Mid-Month Market Commentary: A Three-Day 10%+ Drop... A U.S. Bear Market... Where Are We Now?

June 2022

A surprise European Central Bank interest rate hike followed by a "bad" print on a closely watched inflation gauge created a flight to "quality," resulting in a quick 10%+ drop into bear market territory for U.S. markets. For the last 30+ years, "quality" has meant investments in longer term U.S. Treasury bonds. However, even bonds have been declining with today's inflation issues. It feels like there is nowhere to hide. And the nouveau world of crypto, which had been deemed as the alternative to gold, traditional currency, and decentralization for the good of everyone's future, was hit hardest of all.

Are we in a new investment paradigm? Is the world as we knew it over? Is fixed income dead for the foreseeable future?

No! At least, we don't think so.

As the movements of the market have become 24/7 news, it's easy to get caught up in headlines, and in day-to-day market gyrations. However, this also contributes to the fear/greed swings that create further risk and opportunity - especially for longer term investors.

Some of our thoughts on the negative events and news affecting the markets:

Is recession imminent or already upon us?

Maybe, or in any event, probably. However, a few things to note:

- The markets do not follow an orderly pattern when an economy is in or out of a recession.
    - The market will move up well before fear subsides. And the greatest one-day market gains tend to be off large market losses. The point is, trying to trade or time the market is a fool's game, especially for long-term investors.
- Innovation, great ideas, and general wealth creation will continue to occur.
    - Some of these great ideas may be capital-starved in a recession, so they may take longer to play out, but they will eventually.

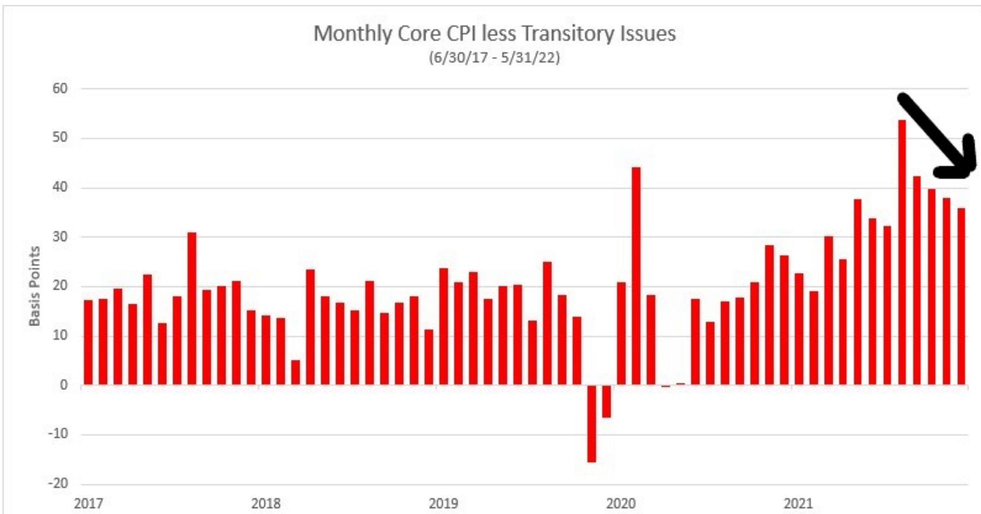
How does inflation end if it even does?

Inflation data comprises a number of measurements, all of which have been hit with different primary inflationary factors.

- For example, it is easy to see energy costs continue to increase for the foreseeable future due to Russian aggression in Ukraine creating major supply issues. And it will take some time to figure out how to replace this.
- At the same time, Fed hikes should have a much quicker effect on housing.
- The supply chain will eventually begin working properly which will also soften inflationary effects on goods and the speed of housing construction. (See our most recent Market Commentary)

Inflation is also measured as year-over-year and month-over-month, so prices have to continually increase. Simply staying flat at elevated pricing for goods and services results in a decline in inflation. So, while it seems like inflation will never end, there are a number of factors that place pressure on the upside. For example,

- Fed hikes are deflationary.
- Recession is deflationary.
- Global supply chain getting fixed is deflationary.
- Year-over-year comparisons will start assisting the headline view.



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Is fixed income dead?

By definition, fixed income is a more conservative investment than equity generally. Fixed income includes a yield requirement and a return of principal requirement, while equity has neither. Over the last few years, yields have been anemic in traditional fixed income for a variety of reasons (deflationary pressures, low growth, bail out of commercial ('08) and consumer ('20) sectors). However, yields are now beginning to normalize towards longer term expectations given the characteristics of our country (aging demographics, higher debt). Over the longer arc of history, yields in the late 1970s and early 1980s were the outlier (above historical norms), not the rule.

In summary, market downturns are scary but actually part of a healthy, functioning economy. And part of that healthy, functioning economy is the general drumbeat of innovation and value creation which we believe will result in future market gains for diversified, longer-term investors.

[1] Courtesy of Bloomberg and Natixis