drops 20% from a recent high over a sustained period of time. The S&P 500 index reached an all-time high on January 3, 2022, capping a dramatic three year surge which nearly doubled investors' stock values. The recent market decline drove the S&P 500 into Bear territory on June 13th, but since has been bouncing around this 20% decline. As of June 30th the S&P 500 is now barely in Bear territory, down 20.6% from it's January 3rd peak. Bonds, usually the ballast to protect portfolios against stock market losses, offered no safe haven dropping 10.3% this year. The double whammy of both stock and bond losses wreaked havoc on all investors' portfolios. There really was **no place to hide!**

Through the end of last year, the US Bull Market grew **fat and sassy** fed by gigantic government stimulus. This massive influx of cash staved off a US recession from the coronavirus shutdowns and buoyed the stock market. The government's manna from heaven burnt a hole in consumers' pockets, clogging US ports, depleting inventories, disrupting distribution channels and, with too much money chasing too few goods, rekindled skyrocketing inflation.

This domino effect rippled throughout the world's economies, creating supply and demand imbalances and stoking inflation that surprised and confused most central bankers. Even our own Fed Chairman Jerome Powell believed inflation to be transitory and therefore was slow to act to try to crush surging inflation. Putin's war on Ukraine added to runaway prices with exploding food and energy costs. Consumer expenses ballooned by 8.6% in May from a year earlier, a peak not seen in 40 years! At their June meeting, the Fed raised rates by 0.75% delivering the biggest interest rate hike since 1994 to combat the runaway inflation. More rate hikes are expected which could tip the US into recession.

The Fed's aggressive war on inflation signifies the end of *"free money"* that's driven our economy since the COVID outbreak. Rising borrowing costs are expected to curb business investment and the Fed, with tough action and strong words, is scaring consumers into slowing their spending, and the shoppers are worried! The University of Michigan's consumer sentiment index sunk to a record low in June. Americans have never felt this bad about the economy. The question is will the shoppers, who represent 70% of our GDP, stop spending?

Corporate profits were the engine which drove stock prices to their record highs over the last three calendar years causing Americans to be richer than ever before. Many economists believe that the Fed cannot engineer that elusive *"soft landing"* and that their aggressive rate hikes will result in recession. The Conference Board forecasts that US economic growth will slow this year and may produce a shallow recession in early 2023. Even though economic growth forecasts are falling, Wall Street analysts raised corporate earnings expectations to 9.6% for 2022.

American families are still flush with cash from the governmental stimulus programs, corporations are still making money, and unemployment is virtually nonexistent. The market volatility may be with us for a while, but predicting the net gains or losses of these near-term swings is impossible. Investors who focus on the longer-term know that, even with this downturn, they have had a good run.

The chart below shows performance of the broad bond and stock markets. Coming off of pandemic induced near-zero rates, the US Aggregate Bond lost over 10% this year, wiping out most of bonds longer-term returns. With the potential of increasing rates, bonds could have more declines, but bond holders can take solace in knowing that their future potential earnings will rise if interest rates continue to climb.

Index	YTD	3 Years	5 Years	10 Years
Bloomberg US Aggregate Bond	-10.3%	-0.9%	0.9%	1.5%
S&P 500	-20.0%	10.6%	11.3%	13.0%
NASDAQ	-29.5%	11.3%	12.4%	14.2%

<<<<<< periods over 1 year are annualized >>>>>>

Even with the S&Ps loss of 20% so far this year, stock investors harvested double-digit gains over the last 3, 5 & 10 years! The tech-heavy NASDAQ had even bigger losses this year, but had built up so much more value in prior years from those high flying tech giants, that it fared even better over longer periods than the S&P 500. Long-term investors have been rewarded for their long-term vision, so stay calm and don't throw in the towel.

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