WAINWRIGHT INVESTMENT COUNSEL, LLC

FINANCIAL MARKETS HIGHLIGHTS

Second Quarter 2022

Significant volatility dominated the headlines during the second quarter. Concerns regarding the slowing economy, high inflation, rising interest rates and Russia's invasion of Ukraine resulted in unstable capital markets.

The S&P 500 Index of large and mega-capitalization U.S. stocks declined 16.1%, with all underlying sectors posting losses. Other stock market indices behaved similarly. The Russell 2000 Index of small-cap US stocks declined 17.2% while the MSCI EAFE Index of international, developed market stocks and the MSCI Emerging Market Index shed 14.5% and 11.5%, respectively.

Investors continued to favor defense as opposed to speculation. Large-cap stocks outperformed small-caps, value outperformed growth and, from a sector standpoint, consumer staples, utilities, energy and healthcare led, while consumer discretionary, technology and communication-services lagged.

On June 13 the S&P 500, entered bear market territory, having declined 20% from its previous peak. This is the S&P 500's eighth bear market since 1970. In the previous seven instances, average cumulative returns 12, 18 and 24 months after bottoming were +46.8%, +59.8%, and +69.8% respectively. While past performance is no guarantee of future results, this may show yet again, that betting against Corporate America's ability to grow earnings, assets and dividends is a fool's errand, and a reminder that it is always darkest before dawn.

The investment-grade bond market, as represented by the Bloomberg U.S. Aggregate Bond Index, had a negative return of 4.7% during the quarter, its fourth worst quarter *ever*. This following the first quarter, its third worst quarter *ever*. Meanwhile the Bloomberg High Yield Index, comprised of bonds rated below investment-grade, declined 9.8%, its fourth worst quarter *ever*. It is not a good time to be a bondholder, but many investors require bonds to generate income and provide portfolio stability. The good news is that current bond yields are now relatively more attractive.

The primary culprit behind the downturn in the capital markets has been historically high inflation and, in response, the U.S. Federal Reserve's (the "Fed") plan to squelch it via aggressively raising the short-term Federal Funds rate, amongst other things. Mechanically, higher interest rates induce savings and inhibit credit-based investment, which in turn slows economic activity and thus eases inflationary pressures. Supply chain issues are also to blame in this inflation conundrum, an issue unaffected by Fed measures.

The Consumer Price Index has increased dramatically since early 2021, bouncing around 8% between January and April 2022, before hitting 9% in May, the highest inflation reading since 1981. The tentacles of inflation are everywhere, but perhaps most noticeably at the gas station. According to AAA, the average price of a regular gallon of gas on June 30 was $4.86, +56% from a year earlier. In response, the Fed raised the short-term Federal Funds rate by 0.50% in May and another 0.75% in June, to a range of 1.50% to 1.75%. The June raise was the largest since 1994. Another rate increase of 0.75% is

Selected Index Returns (%) as of June 30, 2022 (Source: Morningstar Direct). 3, 5, 10 year returns are annualized.

	Apr.	May	Jun.	QTR	YTD	1 Year	3 Year	5 Year	10 Year
S&P 500	-8.72	0.18	-8.25	-16.10	-19.96	-10.62	10.60	11.31	12.96
S&P 400	-7.11	0.75	-9.62	-15.42	-19.54	-14.64	6.87	7.02	10.90
Russell 2000	-9.91	0.15	-8.22	-17.20	-23.43	-25.20	4.21	5.17	9.35
Wilshire U.S. REIT Index	-4.54	-7.28	-7.90	-18.48	-21.64	-6.70	4.01	5.26	7.28
MSCI EAFE	-6.47	0.75	-9.28	-14.51	-19.57	-17.77	1.07	2.20	5.40
MSCI Emerging Markets	-5.56	0.44	-6.65	-11.45	-17.63	-25.28	0.57	2.18	3.06
Bloomberg U.S. Aggregate Bond	-3.79	0.64	-1.57	-4.69	-10.35	-10.29	-0.93	0.88	1.54
Bloomberg High Yield	-3.56	0.25	-6.73	-9.83	-14.19	-12.81	0.21	2.10	4.47

anticipated in mid-July and the Fed now expects the year-end rate to be in the range of 3.25% to 3.50%.

The effects of rising interest rates are broad, but nowhere are they more acute than the housing market. According to housing lender Freddie Mac, on June 30, 2021 a traditional 30-year fixed rate mortgage rate was about 3.0%. One year later, it was 5.7%. On a $500,000 mortgage, excluding taxes and fees, that is a difference of almost $9,600 a year, which puts significant pressure on housing affordability.

Mercifully, some commodity prices have begun to roll over. Since peaking in March, wheat, copper and lumber prices are down 28%, 23% and 53%, respectively. A decline in these input costs will help ease prices on finished products in due course, but will be partially offset by labor costs which remain high, in large part due to unemployment levels which remain historically strong, 3.6% as of late May and near pre-pandemic levels.

Concerns abound regarding the state of the economy and financial markets. Gross Domestic Product ("GDP"), a broad based indicator of economic activity, declined 1.6% during the first quarter and the second quarter was likely down as well based upon bond and stock market indicators and the Atlanta Fed's "GDPNow" measure. Sequential quarters of GDP contraction equal a recession and, while there will be much handwringing on CNBC and elsewhere, it is important to note that measures of GDP are backward looking, while stock prices are based upon profit *expectations* (*i.e.*, forward looking). According to Refinitiv, a global provider of financial market data, S&P 500 profits for the second half of the year are expected to be $120 per share, up from $108 for the year earlier period, and that would put the S&P at ~17x 2022 earnings or, inversely, a ~7% earnings yield … and that is not so bad.

We hope you have a great summer and quarter ahead. If you have any questions or comments, please call us at 617-531-3100.

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