FDP WEALTH MANAGEMENT

Quarterly Market Summary and Outlook

July 2022

The U.S. economy remains on stable footing, supported by a strong labor market, healthy balance sheets, and solid consumer spending. However, persistently high inflation, a tighter Federal Reserve (Fed), a decline in business, and confidence present downside risks. The probability of a recession in 2023 has increased, but if it occurs, it will likely be shallow given that there are few excesses built up in the economy and consumer balance sheets are showing little stress. Monetary policy has tightened, and central bank balance sheets are rolling over as the Fed pursues additional rate hikes and quantitative tightening.

Index	Q2 Return*(%)	2022 YTD Return (%)
DJIA[1]	-11.25	-15.31
Nasdaq Composite[2]	-22.44	-29.51
S&P 500 Index[3]	-16.45	-20.58
The Global Dow[4]	-14.42	-15.23
Bond Yields	**Yield (%) as of 6/30/22**	**Yield (%) as of 12/31/21**
3-month T-bill	1.72 (+1.20)	0.06
2-year Treasury	2.92 (+0.64)	0.73
10-year Treasury	2.98 (+0.66)	1.52
30-year Treasury	3.14 (+0.70)	1.90
Commodities	**Price as of 6/30/22***	**Year End 2021**
Oil per barrel[5]	$105.76 (+5.48)	$75.21
Gold per ounce[6]	$1,807.30 (-146.70)	$1,828.60

Sources: MarketWatch, U.S. Treasury, CNBC, St. Louis Federal Reserve
*Includes Quarterly Change, March 29, 2019 through June 28, 2019

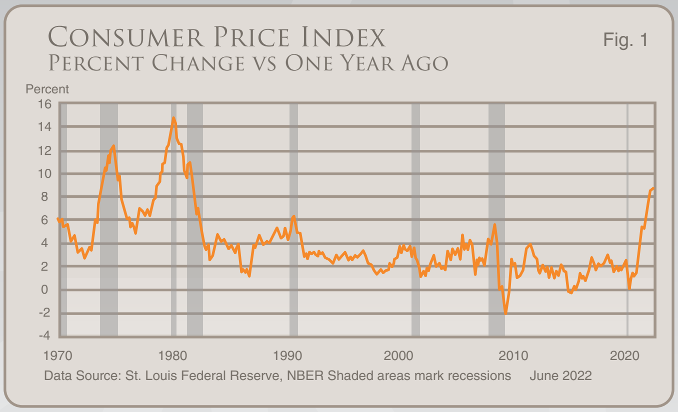
Shifting Fundamentals

As a cheerful reminder, the S&P 500 advanced 29% in 2021, leading us to start 2022 at all-time highs. However, as we headed into this year, markets could not fight off the continued economic headwinds any longer. Stocks during the first half of the year turned in their worst performances since 1970 (source: CNBC). In part, it's a timing issue since the broad-based S&P 500 Index peaked just after the year began, but that doesn't ease the uncertainty that has fueled the decline. Having achieved the 20% drop definition during the quarter, we can officially pronounce U.S. stocks hit a bear market. Most equity indexes (domestic and international) are showing double-digit negative returns year-to-date, with the exception of natural resources. As with equity indexes, rising rates have fueled negative fixed income returns for the second quarter.

Let's back up for a moment. During the 2010s, the economic fundamentals were supportive of stocks: modest economic growth, rising corporate profits, low interest rates, and low inflation. When the Federal Reserve began hiking interest rates, the pace was gradual. Rate hikes were gradual because economic growth wasn't particularly fast, and inflation wasn't a problem. In fact, the Fed fretted over its inability to get inflation up to its 2% target. In retrospect, call it a high-class problem. It's not that we didn't see pullbacks. We did. Stocks never move up in a straight line, and corrections, when they occur, come unexpectedly. Nonetheless, favorable economic fundamentals reasserted, and the broad market indexes trended higher over the decade.

Today, the economic fundamentals have shifted. These include surging inflation, aggressive Fed rate hikes, Russia's ongoing war and its impact on oil and certain commodities, and recent Covid lockdowns in China—all which are helping raise fears of a recession.

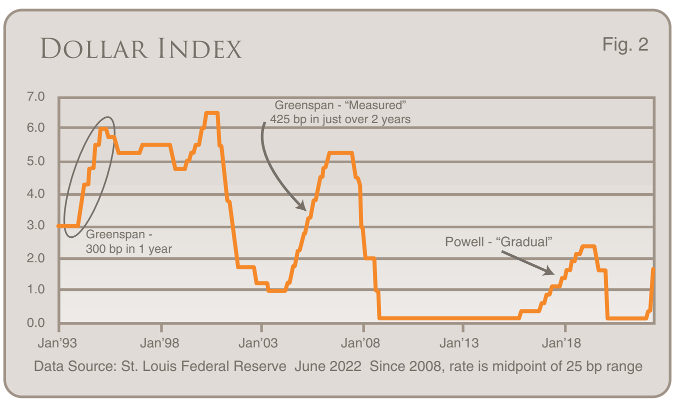
As Figure 1 illustrates, inflation is at a 40-year high, and we have yet to see significant signs that inflation is slowing.



In response to stubbornly high inflation, the Fed shifted away from its super easy money policy last year. Today, it's talking tough, playing catchup, and forcefully raising interest rates in order to wring inflation out of the system. In June, the Fed lifted the fed funds rate by 75 basis points (bp, 1 bp =0.01%) to a range of 1.50–1.75%. It was the first 75 bp rate increase since 1994—see Figure 2.

Still, the aggressive path and factors outside its control have reduced the odds the Fed can engineer a soft landing—a slowdown in inflation that doesn't trigger a recession. If that is the case, it would be a unique recession, from a definition standpoint. Fed Chief Powell acknowledged near the end of June, "It has gotten harder. The pathways (to avoid a recession) have gotten narrower." Such uncertainty has pressured stocks since a recession would hamper corporate earnings.

Figure 2 highlights the path of the fed funds rate over the last 30 years. Former Fed Chief Alan Greenspan preemptively raised rates in 1994—300 bp in one year—to stave off inflation. Though unemployment was high, double-digit inflation of the 1970s and early 1980s was still uppermost on the minds of Fed policymakers.



During the early 2000s, "measured (his word of choice)" rate increases amounted to seventeen 25 bp rate hikes. During the late 2010s, Powell gradually lifted the fed funds rate.

In prior rate-hike cycles, increases were preemptive. Today, the Fed is reacting to high inflation and the Fed believes another 50 or 75 bps is probably appropriate at its upcoming July meeting.

Note in Figure 1 that inflation peaked and slowed during and after a recession.

Why? Consumer demand falls, which makes it more difficult to raise prices. Additionally, the jobless rate rises, and wage growth slows. Smaller wage increases put less pressure on prices. However, let's state the obvious. Triggering a recession to stifle inflation is not ideal.

Today, a recession is a risk but not a foregone conclusion. Some leading economic indicators such as housing sales and consumer confidence have turned lower. But job openings are high, layoffs remain low, job growth is strong, and plenty of stimulus cash remains in the bank.

Perspective

The first half of the year is the worst start since 1970. However, perspective is in order. Since 1957, the S&P 500 Index has averaged a 20% or greater decline over a six-month period roughly every five years (source: CNBC).

And there have been five periods when the broad-based index lost more than 30% over six months. In every instance, stocks eventually recovered.

We believe this cycle will pass, as many others have, yet nobody knows exactly when that will happen. This is why we continue to believe in a disciplined investment approach rooted in diversified, low-cost, tax-efficient, and optimized allocations that weigh both risk and return along with a long-term investor mindset. We are encouraged by the opportunities we see for long-term growth in the next growth cycle for stocks and yield opportunity for bonds.

[1] The Dow Jones Industrials Average is an unmanaged index of 30 major companies which cannot be invested into directly. Past performance does not guarantee future results.
[2] The NASDAQ Composite is an unmanaged index of companies which cannot be invested into directly. Past performance does not guarantee future results.
[3] The S&P 500 Index is an unmanaged index of 500 larger companies which cannot be invested into directly. Past performance does not guarantee future results.
[4] The Global Dow is an unmanaged index composed of stocks of 150 top companies. It cannot be invested into directly. Past performance does not guarantee future results.
[5] CME Group front-month contract; Prices can and do vary; past performance does not guarantee future results.
[6] CME Group continuous contract; Prices can and do vary; past performance does not guarantee future results.

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Barclays Capital Municipal Bond Index – A benchmark index that includes investment-grade, tax-exempt, and fixed-rate bonds with long term maturities (greater than two years) selected from issues larger than $50 million.

Barclays Capital U.S. Aggregate Bond Index – An unmanaged market-value-weighted performance benchmark for investment-grade fixed debt issues, including government, corporate, asset-backed, and mortgage-backed securities, with maturities of at least one year.

Dow Jones/UBS Commodity Index – A rolling commodities index composed of futures contracts on 19 physical commodities traded on U.S. exchanges. The Index serves as a liquid and diversified benchmark for the commodities asset class.

FTSE EPRA/NAREIT Global Real Estate (Financial Times and London Stock Exchange European Public Real Estate Association/National Association of Real Estate Investment Trusts) – The FTSE EPRA/NAREIT Global Real Estate Index is designed to represent general trends in eligible listed real estate stocks worldwide.

HFRX Global Hedge Fund Index (Hedge Fund Research Inc.) – The HFRX Global Hedge Fund Index is designed to be representative of the overall composition of the hedge fund universe. It comprises eight strategies: convertible arbitrage, distressed securities, equity hedge, equity market neutral, event driven, macro, merger arbitrage, and relative value arbitrage. The strategies are asset-weighted based on the distribution of assets in the hedge fund industry.

MSCI All Country World ex-U.S. (Morgan Stanley Capital International) – The MSCI All Country World Index ex-U.S. is a free float adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets, except the U.S.
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