Market Commentary

Market Movement Highlights

As we reach the mid-year point in the financial markets, the million dollar question is whether a recession is imminent. Most would suggest the answer is yes, but at best the answer is arguable. Current technicals are both positive and negative. Arguing for the downside, the yield curve is very flat and nominally inverted, particularly in the 2 to 10 year maturity range. Historically, this portends recession. Further, 1Q22's GDP contracted by (1.6%) and expectations are that 2Q GDP, soon to be published, may register a further contraction "technically" placing the US economy in a recession. On the upside, however, demand remains relatively robust and unemployment at 3.6% hovers at unprecedented lows, though some would contend that the low participation rate is itself a historical anomaly likely masking the true unemployment picture. All this convoluted data aside, inflation pushing +9.1% leaves the Fed with no alternative but to continue to corral price pressures by raising its overnight interbank lending rate and offloading balance sheet bonds. Like the legendary high wire artist, Karl Wallenda, the Fed is now in earnest traversing its own tightrope in a "sure pure" balancing act. Too many rate hikes too soon and the economy is sure to falter. Too few and persistent inflation can dangerously dampen, even derail economic growth. We suspect the back half of the year will define whether a recession takes root, and if so, how deep it might be and how long its duration. For now these questions are premature, leaving financial pundits to speculate daily among themselves… something they do notably well anyway!

Meanwhile, the first half of 2022 witnessed marked price volatility across all financial asset classes. During turbulent markets, such as we are now enduring, all eyes naturally focus on the riskier stock markets for fear of loss.

But over the last six months, it is notable that neither were the bond markets spared. While the S&P 500 and the tech heavy Nasdaq indices retrenched by (20%) and (29%) respectively, breaching bear market territory, investment grade bonds of all ilk concurrently fell on average by (9-14%), causing bond markets to experience their worst half year price drop in the history of data tracking. This rare "double whammy" was a direct result of the FED's seismic policy shift; imposing increasingly tighter money since the beginning of the year after some 15-20 years of loose, if not free money. We see the FED's shift in policy as analogous to Mom pulling out the old *Cod Liver Oil* to fix whatever ails you. Once several times dispensed, its horrible taste eventually subsides and the quivers over the prospect of having to take more of it fades as well. Similarly once the financial markets finally warm up to the idea of the required tightening, volatility will eventually subside, stocks will normalize at less bloated prices, bonds will capture higher coupons and the financial markets will simply move on!

So what, if anything, worked out well for investors in this first half rate rise environment? Broad basket commodity investments including natural resources (despite being inherently volatile and commanding virtually daily monitoring) delivered solid upside return over the first half year. The Bloomberg and US Commodity indices posted +18% and +26%, respectively through the mid-year. Of course the sub-commodities of these indices including crude oil and natural gas, both of which are principal culprits of today's inflationary pressures, contributed outsized short-term performances. Meanwhile midstream energy infrastructure (pipelines and storage facilities) as measured by the AMZA delivered an +8.5% total return through the mid-year.

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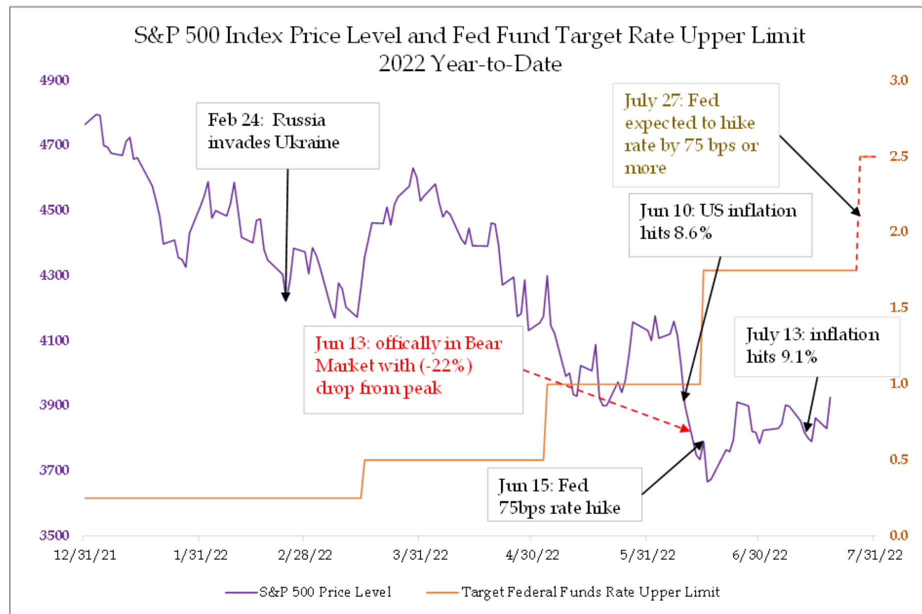
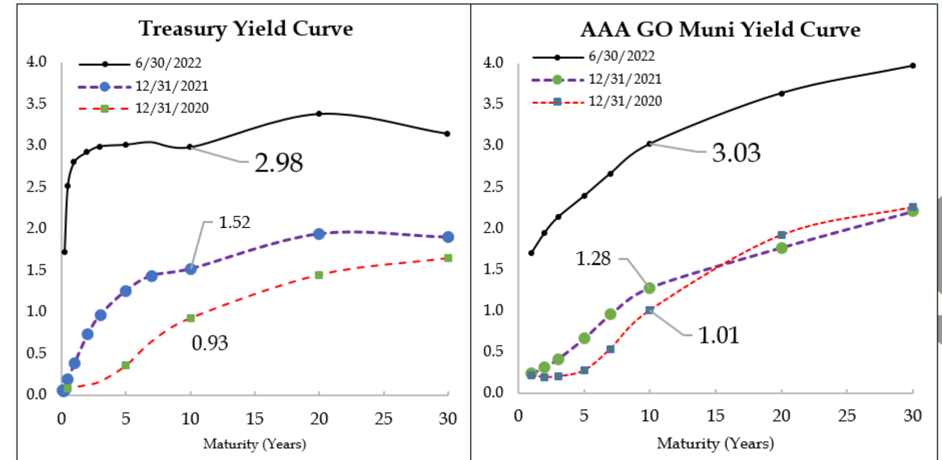
Regarding the US equity market, the chart below traces precisely how the S&P 500 index tracked as Fed policy tightened and the Russian invasion of the Ukraine unfolded over the first half year. On January 3rd, the index had reached its all-time price pinnacle only to officially breach bear market territory falling greater than (20%) by mid-June.



Regarding the bond markets, the left-hand chart above illustrates how swiftly risk-free Treasury rates moved over time in response to the Fed's tightening and bond market trading sentiment. Of note is how high and rapidly rates have moved on the short vs long end of the yield curve. The right-hand chart specifically addresses how the municipal bond market has comparatively fared to the risk free taxable market over the same periods.



Historical Performance During and Post Bear Markets

For the more inquisitive of our client families, let us take a moment to offer a historical review of the S&P 500 in what have been 13 bear markets since 1937. While steeped in detail, the chart on the next page offers valuable historical insight that may provide useful, perhaps even reliable perspectives on the equity market's future in terms of how long or deep the next recessionary cycle might be since we all know that history, financial or otherwise, does tend to repeat itself.

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Wall Street Journal Data						Eideard Analysis		
PRIOR BEAR MARKETS FOR THE S&P 500								
START DATE	END DATE	START PRICE	END PRICE	MONTHS in Bear Market	S&P 500 % CHANGE in Bear Market	Following Bull Market Months	Following Bull market S&P 500 % Total Gain	Following Bull Market Annualized % Gain
3/6/1937	4/29/1942	18.7	7.5	62	(60.0)	50	157.7	25.7
5/29/1946	6/14/1949	19.3	13.6	37	(29.6)	87	266.3	19.6
8/2/1956	10/22/1957	49.6	39.0	15	(21.5)	50	86.4	16.0
12/12/1961	6/27/1962	72.6	52.3	7	(28.0)	44	79.8	17.3
2/9/1966	10/7/1966	94.1	73.2	8	(22.2)	26	48.0	19.7
11/29/1968	5/26/1970	108.4	69.3	18	(36.1)	32	73.5	22.9
1/11/1973	10/3/1974	120.2	62.3	21	(48.2)	75	125.6	13.9
11/28/1980	8/12/1982	140.5	102.4	20	(27.1)	61	228.8	26.2
8/25/1987	12/4/1987	336.8	223.9	3	(33.5)	32	64.8	20.7
7/16/1990	10/11/1990	369.0	295.5	3	(19.9)	115	417.0	18.7
3/24/2000	10/9/2002	1527.5	776.8	31	(49.1)	61	101.5	14.8
10/9/2007	3/9/2009	1565.2	676.5	17	(56.8)	133	400.5	15.6
2/19/2020	3/23/2020	3386.2	2237.4	1	(33.9)	22	114.4	52.5
AVERAGE				**19**	**(35.8)**	**61**	**166.5**	**21.8**
If Bear is Worse Than -30% (Recession)				**22**	**(45.4)**	58	148.3	23.7
If Bear is Better Than -30% (Just a Bear)				**15**	**(24.7)**	64	187.7	19.6
Current Bear Market								
1/3/2022	***6/16/2022****	***4796.6***	***3666.8***	***6***	***(23.6)*** *	***What will be the coming bull market look like?***		
*: We don't know if 06/16/2022 is the bottom yet.						To be Decided		

- By definition, a bull market always follows a bear market's end!
- On average, bear markets have lasted 19 months from market peak to trough. During this time the S&P 500 index on average contracted by (36%).
- Among those bear markets, which had fallen by less than (30%) and which were not accompanied by a recession, the bear lasted only 15 months with an average fall of (25%).
- The past 13 bull markets on average lasted 61 months from bottom to peak, with average gains in excess of +166%. The S&P 500 experienced an annualized return of +22%. The takeaway here, is that a wise investor cannot afford to miss any of these periods!
- The mantra therefore is stay put and read a book!

Looking Forward

Despite the trying market conditions of late, both for stocks and bonds, there are some silver linings.

First, much of the "excess" pricing has been stripped away from the US equity market. Through the mid-year, we've seen the S&P 500's P/E ratio contract to its proximate 19.4 multiple; below its 40 year average ratio of 21.9 x. Looking forward, corporate earnings are still expected to grow more than 10% over the second half of the year.

Second, however you cut it, the job market remains robust. And despite that inflation has eroded buying power, consumer spending, while becoming more judicious, remains resilient!

Third, there is some evidence that inflation may be moderating. Critical to mitigating price pressure is energy, and to that point we've seen oil prices drop by some (20%) from recent highs, while other inflated commodity prices, i.e. lumber and copper have fallen by as much as (30%) and (20%), respectively.

Notwithstanding the above, realism dictates that price pressure and rising rates, periodic supply chain disruptions, the tragedy of war and consequent worldwide shortages both in energy and food are likely to continue to dominate the global financial landscape over the near to intermediate term. But as all things do, these too shall pass in time.

In the meantime, however the financial markets play out, we stand ready to assist you with thoughtful financial guidance until what is sure to become an eventual recovery and financial market normalization.

Best Regards,

Eideard Group **July 19, 2022**

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