QUARTERLY MARKET COMMENTARY: 2022-Q2

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Let us begin by briefly reflecting on the point that contributed to the worst first half of a year for equity markets since 1972. The May inflation reading of 8.6% exceeded expectations and caused a swift reaction from the Federal Reserve. The 75-bps rate increase that followed easily provided a catalyst for the recent volatility in both the stock and bond markets. As we remain in oversold territory with the S&P 500, down 20% as of 6/30/22, the question on everyone's mind is where do we go from here?

Despite a hotter than expected inflation reading, we did not believe a 75-bps increase by the Fed last month was necessary instead of the anticipated 50-bps. Even though the larger bump up may be an understandable reaction, we recognize that it would not be detrimental to our long-term economic outlook. The optics of an aggressive Fed can be a double edge sword. Projecting a serious tone about taming inflation, which is positive, also comes with the price tag of higher interest rates. Higher rates can possibly result in a recession and a negative outlook for corporate earnings. We can see this thought process continuing to impact swings in the 10-yr Treasury yield and driving volatility in equity markets.

In addressing how to label the current state of the economy, we are assuming that we are already in a recession moving forward. Accepting the possibility of Gross Domestic Product (GDP) contraction in the 2nd quarter, in addition to the reported 1st quarter GDP of -1.6%, enables us to see beyond an annoying veil and focus more on the primary issue of inflation.

As we dissect inflation reports, we find oil prices as one of the main culprits driving higher prices. The challenge here is how to bring down the price of oil. In addition to our belief that any rate increase will not have a direct impact on oil prices, we believe that elevated prices for oil can be anti-inflationary itself. This should alleviate some pressure on the Fed to aggressively raise rates. The perfect scenario for oil is a trading range of $90-$100 per barrel. This would bring a welcome relief in prices at the pump while enabling oil companies to maintain a healthy cash flow.

Even though the Dow Jones Industrial Average (DJIA) is limited in providing a broad-based representation of domestic equity markets, the limited number of companies allows us to take a more intimate look at corporate fundamentals. Using our fair market valuation range for the DJIA, we observed a breakout to the downside below our lower fundamental threshold of 33,500, creating an oversold environment. A turnaround from current levels cannot begin without convincing softness in inflation readings. Should the inflation outlook improve, we see a potential recovery in U.S. equity markets in the range of 7% to 10%+ from the close on 7/8/22. Despite a potential recovery by year-end, we anticipate a negative close of approximately 4%+ for 2022. With the expectations of a shallow recession, we believe in the possibility of revisiting all-time highs during the 2nd half of 2023.

In closing, we are excited to welcome the newest addition to our team, Kate Lanza. In her role as our Assistant Office Manager, she will play an integral part of Ellis as we continue to grow. On a market note, based on past experiences, we recognize the recent downturn in capital markets can present opportunities for the long run. Please reach out to your adviser should you have any questions concerning your portfolio or financial plan as we continue to patiently navigate through these challenging times.