Q2 MARKET INSIGHTS

Summer 2022

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The broad selloff across traditional asset classes continued during the second quarter as the perfect storm of events accelerated fears of a recession. Prolonged geopolitical tensions driven by the ongoing war in Ukraine, multi-decade highs in inflation, tightening of monetary policy by central banks, and reports of slowing economic data weighed on investor sentiment. Additionally, substantial lockdown measures implemented in China during the month of April (as the country continues to enforce a "Zero-COVID" policy) increased concerns about additional challenges to already weakened supply chains. Unsurprisingly, equity markets performed poorly against this backdrop with the S&P 500® Index posting its worst first-half performance since 1962. The S&P 500 ended the quarter down 16.11% and is now down 19.97% year-to-date through June. For reference, the S&P 500 finished the first six months of 1962 down 22.23%. International equity markets also declined during the second quarter, however, they outperformed U.S. markets on a relative basis as foreign central banks are expected to be less aggressive in future interest rate increases when compared to the Federal Reserve (the "Fed"). For the quarter, foreign developed markets, represented by the MSCI EAFE Index fell 14.32% (-19.23% YTD). Emerging markets, which benefited from elevated commodity prices, performed slightly better, with the MSCI Emerging Markets Index dropping 11.40% during the second quarter (-17.57% YTD). Even traditional safe havens offered little protection this year. Fixed income has historically done well when stocks have dropped, but inflation and the prospect of faster-than-expected rate increases from the Fed have caused bond prices to decrease. The Bloomberg Barclays U.S. Aggregate Bond Index, the leading benchmark for bonds, declined 4.69% for the second quarter (-10.35% YTD).

HAS INFLATION PEAKED?

Investors remain fixated on inflation reports that have shown significant pricing pressure throughout the economy. The latest reading of the Consumer Price Index ("CPI") indicated that the prices of goods and services increased 8.6% over the past year; the highest year-over-year change since 1981. Not only have things gotten more expensive for consumers, but this also means that investors who held cash instead of equities or bonds, in an effort to avoid current market volatility, lost 8.6% of their purchasing power on their cash. Again, this reiterates that safe havens have offered investors very little protection this year. The inflationary pressures we are experiencing can be attributed to several factors including excessive demand created by fiscal stimulus, supply chain bottlenecks as a result of pandemic lockdowns, as well as government policies aimed at promoting the use of clean energy sources. Exacerbating the issue was Russia's invasion of Ukraine, which caused further upward pressure on energy and food prices. While it is difficult to predict how and when things in the Ukraine will be resolved, some of the other factors contributing to the high levels of inflation appear to be subsiding. First, fiscal stimulus (like COVID checks and other forms of relief) have been exhausted, and the prospects of additional stimulus programs being passed by Congress (like Build Back Better) appear unlikely. Second, supply chain bottlenecks appear to be clearing. One of the most widely referenced concerns amidst the global supply chain morass has been the number of ships floating off the ports of Los Angeles and Long Beach, waiting to be unloaded. When ships are slow to unload, not only are fewer ships available for future deliveries, but perishable goods often spoil, and cargo that manages to make it off the ships frequently needs to be

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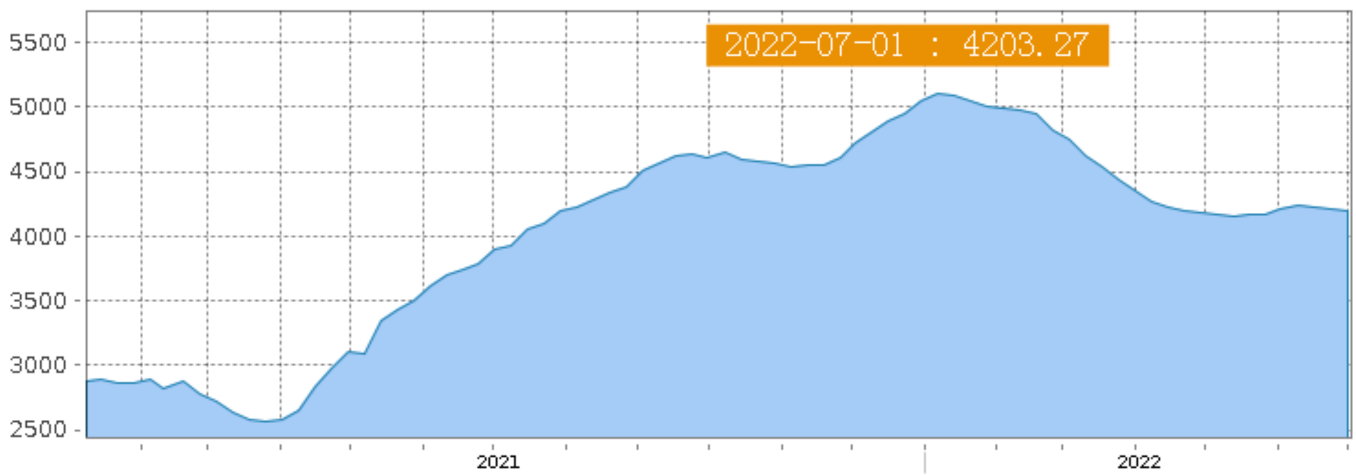
expedited to its final destination. Each of these issues, in its own way, leaves companies scrambling to push cost increases through to their customers. However, even amidst the issues in Ukraine and a re-acceleration of COVID cases in China, port congestion is moderating significantly from its February peak and containerized ocean freight prices from China have declined (see Shanghai Containerized Freight Index Chart below). In addition, trucking prices have also skyrocketed over the last year, yet there is some evidence that relief is coming as spot prices to move goods by truck (especially when you adjust for fuel surcharges) continue to trend lower (see Dry Van Spot Rates Chart below).

Shanghai Containerized Freight Index



Source: Shanghai Shipping Exchange

Dry Van Spot Rates

Weekly broker-posted rate per mile, total and excluding imputed fuel surcharge

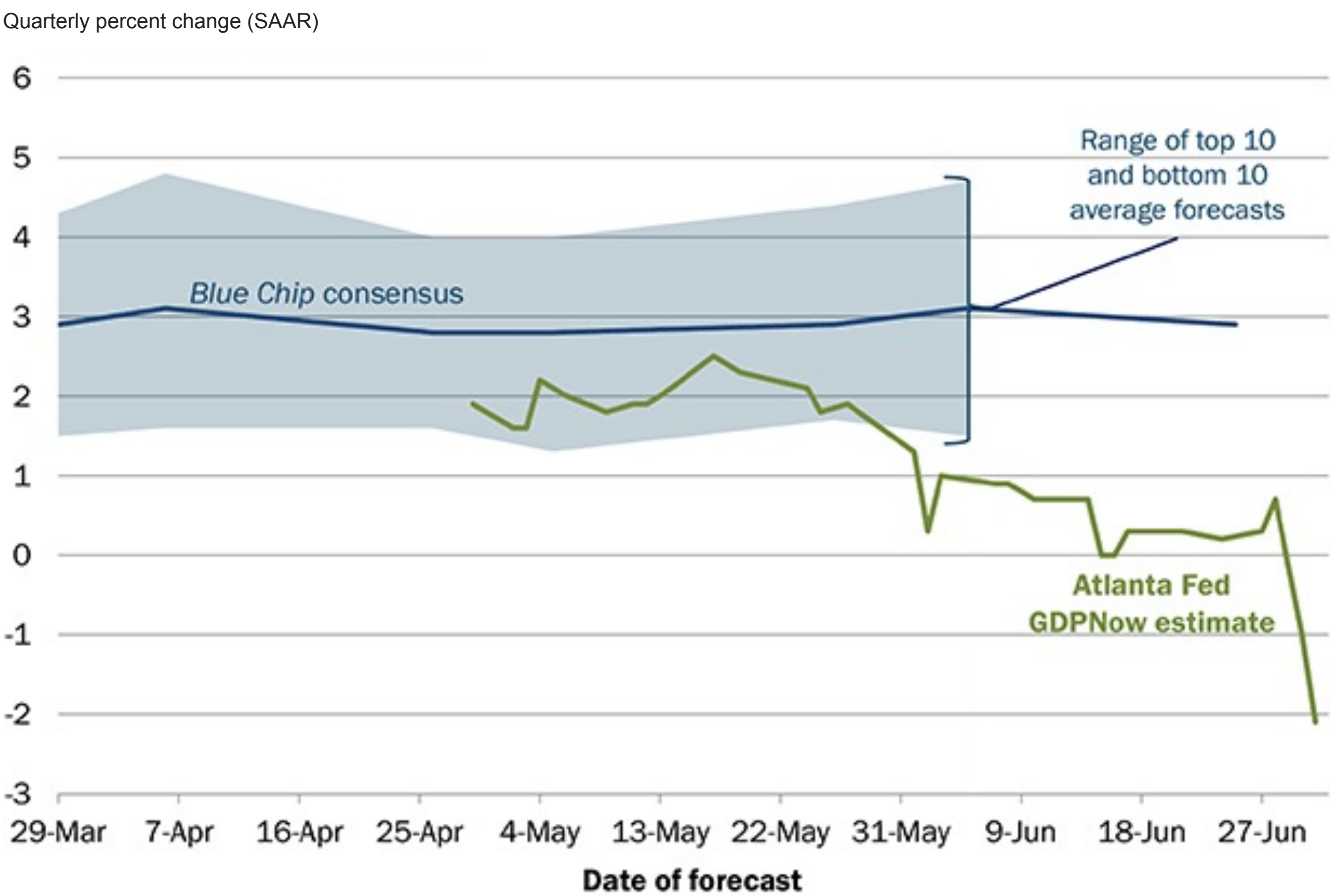
Source: Truckstop.com, FTR - http://freight.ftrintel.com/spotmarketinsights

The clearing up of these supply chain bottlenecks has also led to increased inventories at retailers. Management teams for both Target and Walmart have recently discussed this very issue stating that they are taking steps to reduce inventories, which will include sale promotions and price cuts. This should also help ease some of the inflationary pressures on the prices of many goods, although it will have a negative impact on margins and earnings of many retail companies (more on that below). Additionally, we are beginning to see a rollover in broad commodity prices, particularly among industrial commodities. This indicates that demand is cooling due to the high price effect. Oil prices remain stubbornly high but that has much to do with Federal energy policy, capacity, and supply constraints. Taken together, this data suggests that maybe we are close to the peak in inflation, however, we still expect CPI to remain elevated. We believe the inflationary effects amplified by the conflict in Ukraine has forced the Fed to be more aggressive in raising interest rates. Therefore, we believe that the Fed has not quite finished raising interest rates yet and is at risk of making a policy mistake. Again, as we have highlighted many times in previous updates, the Fed is in a precarious position where it must carefully try to dampen inflation (through raising interest rates) without pushing the U.S. into a recession (due to the historically high levels of debt in the economy).

IS THE EQUITY MARKET ALREADY PRICING IN A RECESSION?

Given that the Fed will likely continue to tighten monetary policy, we believe the probability of a recession in the U.S. has risen. Central bank tightening has started to impact the most rate-sensitive sectors (such as housing and auto purchases), and consumer confidence has been weakening. In fact, we may already be in a recession. First quarter Gross Domestic Product ("GDP") was -1.6%. Based on the Atlanta Fed's GDPNow Forecast, second quarter GDP growth may also be negative (see Atlanta Fed GDPNow chart below which shows GDP growth of -2.1% for 2Q22).

Evolution of Atlanta Fed GDP Now Real GDP Estimate for 2022: Q2



Source: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*

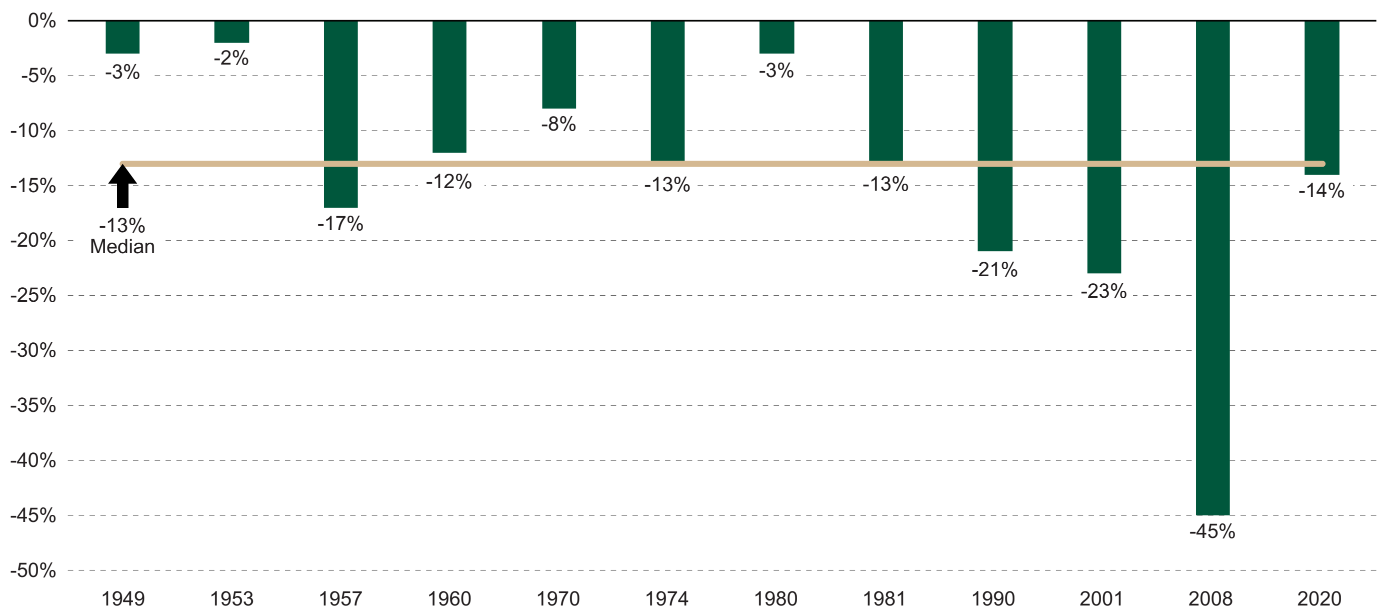
Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip survey*.

This would be two straight quarters of negative economic growth in the U.S. The U.S. National Bureau of Economic Research ("NBER"), the official arbiter of recessions, defines a recession as a "significant decline in economic activity that is spread across the economy and lasts more than a few months." While that definition is fairly broad, and somewhat vague, based on the forecast above, we may be in a recession already.

It's important to remember that recessions are a normal part of the economic cycle. Recessions are not a matter of "if" but simply a matter of "when" they will occur. The news media often portray them as a catastrophe, but the reality is that every economic cycle ends in a recession, allowing any excesses to be wrung out, and thus making the way for the start of a new cycle.

So this begs the important question: if a recession appears imminent (or is already occurring), and given the recent equity market correction, have the equity markets already factored in a recession? We believe one of the critical components in answering that question is trying to figure out what is going to happen to corporate earnings. Corporate earnings growth currently remains positive, with expectations of 10.2% earnings per share ("EPS") growth for the S&P 500 for fiscal year 2022 and 9% for fiscal year 2023. However, the increasing macro headwinds will likely begin to weigh on the earnings outlook, causing some downward adjustments to expectations. According to data compiled by Goldman Sachs, S&P 500 earnings have dropped an average of 14.5% (and a median of 13%) from peak to trough around the twelve recessions that have occurred since WWII (see Chart Below).

Peak to Trough Decline in LTM S&P 500 EPS During 12 Recessions Since WWII



Source: Goldman Sachs

To calculate what the market may be assuming for future earnings growth, we look to the historical Equity Risk Premium ("ERP") for the S&P 500. The ERP is the level of excess return required by investors, to compensate for the additional risk of investing in equities over bonds. This is calculated by taking the earnings yield on the S&P 500 minus the inflation adjusted yield on the U.S. 10-year Treasury Note. If we were to take the historical ERP of 4.46% and add the inflation adjusted yield of the U.S. 10-year Treasury Note as of June 30th, which was 0.36%, we come up with an earnings yield of 4.82%. Using the quarter end value of the S&P of 3,785, we would calculate that the market is expecting an EPS of $182 over the next twelve months (4.82% X 3,785). The current trailing 12-month EPS for the S&P 500 is $218, so based on the historical ERP, the market is likely pricing in an earnings decline of 16.5% or ($182 ÷ $218) – 1. It would appear, based on this method, the market is already pricing in an average recession.

In addition to earnings, Goldman Sachs also compiled data examining the returns of the S&P 500 around recessionary periods. Again, looking at the past twelve recessions that have occurred since WWII, the S&P has contracted by an average of 30% (median of 24%) peak-to-trough around these periods (see Chart Below).

It's important to note that the S&P fell 23.6% from its peak on January 3rd to its recent low on June 16th. Looking at this data, it appears the market is discounting (for lack of a better term) a "normal' recession. Now we are not saying that we have reached a market bottom. There could be some exogenous event that we don't know about that could send a shock through the global financial system. On the other hand, if we were to get a resolution in Ukraine, or if the Fed is successful in engineering a soft landing for the economy, then we believe that the market would move higher from here. The point here is that the data is suggesting that recession risk is for the most part, priced into this market.

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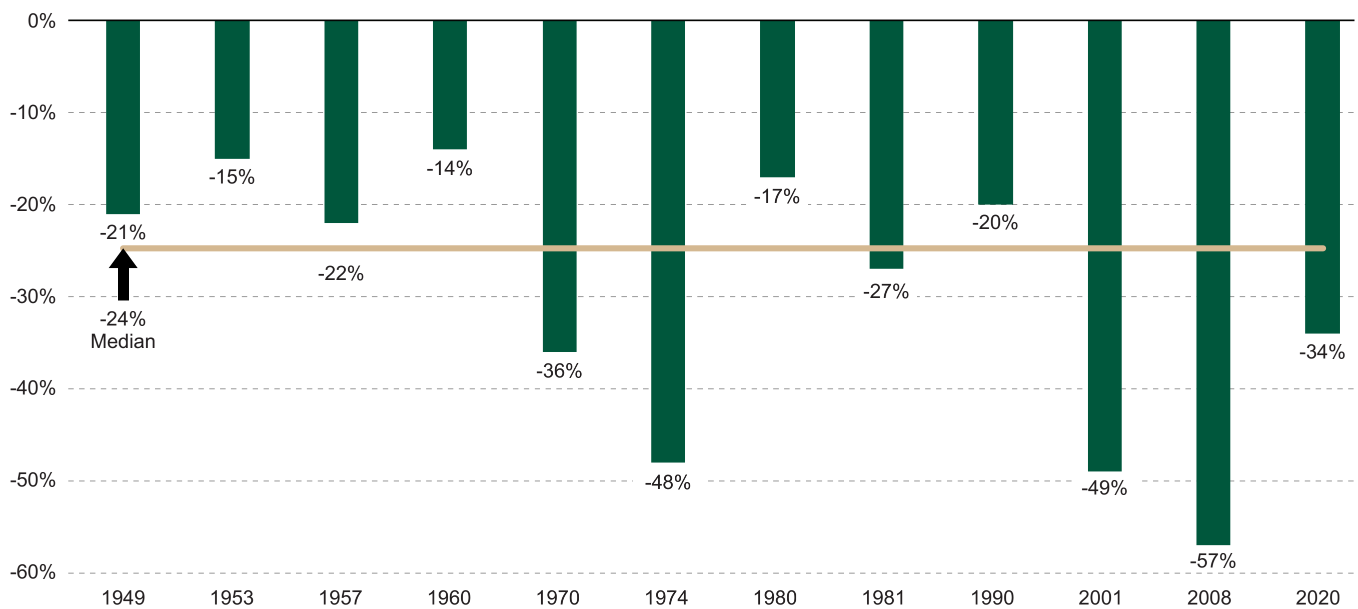
Peak to Trough S&P 500 Decline Around 12 Recessions Since WWII



Source: Goldman Sachs

WHEN WILL THE MARKET BOTTOM?

Everyone wants the answer to that question. While there is no specific answer, there are indicators and technical measures that suggest that the market may be due for a bounce. The first chart (on the next page) shows the S&P 500 on the top panel (black line) with the percentage of stocks trading above their 200-day moving average on the lower panel of the chart (green line). As you can see, the percentage of stocks trading above their 200-day moving average has fallen below 20% (red line) near the end of recent market bottoms (emphasized by the red circles). You can also see that the number of stocks trading above their moving average fell to 12.6% back on June 17th (last red circle on the right), which would be consistent with previous market bottoms in 2011, 2015, 2016, 2018, and 2020.

S&P 500 and the Percentage of Stocks Trading Above their 200 Day Moving Average

Source: Bloomberg

The next chart shows the S&P 500 on the top panel (black line) with the percentage of stocks trading at a new 52-week high (green bars) or 52-week low (orange bars) on the lower panel. As you can see, previous market bottoms in 2011, 2015, 2016, 2018, and 2020 (red circles) have seen at least 35% of the S&P 500 hit a new 52-week low (highlighted by the red line). As of June 16th, the number of stocks trading at new 52-week lows fell to 43%, consistent with previous market bottoms.

S&P 500 and the Percentage of Stocks Trading at 52 week Highs and Lows

Source: Bloomberg

15%+ Quarterly Drops for the S&P 500: Post WWII

Quarter	Quarterly Drop (%)	Next Quarter (%)	Next Half (%)	Next Year (%)
Sep-46	-18.83%	2.27%	1.40%	1.00%
Jun-62	-21.28%	2.78%	15.25%	26.70%
Jun-70	-18.87%	15.80%	26.72%	37.10%
Sep-74	-26.12%	7.90%	31.19%	32.00%
Dec-87	-23.23%	4.78%	10.69%	12.40%
Sep-02	-17.63%	7.92%	4.04%	22.16%
Dec-08	-22.56%	-11.67%	1.78%	23.45%
Mar-20	-20.00%	19.95%	30.12%	53.71%
Jun-22	-16.11%	?	?	?
Average		**6.22%**	**15.15%**	**26.07%**
Median		**6.34%**	**12.97%**	**25.08%**

Source: Bespoke Investment Group

Finally, the table above presents the previous eight times the S&P 500 has posted a quarterly decline of 15% or greater since WWII. Based on the historical data, there is a very good probability that we could see some positive returns, especially over the next six to twelve months, as negative returns like we experienced this past quarter are often followed by modest to sometimes more robust recoveries.

PUTTING THINGS INTO PERSPECTIVE

The volatility and market declines of the first six months of 2022 have been challenging for investors. But we must remember that markets are cyclical and bear markets are a normal part of investing. The chart (on the next page) shows how a hypothetical investment of $10,000 in the S&P 500 in 1926 would have grown to more than $74 million today. Visually, the chart makes investing look simple. But the market does not move in a straight line upward. Again, bear markets happen and, in many cases, are inevitable. Investors that expect them and put them in the proper historical perspective should have better long-term success. That's the power of having a proper asset allocation based on a long-term investment plan.

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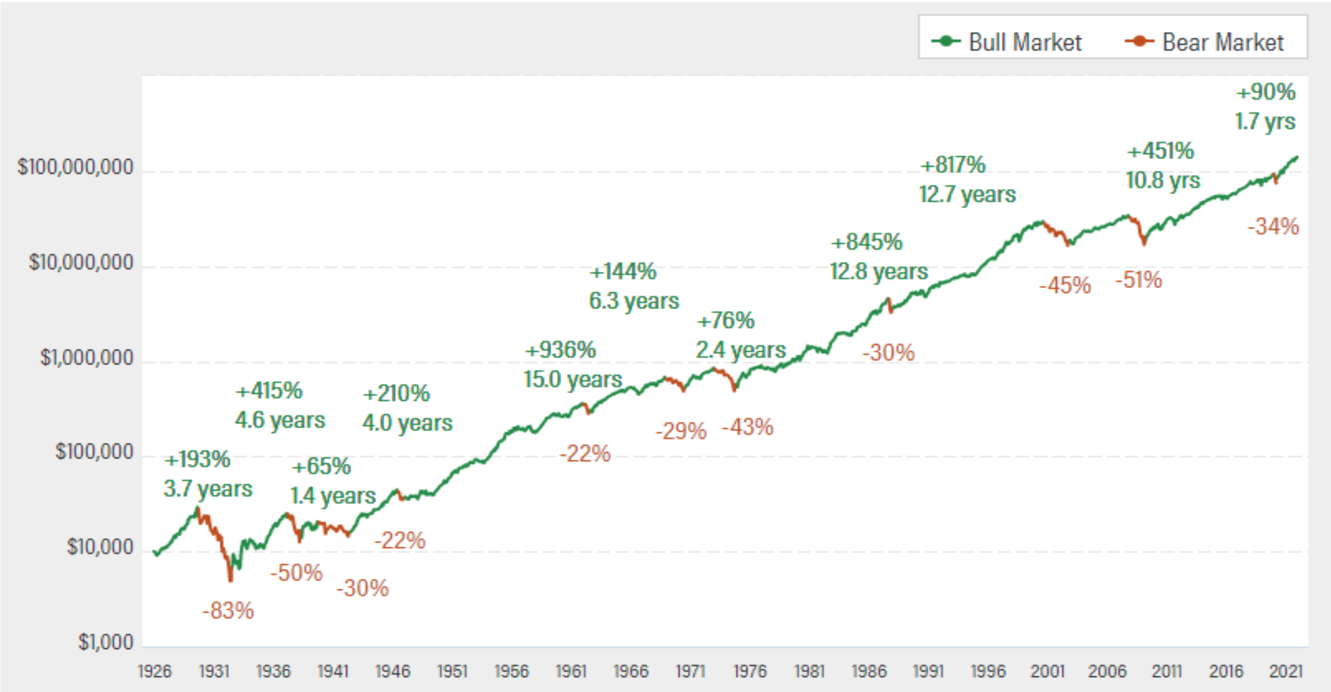
Hypothetical Growth of an Investment of $10,000 in the S&P 500 in 1926



Average Bull Markets:	
Average Increase:	387%
Average Duration:	7.2 Years

Average Bear Markets:	
Decline:	-39%
Duration:	1.3 Years
Frequency:	7.7 Years

Source: FactSet, S&P Dow Jones Indices as of December 31, 2021. The indices are unmanaged, are not available for investment, and do notincur expenses.

> "Successful investing is a marathon, not a sprint. Extended bouts of volatility like we've experienced over the past six months should not alter an established, diversified approach designed to meet your long-term investment goals."

Behavioral economics suggests that people have an inherent bias towards action—doing something provides the illusion of control— but in reality, long-term investors should avoid trying to become short-term traders. Investors would be wise to put probability and reward-to-risk assessments in the context of their financial position, risk tolerance, and investment timeline, when making asset allocation decisions. Successful investing is a marathon, not a sprint. Extended bouts of volatility like we've experienced over the past six months should not alter an established, diversified approach designed to meet your long-term investment goals.

We thank you for your ongoing confidence and trust. Please know that our entire team will remain dedicated to helping you successfully navigate these financial markets.

Happy Summer!

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Definitions:

S&P 500® Index is a registered trademark of Standard & Poor's Financial Services LLC, a division of S&P Global ("S&P"). S&P 500 Index is an unmanaged index used as a measurement of change in U.S. equity markets. Performance numbers for the index are total return with dividends reinvested in the index.

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The MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets (Europe, Australasia, Far East), excluding the US & Canada. The MSCI EAFE Index is an equity index which captures large and mid-cap representation across Developed Markets countries around the world, excluding the US and Canada. With 913 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Indices are not managed and do not incur fees or expenses. Performance numbers for the index are total return with dividends reinvested in the index.

The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (EM) countries*. With 838 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Performance numbers for the index are total return with dividends reinvested in the index.

The Bloomberg Barclays US Aggregate Bond Index provides a measure of the total return performance of the U.S. dollar denominated investment grade bond market, which includes investment grade government bonds, investment grade corporate bonds, mortgage pass through securities, commercial mortgage backed securities and asset backed securities that are publicly for sale in the United States.

The Consumer Price Index (CPI) is issued by the U.S. Bureau of Labor Statistics and is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Indexes are available for the U.S. and various geographic areas.

The Shanghai Containerized Freight Index is the most widely used index for ocean freight and the associated seaborne surcharges of individual shipping routes worldwide. This index has been calculated weekly since 2009 and shows the most current freight prices for container transport from the Chinese main ports, including Shanghai. The index is therefore named after the largest container port in the world.

The Federal Reserve Bank of Atlanta GDPNow forecast provides a "nowcast" of the official estimate of GDP. The growth rate of real GDP is a key indicator of economic activity, but the official estimate is released with a delay. The GDPNow forecasting model provides a "nowcast" of the official estimate prior to its release by estimating GDP growth using a methodology similar to the one used by the U.S. Bureau of Economic Analysis. GDPNow is not an official forecast of the Atlanta Fed. Rather, it is best viewed as a running estimate of real GDP growth based on available economic data for the current measured quarter. There are no subjective adjustments made to GDPNow—the estimate is based solely on the mathematical results of the model. The GDPNow forecast is constructed by aggregating statistical model forecasts of 13 subcomponents that comprise GDP.

The Equity Risk Premium (ERP) refers to the excess return that investing in the stock market provides over a risk-free rate. This excess return compensates investors for taking on the relatively higher risk of equity investing. The size of the premium varies and depends on the level of risk in a particular portfolio. It also changes over time as market risk fluctuates. It is most commonly viewed as the level of excess return required by investors, to compensate for the additional risk of investing in equities over Government bonds.

Please contact us at 781-400-2800 for more information on how we can assist you with your financial needs.

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