One For The Record Books

The first half of 2022 was not kind to investors. The S&P 500 Index is off to one of its worst starts ever (see table at right), and for the first time in a long while fixed income investors are having to deal with the negative price impacts of rising interest rates.

In fact, the first half of this year was the first time in nearly fifteen years that stocks and bonds both posted negative returns in consecutive quarters.

History tells us that when the stock market has a poor first half of a year, returns in the second half could go anywhere. While we're hoping for a healthier market in the coming months, there are a few reasons why we are positioned more cautiously.

First off, the Federal Reserve appears unwilling to support asset prices during this current decline. In the era of Quantitative Easing (or "QE"), the Fed's policy was to pump liquidity into financial markets to maintain price stability. With low-to-no inflation, this policy was successful and compelled investors to "buy the dips."

The red-hot inflation readings we've seen this year have effectively killed this policy response, which was known as the "Fed put." The Fed, desperate to choke off inflation after falling behind the curve, would only be making the situation worse if they decided to pump liquidity into the system at this point.

SECOND HALF RETURNS ARE A COIN FLIP

Negative 1st Halves for S&P 500 Index, Since 1950

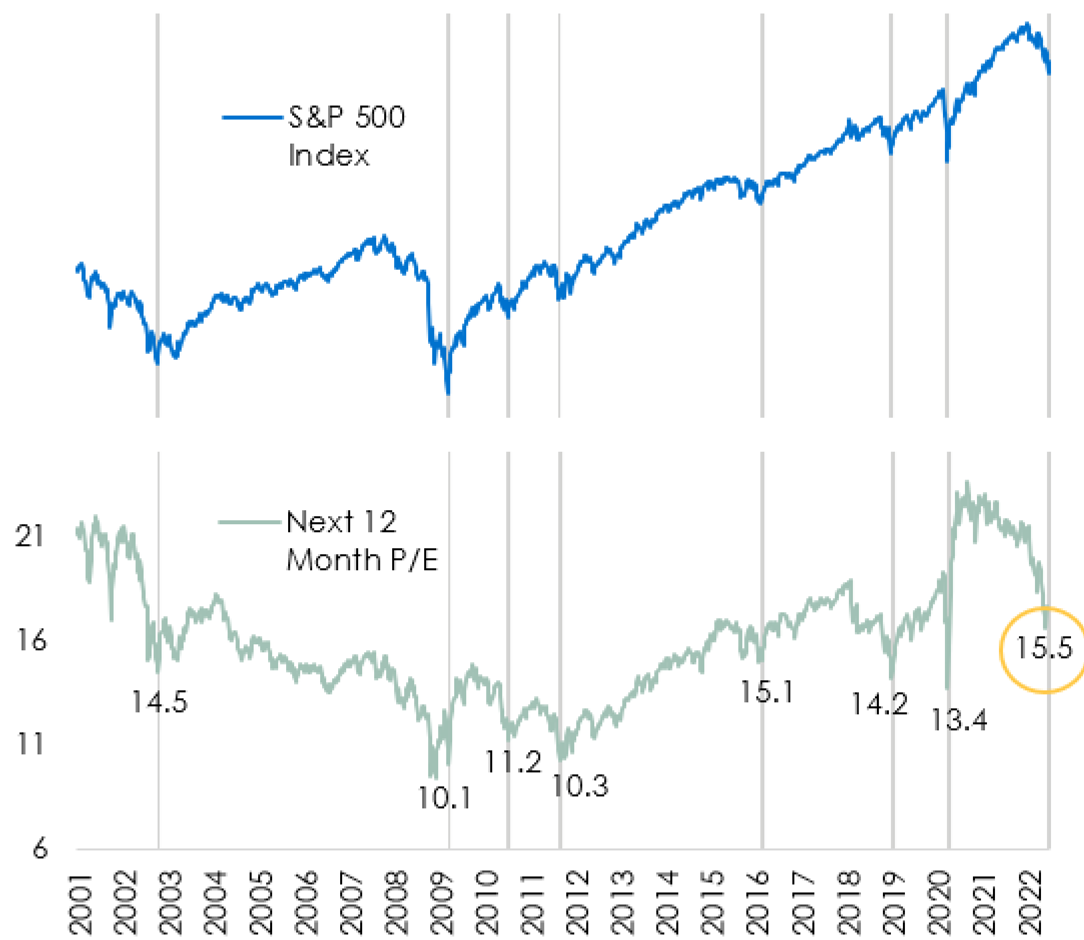
Year	1st Half	2nd Half
1962	-23.5%	15.3%
1970	-21.0%	26.7%
2022	**-20.6%**	**???**
2002	-13.8%	-11.1%
2008	-12.8%	-29.4%
1974	-11.8%	-20.3%
1973	-11.7%	-6.4%
1982	-10.6%	28.3%
1953	-9.1%	2.8%
1966	-8.3%	-5.2%
2010	-7.6%	22.0%
2001	-7.3%	-6.2%
1984	-7.1%	9.2%
1977	-6.5%	-5.4%
1969	-5.9%	-5.8%
1960	-5.0%	2.1%
1994	-4.8%	3.4%
2020	-4.0%	21.2%
1981	-3.4%	-6.6%
1992	-2.1%	6.8%
2005	-1.7%	4.8%
2000	-1.0%	-9.2%
1965	-0.7%	9.9%

Source: Strategas

Equity valuations are another area that we are watching closely. Thus far, the stock market decline is that it has been driven almost entirely by falling price-to-earnings (P/E) multiples. Leading the way down have been the large, high growth stocks that were (in our opinion) excessively valued heading into 2022.

Even though market P/E multiples have contracted a fair amount already this year, they still aren't in the 10-13x range that has historically signaled a major market bottom.

Valuations Still Not At Trough Levels

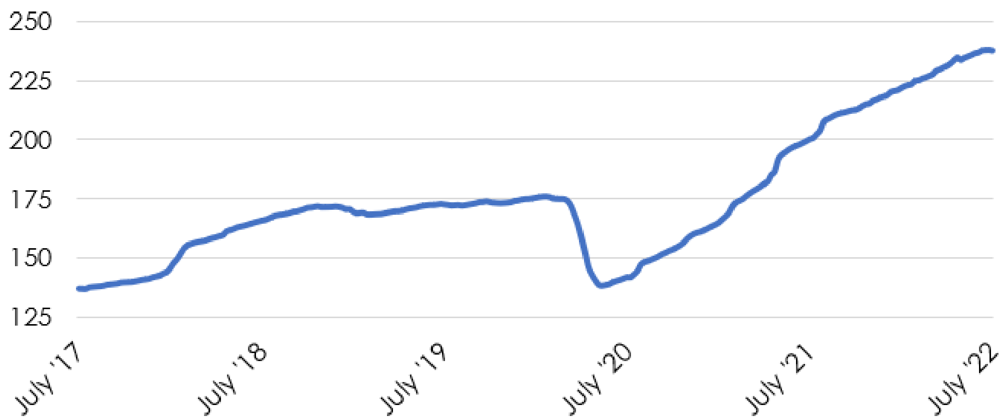


Source: Factset, YCAG Research. Data through July 1, 2022

While falling valuation multiples have dragged the market down, the next leg lower for the stock market could be driven by declining earnings expectations. In the chart at right, you can see that at this point Wall Street isn't anticipating any slowdown in earnings for the market. Companies will soon start to release earnings figures for the June 30 quarter, and the tone of mangement comments will be key for what the market does for the rest of the year.

Earnings Haven't Fallen - Yet

S&P 500 Index Earnings Per Share Next Twelve Months



Source: Factset

While we still view the current macroeconomic picture as atypical of a recession, the rate of growth is slowing at an increasing rate. Financial conditions are tightening and the odds of an economic downturn are increasing. As such, we will continue to focus on "value" and "quality" as this economic cycle matures.

Stock market volatility, thus far, has largely been due to valuations resetting lower rather than a significant deterioration in the fundamentals. Throughout the past year, we have trimmed "riskier" assets in client portfolios (stocks and alternatives) to maintain a relative balance with lower volatility securities, like fixed income and hedges against market volatility.

We have become slightly underweight equities in general and we continue to favor "value" and "quality" within the large-cap domestic market. We've also taken steps to become more defensive in terms of our sector weightings in our individual equity portfolios.

In the fixed income area, we remain focused on higher quality credit-sensitive securities (with less exposure to the more cyclical areas of the market) with shorter maturities as a hedge against potentially rising interest rates.

Within the alternative market segments, we have maintained an emphasis on "real assets" (think commodities and, to a lesser extent, real estate) as a hedge against the potential for continued inflation. We maintain an overweight to the diversified alternative sector as a hedge against market volatility.