ECONOMIC & INVESTMENT PERSPECTIVES

JUNE: MARKETS DETERIORATE FURTHER
MID-YEAR MARKET REVIEW: NOWHERE TO HIDE

Figure 1: 6/30/2022 Returns (source: Bloomberg)
Conditional formatting: green (high) to red (low) for each time period

Bonds	ETF	Month	3MO	YTD	1YR	vs. 52-wk High	vs. 52-wk Low
US Aggregate Fixed Income	AGG	-1.6%	-4.6%	-10.2%	-10.3%	-13.0%	2.9%
Investment Grade Corp Bonds	LQD	-3.6%	-8.4%	-16.1%	-16.1%	-19.6%	2.7%
U.S. Treasury Bonds	GOVT	-0.8%	-3.7%	-10.0%	-9.2%	-11.6%	2.8%
U.S. 20+ YR Treasuries	TLT	-1.3%	-12.6%	-21.9%	-19.1%	-25.9%	6.2%
Muni Bonds	MUB	-1.5%	-2.5%	-7.8%	-7.6%	-9.9%	2.1%
High Yield	HYG	-7.0%	-9.5%	-13.8%	-12.8%	-16.5%	1.0%
Non-US Corp Bonds	IBND	-5.5%	-12.0%	-18.8%	-22.4%	-24.0%	3.1%
Emerging Markets Bond LC	EMLC	-4.2%	-8.2%	-12.7%	-18.0%	-21.8%	1.7%
Global Equity							
ACWI Global Equity	ACWI	-8.1%	-15.1%	-19.9%	-15.4%	-21.9%	3.2%
United States	VTI	-8.2%	-16.8%	-21.3%	-14.2%	-22.7%	3.8%
International Developed	EFA	-8.7%	-13.2%	-18.8%	-17.4%	-24.1%	2.2%
Emerging Markets	EEM	-5.1%	-10.4%	-17.2%	-25.6%	-27.4%	3.0%
Global Equity by Region							
United States	VTI	-8.2%	-16.8%	-21.3%	-14.2%	-22.7%	3.8%
Europe	IEUR	-9.9%	-13.9%	-20.9%	-18.6%	-25.2%	2.0%
Asia ex-Japan	AAXJ	-3.0%	-7.3%	-15.9%	-25.0%	-26.6%	6.0%
China	MCHI	8.4%	6.1%	-10.6%	-31.4%	-32.3%	28.4%
Japan	BBJP	-7.2%	-13.1%	-20.0%	-19.7%	-28.8%	2.1%
Latin America	ILF	-17.3%	-22.6%	0.2%	-20.2%	-28.8%	1.5%
US Equity							
US S&P 500	IVV	-8.3%	-16.2%	-20.0%	-10.6%	-21.3%	4.2%
NASDAQ 100 QQQ	QQQ	-8.9%	-22.5%	-29.3%	-20.5%	-31.4%	4.1%
US Large Growth	IWF	-8.0%	-21.1%	-28.2%	-19.0%	-29.9%	5.2%
US Large Value	IWD	-8.7%	-12.3%	-12.9%	-7.0%	-15.4%	3.6%
US Eqwt S&P 500	RSP	-9.4%	-14.4%	-16.7%	-9.5%	-18.6%	3.6%
US Mid Cap	IJH	-9.6%	-15.4%	-19.6%	-14.7%	-22.5%	3.8%
US Small Cap	VTWO	-8.3%	-17.2%	-23.5%	-25.2%	-30.8%	3.8%

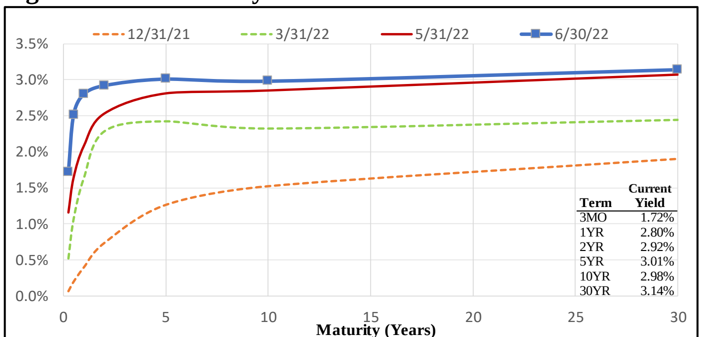
Global markets remained under pressure in June amid unrelenting headwinds (inflation, rising interest rates, recession concerns, Russia-Ukraine crisis). Global stock markets reached new 52-week lows mid-month before churning into month-end. Performance highlights for the month and quarter (Q2) are summarized below. (Note: Year-to-date returns are discussed on page 2.)

- Bonds: The U.S. Aggregate index (AGG) fell 1.6% (-4.6% Q2) as interest rates rose. Corporate bonds (LQD) were down 3.6% (-8.4% Q2), and high yield bonds (HYG) lost 7.0% (-9.5% Q2) as credit spreads widened (recession fears). Non-U.S. bonds (IBND and EMLC) under-performed due to the strong dollar.
- Global equity (ACWI): -8.1% in June (-15.1% Q2).
- U.S. Equity: The broad market (VTI) fell 8.2% (-16.8% Q2), and the S&P 500 (IVV) lost 8.3% (-16.2% Q2). Large growth stocks (QQQ and IWF) fell more than 20% in Q2 and are nearly 30% below all-time highs as rising interest rates erode the present value of future earnings. Small stocks (VTWO) fell 8.3% (-17.2% Q2) and are also 30% below 52-week highs. All sectors posted negative returns for the month and quarter; June losses were led by energy stocks (XLE -17.1%) as oil prices moderated to $106 per barrel from highs over $120.
- Non-U.S. Equity: Developed market stocks (EFA) were down 8.7% (-13.2% Q2), with sizable losses in Europe and Japan. Emerging markets (EEM) lost 5.1% (-10.4% Q2); Latin American stocks (ILF) lost 17.3% (-22.6% Q2) due to heavy commodity exposure. China was up 8.4% in June (+6.1% Q2) as their economy began to emerge from COVID lockdowns.

Interest Rates and the Economy

The yield curve (Figure 2) plots the yields (Y-axis) for various maturities (X-axis) of U.S. Treasuries. The Fed announced a Fed Funds rate hike of 0.75% and is likely to announce a similar increase in their July meeting before pausing to reassess economic conditions. This pushed short-term interest rates higher, but long-term rates did not rise commensurately; the curve remains flat at longer maturities, signaling tepid growth expectations and recession concerns. The 10-year Treasury bond now yields 2.98%.

Figure 2: US Treasury Yield Curve

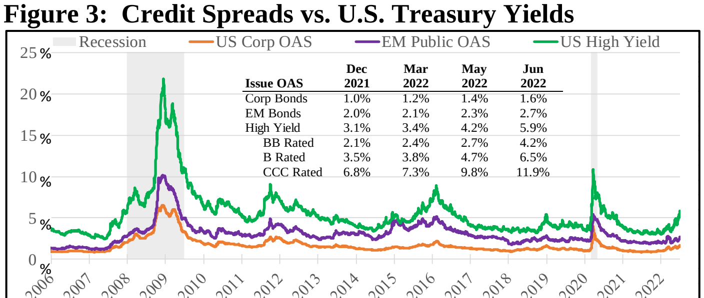


Source: Board of Governers of the Federal Reserve System via St. Louis Fed (FRED)

For bonds other than U.S. Treasuries, we track the option-adjusted yield spread (OAS) versus Treasuries of comparable maturities. Low or narrowing spreads signal optimism while high or rising spreads signal fear. Spreads have widened materially, confirming the "risk-off" tone of global markets.

- Investment grade corporate bond spreads widened to +1.6% this month and remain higher than +1.0% spreads at year-end.
- High yield (non-investment grade) spreads increased to +5.9% but are not yet at or near panic levels. The riskiest bonds (rated CCC & below) spiked to +11.9% over Treasuries and are significantly above 2021 year-end spreads of +6.8%.
- Emerging market bond spreads rose to +2.7% after remaining stable for most of Q2 amid on-going geopolitical tensions; despite relatively stable credit spreads, emerging market debt has under-performed due to the strength of the U.S. dollar YTD.

Figure 3: Credit Spreads vs. U.S. Treasury Yields

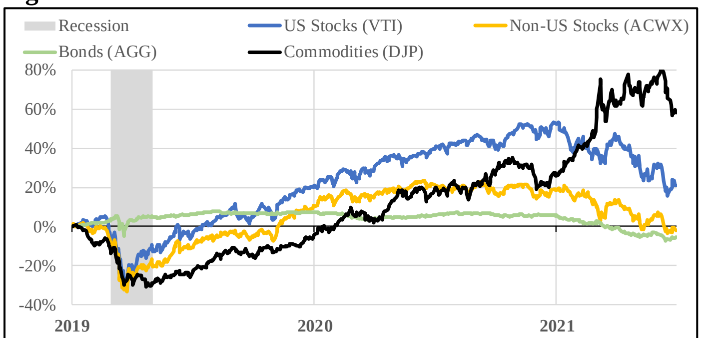


Source: Ice Data Indices, LLC via St. Louis Fed (FRED)

Mid-Year Review: Nowhere to Hide

Now that we are halfway through 2022, it is instructive to review the year-to-date (YTD) market action. Stocks and bonds alike have logged significantly negative returns in 2022. The fact that bonds have not offered diversification or a meaningful cushion while equity markets have entered bear market territory (down more than 20%) is particularly frustrating for investors. While this year has gotten off to the worst start in decades, it is important to put these jarring returns in context of where markets have been over the past several years. Figure 4 plots the total returns of various index ETFs since 2019 year-end (pre-pandemic).

Figure 4: Total Market Returns Since Before the Pandemic

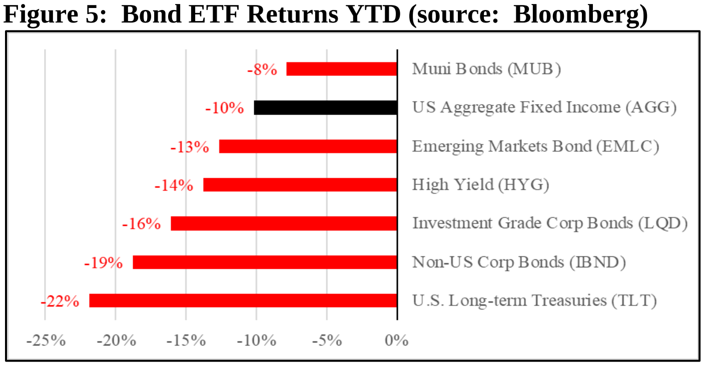


Sources: Bloomberg, Yahoo! Finance, ACIMA

Even with the significant drawdown YTD, U.S. stocks are still 20% higher than before the pandemic began, thanks to huge gains in 2020-2021 fueled by unprecedented monetary and fiscal stimulus. As the Fed has begun to remove accommodative measures to fight inflation (raising interest rates, shrinking its balance sheet), U.S. stock and bond markets have imploded. Non-U.S. stocks have given back all of their earlier gains. The only place to hide from this bear market has been in commodities, which have rocketed higher in 2022 as Russia's invasion of Ukraine threatened the global supply of oil, gas, materials and food.

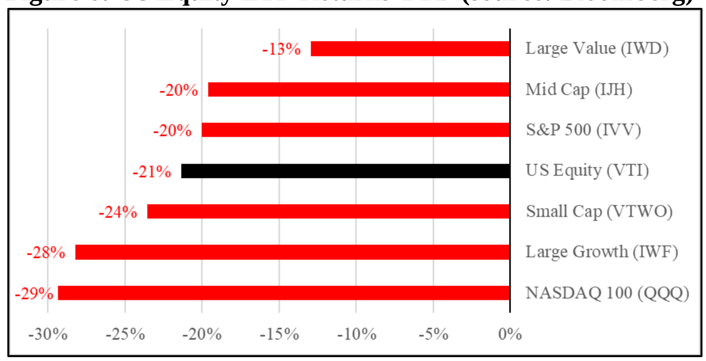
As previously noted, bonds have not provided any shelter in the 2022 financial market storm, as illustrated in Figure 5. When interest rates rise as they have this year, bond prices fall; the result has been a -10% return on the U.S. Aggregate bond index (AGG). The worst fixed income returns have come from long-term bonds (TLT), which are most sensitive to interest rate changes. Municipal bonds (MUB) have fared better on a relative basis, but other credit instruments (corporate bonds, high yield, non-U.S. bonds) have generated more negative returns as widening credit spreads (default risk) have compounded the impact of rising interest rates.

Figure 5: Bond ETF Returns YTD (source: Bloomberg)



U.S. equity returns are even worse than the bonds, as illustrated in Figure 6. The broad market (VTI) is down roughly 21% YTD, led lower by large growth stocks (tech, e-commerce, consumer stocks that previously led to the upside) as rising interest rates reduce the present value of future earnings. Small stocks are highly sensitive to U.S. economic growth; their under-performance is consistent with rising recession probabilities. Value stocks (financials, health care, utilities and other defensive stocks) have fared better but are still down 13% on average.

Figure 6: US Equity ETF Returns YTD (source: Bloomberg)



High inflation, rising interest rates and recession probabilities are global concerns, and global equity markets have similarly suffered so far this year, as illustrated in Figure 7. Developed markets (primarily the U.S., Europe and Japan) are down 20% or more YTD, under-performing commodity-centric markets like Brazil, Canada, U.K. and Australia. Interestingly, China has begun to recover as its economy emerges from draconian COVID lockdowns; the Chinese stock market (MCHI) has bounced 28% from 52-week lows but is still down over 10% YTD and more than 30% below last year's highs.

Figure 7: Global Equity ETF Returns (source: Bloomberg)

Global Equity	ETF	YTD	vs. 52-wk High	vs. 52-wk Low
Latin America	ILF	0.2%	-28.9%	1.4%
China	MCHI	-10.6%	-32.5%	28.0%
MSCI All-Country World Index	**ACWI**	**-19.9%**	**-21.9%**	**3.2%**
Japan	BBJP	-20.0%	-28.8%	2.1%
Europe	IEUR	-20.9%	-25.2%	2.0%
United States	VTI	-21.3%	-22.7%	3.8%

Bottom Line

Global economies and markets continue to face significant headwinds. High inflation has become more entrenched in the U.S., Europe and beyond, exacerbated by Russia's invasion of Ukraine and weaponization of the commodity markets, threatening the global supply of energy (oil, gas), metals, materials and food (Ukraine is one of the world's major exporters of wheat). Inflation is essentially a supply-demand imbalance; when there is too much demand and not enough supply, prices rise. The Fed and its global counterparts are powerless to solve the supply problems in this environment; all they can do is try to reduce demand by slowing the economy. The risk is that the U.S. and global economies stall, i.e., fall into recession. As this outcome has become increasingly likely, the questions going forward are how deep and how long the recession will be. We will be watching earnings growth over the coming quarters to provide clues. While we are encouraged by the recent resilience in non-U.S. equities (China, Latin America), global markets are likely to remain volatile; diversification and a balanced risk profile (global equity, bonds and alternative investments) make sense in this environment.

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