MAY 2022 MARKET REVIEW

Market Recap: Economic data releases during the month of May, particularly in the latter half, show a global economy that is continuing to decelerate. Data points across manufacturing (US), housing (US), services (Europe), and consumer sentiment (US) represent an economy that has been hit from multiple angles. Some of this was inevitable; the amount of liquidity in the financial system has allowed investors to be less discerning with their investment decisions since early 2020, however, liquidity levels are reversing due to central bank policy decisions and are dragging overvalued assets with it. Markets have exhibited higher levels of volatility for several months now, as they adjust to the changing economic environment. But, something changed in late May, where bad economic news was actually celebrated by markets - equities experienced a relief rally, expectations of further central bank hikes moderated, and interest rates fell. We take a slightly different viewpoint on this – if expectations of future rate hikes fall due to a worsening economy and equities rally as a result, there is a clear disconnect between equities and the real economy. Our current thinking is that growth will continue to moderate, however, we will be able to avoid a deep recessionary environment. Risk factors have clearly risen, and we see no reason for equities to celebrate a weakening economy, however, valuation in segments of the equity market is pricing in a doomsday scenario that may not play out.

The vast majority of the S&P 500 has reported their Q1 earnings as of the end of May. Despite some notable exceptions (Target, Wal-Mart, & Amazon), the reports were largely positive with the aggregate level of revenue and earnings growth outpacing expectations. Commodity exposed sectors, Energy and Materials, posted the largest year-over-year earnings growth, while both consumer sectors, Discretionary and Staples, posted negative earnings growth. Energy and Materials companies have been able to increase profit margins significantly (unsurprisingly), while both consumer sectors saw their profit margins contract due to a buildup of inventories and the inability to pass higher costs onto their customers. Looking forward, many companies have lowered their earnings targets for the year ahead citing continuing supply-chain issues and inflationary impacts. Companies tend to be conservative in their guidance and the way in which they discuss the future, but only 20% of the S&P 500 typically issue official forward guidance, so it is difficult to glean much value from this. Overall, we expect earnings to continue to grow, but perhaps at a more moderate pace than what we have experienced over the past 18 months.

How does this impact our perspective? Our client conversations recently have been focused on how the recent market pull back has affected the likelihood of achieving various financial goals. While corrections and bear markets can be nerve-racking, they can also be opportune times to deploy certain strategies across financial planning and investment management. On the investment side, rebalancing back to policy targets during selloffs, while employing tax-loss harvesting strategies, can result in positive long-term outcomes. Stressed market environments (like the one we are in) are always considered and incorporated into our planning analysis from the outset, as we expect various bumps in the road. Additionally, continually reassessing short and long term goals is imperative. Emotions tend to run hot during selloffs, so it is crucial to take a step back and understand the implications of impulsive decisions. Everyone's situation is unique, so while we may be taking action in certain relationships, we may recommend others to stand pat.