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High Inflation and Rising Interest Rates Result in the Worst S&P 500 Performance in Decades

The S&P 500 continued to decline in the second quarter, hitting the lowest level since December 2020 as still-high inflation, sharp increases in interest rates, rising recession risks, and ongoing geopolitical unrest pressured stocks and other assets.

After a rebound in March, the S&P 500 dropped sharply in April to start the second quarter. While some of the reasons for the declines were similar to the first quarter (rising rates, high inflation, geopolitical concerns) the primary catalyst for the April sell-off was something new: a massive COVID-related lockdown in China. Unlike most of the rest of the world, China continues to enforce a "Zero-COVID" policy, whereby small outbreaks are met with extremely intense city- and province-wide lockdowns. At the peak of the recent COVID outbreak and subsequent lockdowns throughout China, it was estimated that 46 separate cities and provinces, impacting 300 million people and representing nearly 80% of China's economic output were shut in and shut down, essentially halting the world's second-largest economy. This sharp drop-in economic activity not only increased the chances of a global recession but also compounded global supply chain problems (Shanghai, the world's busiest port, operated far below capacity during the lockdowns). The severe decline in economic activity in China combined with lingering concerns about rising interest rates and high inflation hit stocks hard in April, and the S&P 500 fell 8.7%.

The selling continued in early May, as the Federal Reserve raised interest rates by 50 basis points at the May 4th meeting, the single-biggest rate hike in 22 years. Additionally, at the press conference, Fed Chair Jerome Powell clearly signaled that the Fed would continue to hike rates aggressively to tame inflation and that weighed on stocks, pressuring the S&P 500 to fall to new 2022 lows in mid-May. But towards the end of the month, markets staged a modest rebound thanks to potential improvement in multiple market headwinds. First, as COVID cases declined, the Chinese economy started to reopen, and by the end of May, the port of Shanghai was operating at 80% capacity, a material improvement from earlier in the month. Additionally, Atlanta Fed President Raphael Bostic stated that the Fed might "pause" rate hikes in the late summer or early fall, and that gave investors some hope that the end of the Fed rate hike cycle may be closer than previously thought. Finally, some inflation metrics implied price pressures may be peaking. Those potential positives, combined with deep, short-term oversold conditions in equity markets, prompted a solid rally in late May and the S&P 500 finished the month with a fractional gain.

But the relief didn't last long. On June 10th, the May CPI report showed inflation had not yet peaked as CPI rose 8.6% year-over-year, the highest reading since 1982. That prompted a violent reversal of the late-May gains, and the selling and market volatility was compounded when the Federal Reserve increased interest rates by 75 basis points on June 15th, the biggest rate hike since 1994. Additionally, Fed Chair Powell again warned that similar rate hikes are possible in the coming months. The high CPI reading combined with the greater-than-expected rate hike hit stocks hard, and the S&P 500 dropped sharply in mid-June to its lowest level since December 2020. During the last two weeks of the quarter, markets stabilized as commodity prices declined while U.S. economic readings showed a clear moderation in activity and that rekindled hope that a peak in inflation and an end to the rate hike cycle might come sooner than feared. Those factors, combined with the fact that markets had become near-term oversold again, resulted in a modest bounce late in the month, but the S&P 500 still finished with a solidly negative return for June.

In sum, the factors that pressured stocks in the first quarter, including high inflation, the prospect of sharply higher interest rates, geopolitical unrest, and rising recession fears, also weighed on stocks in the second quarter and until investors get relief from these headwinds, markets will remain volatile.

Second Quarter Performance Review

All four major stock indices posted negative returns for the second straight quarter, and like in the first quarter, the tech-heavy Nasdaq underperformed primarily thanks to rising interest rates while the Dow Jones Industrial Average relatively outperformed. Also, like the first quarter, rising rates and growing fears of an economic slowdown fueled the continued rotation from high valuation, growth-sensitive tech stocks to sectors of the market that are more resilient to rising rates and slowing economic growth.

By market capitalization, large-cap stocks again outperformed small-cap stocks in the second quarter, although the performance gap was small. Large-cap outperformance continued to be driven by the rise in interest rates as well as growing recession fears. Small-cap stocks are typically more reliant on debt financing to sustain their businesses, and therefore, more sensitive to rising interest rates than large-cap stocks. Additionally, investors again moved to the relative safety of large caps amidst rising risks of a future slowing of economic growth or recession.

From an investment style standpoint, both value and growth registered losses for the second quarter, a departure from the first quarter where value posted a positive return. However, value did again handily outperform growth on a relative basis in the second quarter. Rising interest rates, still-high inflation, and increasing recession concerns caused investors to continue to flee growth-oriented tech stocks and rotate to more fairly valued sectors of the market, although again, both styles finished the quarter with negative returns.

On a sector level, all 11 S&P 500 sectors finished the second quarter with negative returns. Relative outperformers included traditionally defensive sectors such as utilities, consumer staples, and healthcare, which are historically less sensitive to a potential economic slowdown, and the quarterly losses for these sectors were modest. Energy was also a relative outperformer thanks to high oil and gas prices for much of the second quarter, although a late-June drop in energy commodities caused the energy sector to finish the quarter with a small loss.

Sector laggards in the second quarter were similar to those in the first quarter, with communication services, tech, and consumer discretionary sectors seeing material declines due to the aforementioned, broad rotation away from the more highly valued corners of the market. Specifically, internet stocks again weighed on the communications sector, while traditional retail stocks were a drag on the consumer discretionary sector following unexpectedly bad earnings from several major national retail chains. Financials also lagged in the second quarter thanks to rising fears of a future recession combined with a flattening yield curve, which can compress bank profit margins.

US Equity Indexes	Q2 Return	YTD
S&P 500	-17.41%	-19.96%
DJ Industrial Average	-12.17%	-14.44%
NASDAQ 100	-23.50%	-29.22%
S&P MidCap 400	-16.62%	-19.54%
Russell 2000	-18.02%	-23.43%

Source: YCharts

Internationally, foreign markets declined in the second quarter as the Russia-Ukraine war continued with no signs of a ceasefire in sight. However, foreign markets relatively outperformed U.S. markets as foreign central banks are expected to be less aggressive with future rate increases compared to the Fed. Emerging markets outperformed foreign developed markets thanks to high commodity prices (for most of the quarter) and despite rising global recession fears.

International Equity Indexes	Q2 Return	YTD
MSCI EAFE TR USD (Foreign Developed)	-15.15%	-19.25%
MSCI EM TR USD (Emerging Markets)	-11.92%	-17.47%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	-14.34%	-18.15%

Source: YCharts

Commodities registered slightly negative returns in the second quarter thanks mostly to steep declines in late June. Fears of a global recession hit most commodities at the end of the quarter and erased what was, up to that point, a solidly positive performance for the broader commodity complex. Oil finished the quarter with a small loss. Prior to late June, oil prices were sharply higher for the quarter, but rising fears of reduced future demand and increased supply weighed on the oil market into the end of the quarter. Gold, meanwhile, logged solidly negative returns despite the increase in market volatility and multi-decade highs in inflation, as the strong dollar and rising real interest rates weighed on the yellow metal.

Switching to fixed-income markets, most bond indices again registered solidly negative returns as still-high inflation and the prospect of faster-than-expected rate increases from the Fed weighed on fixed-income investments.

Looking deeper into the bond markets, shorter-term Treasury Bills again outperformed longer-duration Treasury Notes and Bonds as high inflation and the threat of more than previously expected Fed rate hikes weighed on fixed income products with longer durations. Short-term Treasury Bills finished the quarter with a slightly positive return.

Corporate bonds underperformed in the second quarter as rising recession fears paired with already-high inflation weighed considerably on corporate debt. For much of the quarter, high-quality investment-grade bonds and lower-quality high yield corporate bonds had similar negative returns, implying investor concerns about a future recession were general in nature. However, an increase in disappointing economic data hit high-yield corporate bonds at the end of the quarter and they underperformed their higher-quality counterparts.

Third Quarter Market Outlook

The S&P 500 just realized its worst first-half performance since 1970 as initial market headwinds of high inflation and sharply rising interest rates combined with growing recession risks and extreme geopolitical uncertainty pushed stocks and bonds sharply lower through the first six months of the year.

Those declines are understandable considering inflation reached a 40-year high, the Federal Reserve raised interest rates at the fastest pace in decades, the world's second-largest economy effectively shut down and the Russia-Ukraine war raged on.

But while the volatility and market declines of the first six months of 2022 have been unsettling and painful, the S&P 500 now sits at much more historically attractive valuation levels. And at current prices, a lot of negativities have been priced into the market, opening the possibility of positive surprises as we move forward in 2022.

Regarding inflation and Fed rate hikes, markets have aggressively priced in stubbornly high inflation and numerous additional rate hikes from the Federal Reserve between now and early 2023. But if we see a definitive peak in inflationary pressures in the coming months, then it's likely the Federal Reserve will hike rates less than currently feared, and that could be a materially positive catalyst for markets.

On economic growth, the Chinese economic shutdown has increased global recession concerns, but recently officials in Shanghai declared "victory" against the latest COVID outbreak and if Chinese economic activity can return to normal, that will be a positive development for global economic growth. Meanwhile, recession fears are rising in the U.S., but stocks are no longer richly valued, and as such, aren't as susceptible to an economic slowdown as they were at the start of the year.

Finally, regarding geopolitics, the human tragedy in Ukraine continues with no end in sight, but the conflict has not expanded beyond Ukraine's borders, and many analysts believe that some sort of conflict resolution can be reached in the coming months. Any sort of a truce between Russia and Ukraine will likely reduce commodity prices and global recession fears should decline as a result.

Bottom line, the markets have experienced numerous macro-and micro-economic headwinds through the first six months of the year, and they have legitimately pressured asset prices. But the sentiment is very negative at the moment, and a lot of potential "bad news" has been at least partially priced into stocks and bonds at these levels, again creating the opportunity for potential positive surprises.

To that point, the S&P 500 has declined more than 15% through the first six months of the year five previous times since 1932. And in all those instances, the S&P 500 registered a solidly positive return for the final six months of those years.

Obviously, past performance is not necessarily indicative of future results, and we will continue to be vigilant to additional risks to portfolios, but market history provides a clear example that positive surprises can and have occurred even in difficult markets such as this. More importantly, through each of those declines, markets eventually recouped the losses and moved to considerable new highs.

Successful investing is a marathon, not a sprint, and even extended bouts of volatility like we've experienced over the past six months are unlikely to alter a diversified approach set up to meet your long-term investment goals.

Rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment.

Please do not hesitate to contact us with any questions, or comments, or to schedule a portfolio review.

Enclosure #1 – Our first enclosure is the Investment Strategy Quarterly piece from Raymond James. This provides a quick understanding of relevant themes in the investment world. Additionally it provides an economic snapshot as well as a tactical outlook. We like to include this in the Weiss Report as a handy two-page reference.

Enclosure #2 – Our second enclosure is a piece by Brian Wesbury from First Trust Advisors that provides an introduction to Keynesian economics.

Enclosure #3 – Our last enclosure is a new writing from our team member Lenny Weiss. He provides some examples of things to be excited about in our economy.

Important Disclosures

This report is not intended as a complete description of the securities, markets or developments referred to herein. It should not be viewed as an offer to buy or sell any of the securities mentioned. Information has been obtained from sources considered reliable, but we do not guarantee that the foregoing report is accurate and complete. Additional information and sources are available upon request.

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One cannot invest directly in an index. Past Performance does not guarantee future results. Sector Investments are companies engaged in business related to a specific sector. They are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification. Investing in oil involves special risks, including the potential adverse effects of state and federal regulation and may not be suitable for all investors. Bond prices and yields are subject to change based upon market conditions and availability. International investing involves special risks, including currency fluctuations, differing financial accounting standards, and possible political and economic volatility.

Investing in commodities is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Raymond James is not affiliated with and does not endorse the opinions or services of Brian Wesbury, First Trust Advisors, or Nationwide

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Enclosure #2: Information was developed by First Trust, an independent third party. The opinions of Brian Wesbury are independent from and not necessarily those of RJFS or Raymond James.

*Prices of DJIA and NASDAQ as of 04/11/2022 close.

INVESTMENT STRATEGY QUARTERLY QUICKVIEW

JULY 2022

THEMES

Fed Air: Prepare for Landing

Monetary policy from the Federal Reserve (Fed) will remain on a tightening path until the end of this year, when we believe the Fed will revise its views on further policy tightening in light of incoming information on inflation. Americans have seen their net worth surge significantly since the pandemic began, but the truth is, most people don't live off their net worth. If a recession were to come along in the near future, it is likely that it won't be as strong as the Great Recession, but rather a mild economic slowdown.

Q&A: The Path Forward for Fixed Income

- One of the things to remember about the difficult bond market in 2022 is that this is not a credit event. What we have seen in corporate bond spreads after the first half is a pretty significant widening, with investment-grade bond spreads about 50 basis points wider than they were at year end. That may represent a good yield opportunity.
- At the end of the day, we are not in a 1970s-style unraveling of the bond market or a gigantic spike in interest rates. However, growth will slow. As we move into the 12- to 18-month time frame, we will possibly see more pro-growth, more pro-economic stimulus policies.

Navigating Choppy Markets

Unless the narrative changes regarding Russia backing off or China ending COVID lockdowns, it will be difficult for equities to sustainably move to the upside without better inflation data. While overall we believe that the market may remain challenged with additional weakness in the coming weeks and months, we also believe equities will be higher over the next 12 months given our belief that inflation moderates as the year progresses. We recommend long-term investors use the market downdrafts as opportunities to accumulate favored areas – increasing our conviction as inflation and/or technical momentum improves.

No Simple Recipe for Energy Security

There is recognition that the European continent's long-standing dependence on Russian energy is no longer a viable option. Approximately one-third of Europe's oil consumption (4.5 out of 13 million barrels per day) and natural gas (15 out of 45 billion cubic feet per day) came from Russia; however, Russia needs Europe as a customer more than Europe needs Russia as a supplier. With natural gas, the transition from Russian supply will be both time consuming and logistically complex.

For more information, refer to the full Investment Strategy Quarterly.

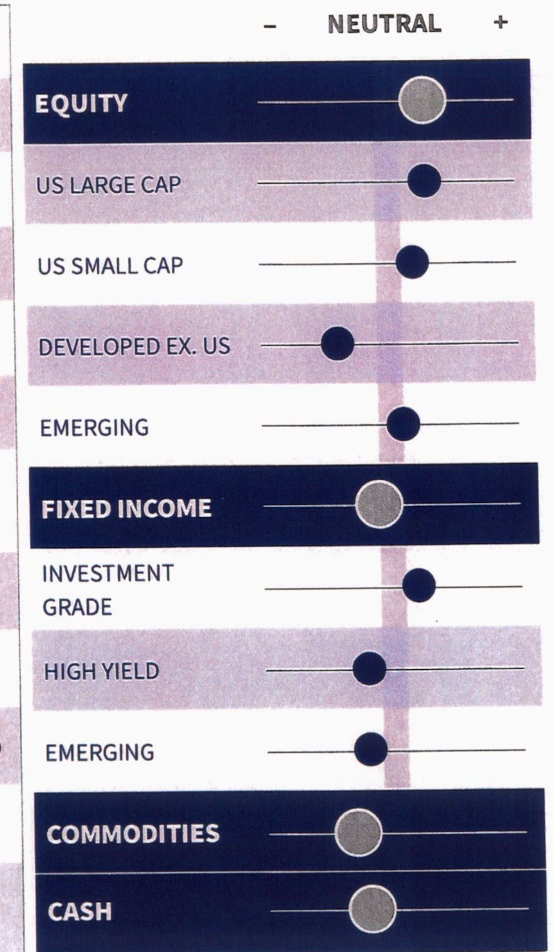
Economic Snapshot

Economic Indicator

FAVORABLE	EMPLOYMENT
FAVORABLE	BUSINESS INVESTMENT
FAVORABLE	MANUFACTURING
FAVORABLE	THE DOLLAR
NEUTRAL	GROWTH
NEUTRAL	CONSUMER SPENDING
NEUTRAL	HOUSING AND RESIDENTIAL CONSTRUCTION
NEUTRAL	LONG-TERM INTEREST RATES
NEUTRAL	FISCAL POLICY
NEUTRAL	REST OF THE WORLD
UNFAVORABLE	INFLATION
UNFAVORABLE	MONETARY POLICY

Eugenio J. Alemán, PhD
Chief Economist, Raymond James

Tactical Outlook



The tactical asset allocation outlook above reflects the Raymond James Investment Strategy Committee's recommendations for current positioning. Your financial advisor can help you interpret each recommendation within this material relative to your individual asset allocation policy, risk tolerance and investment objectives.

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INVESTMENT STRATEGY QUARTERLY QUICKVIEW

JULY 2022

Capital Markets Snapshot

EQUITY	AS OF 6/30/2022*	2Q 2022 RETURN**	12-MONTH RETURN**
DOW JONES INDUSTRIAL AVERAGE	31,029.31	-10.52%	-10.07%
S&P 500 INDEX	3,785.38	-16.45%	-11.92%
NASDAQ COMPOSITE INDEX	11,177.89	-22.44%	-23.96%
MSCI EAFE INDEX	1,852.00	-13.60%	-19.47%
RATES	**AS OF 6/30/2022**	**AS OF 12/31/2021**	**AS OF 6/30/2021**
FED FUNDS RATE TARGET RANGE	1.50-1.75	0-0.25	0-0.25
3-MONTH LIBOR	2.29	0.21	0.15
2-YEAR TREASURY	2.93	0.73	0.25
10-YEAR TREASURY	2.98	1.51	1.45
30-YEAR MORTGAGE	5.70	3.27	3.13
PRIME RATE	4.75	3.25	3.25
COMMODITIES	**AS OF 6/30/2022***	**2Q 2022 RETURN**	**12-MONTH RETURN**
GOLD	$1,817.50	-6.99%	2.59%
CRUDE OIL	$109.78	9.47%	49.42%

*Price Level
**Total Return

Sector Snapshot

	SECTOR	S&P WEIGHT
OVERWEIGHT	HEALTH CARE	14.6%
OVERWEIGHT	FINANCIALS	11.0%
OVERWEIGHT	ENERGY	4.6%
EQUAL WEIGHT	INFORMATION TECHNOLOGY	27.0%
EQUAL WEIGHT	CONSUMER DISCRETIONARY	10.8%
EQUAL WEIGHT	COMMUNICATION SERVICES	9.0%
EQUAL WEIGHT	INDUSTRIALS	7.9%
EQUAL WEIGHT	MATERIALS	2.7%
EQUAL WEIGHT	REAL ESTATE	2.8%
UNDERWEIGHT	CONSUMER STAPLES	6.7%
UNDERWEIGHT	UTILITIES	2.9%

First Trust
Monday Morning OUTLOOK

Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Dep. Chief Economist
Strider Elass – Senior Economist
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How About More Freedom?

As we celebrate 246 years of national independence, our country is now more than two years into an economic recovery from the two-month COVID Lockdown Depression. Although the economy has improved dramatically from the complete lockdown bottom in April 2020, it's still feeling lingering pain from policy mistakes made to address the pandemic.

First the good news. The unemployment rate is down to 3.6%, very close to where it was before COVID started. Manufacturing production is 3.8% above where it was pre-COVID. The problem is that a smaller share of workers are participating in the labor force and the number of jobs still hasn't fully recovered. Meanwhile, inflation is running at the fastest pace in forty years.

In our view, we are still suffering from three major policy mistakes. First, running an overly loose monetary policy. Second, handing out too many government checks, which allowed American consumers to borrow from future production and spend more in the past two years than they would have if no pandemic had ever occurred. And third, shutting down many parts of the economy through government mandates at multiple levels.

That last part, the shutdowns, is key because here we are about eighteen months after vaccines were introduced and supply chains are still a mess. We think much of this represents lingering pain from shutdowns that broke relationships among firms and within firms. This makes it much tougher for companies to keep up with demand that was temporary and artificially boosted by government stimulus checks.

Markets are extremely robust under normal circumstances. War, hurricanes, drought, power failures are all disruptive, but markets absorb them and move on. But, by taking the unprecedented path of shutting down large parts of the economy, government made the recovery process extremely hard. Markets only work when information (the pricing system) is allowed to function. It hasn't functioned properly for over two years now.

The Atlanta Federal Reserve's GDP Now model is now projecting that real GDP declined at a 2.1% annual rate in the second quarter. We think that's way too pessimistic and not consistent with continued increases in industrial production and job growth, both of which are signaling continued economic growth.

Nevertheless, the Atlanta Fed's model is picking up the cost of the shutdowns and we think the lesson for future policymakers should be obvious: let's not shutdown the US economy again. People are much smarter than policymakers think; workers, customers, and private business, all by themselves, without mandates and extra rules, could figure out when to step back from certain high-risk activities and when they don't have to.

Fortunately, some business leaders are starting to push back against political leaders who think they know how to run the US economy all by themselves. For example, a recent comment from a consortium of oil companies urged that the author of a White House statement on energy take a basic course in economics. Another example: Jeff Bezos openly disagreeing with the White House on inflation.

In a sense, the answers to our problems were all around us this past weekend, in all the celebrations of America and in all our connections with family and friends. The answer is us. What we need is more of all of us thinking things through on our own, figuring things out, with fewer Washington rules, mandates, and regulations getting in between. Freedom works.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-5 / 9:00 am	Factory Orders – May	+0.5%	**+0.6%**		+0.3%
7-6 / 9:00 am	ISM Non Mfg Index – Jun	54.0	**54.5**		55.9
7-7 / 7:30 am	Initial Claims - Jun 26	230K	**231K**		231K
7:30 am	Int'l Trade Balance – May	-$84.7 Bil	**-$85.4 Bil**		-$87.1 Bil
7-8 / 7:30 am	Non-Farm Payrolls – Jun	273K	**275K**		390K
7:30 am	Private Payrolls – Jun	240K	**250K**		333K
7:30 am	Manufacturing Payrolls – Jun	25K	**25K**		18K
7:30 am	Unemployment Rate – Jun	3.6%	**3.5%**		3.6%
7:30 am	Average Hourly Earnings – Jun	+0.3%	**+0.4%**		+0.3%
7:30 am	Average Weekly Hours – Jun	34.6	**34.6**		34.6
2:00 pm	Consumer Credit– May	$30.0 Bil	**$31.8 Bil**		$38.1 Bil

The Weiss Report
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Enclosure #3

Beer and Tax Code

By: Leonard A. Weiss

Each night 10 friends meet at Joe's Place and share a beer. Each round costs $50. They decide to allocate the amount owed according to the Tax Code. This way, the price of drinking would be 'fairly' shared.

Currently, 70% of income taxes collected come from the 1% (drinker 1) so he should pay $35. The bottom 30% pay no taxes at all, the bottom three (drinkers 8-10) will drink for free and thank those around them for the free beer. See table #1 below:

FRIEND	AMOUNT PAID
#1	$35
#2	$6
#3	$6
#4	$1
#5	$1
#6	$0.50
#7	$0.50
#8	Free
#9	Free
#10	Free

After a few months, Joe rewards the group with a $20 rebate for the next round, but how should the rebate be shared fairly? The first idea was all 10 friends share equally in the $20 rebate. If each person were rebated $2 each, then friend #1 would see his cost fall from $35 to $33, but this arrangement results in seven people actually getting a rebate of $2 even though they either paid less than $2 or drank for free. This seems extreme, but who says you have to pay into the pot to take part in the $20 rebated in cost? See table #2 below:

FRIEND	AMOUNT PAID
#1	$33
#2	$4
#3	$4
#4	Gets $1
#5	Gets $1
#6	Gets $1.50
#7	Gets $1.50
#8	Gets $2
#9	Gets $2
#10	Gets $2

Finally, friend #1 says; "I paid 70% of the cost of the beer, it's only fair that I receive 70% of the rebate. There are now seven guys getting paid to have a beer!" That would amount to $14, not the $2 from the 'all share equally' idea. Even with 70% of the rebate, friend #1 would still be paying $21 of the $30 tab.

With this idea on the table, the other nine friends beat up friend number 1 and put him into the hospital.

The next night, only nine friends showed up, but they had to refigure a new formula to pay the beer tab.

I guess it comes down to what the definition of 'fair' is.

I think that the people who pay the tab (paid taxes) should receive the same percentage from a rebate (tax cut) as they paid in. Furthermore, I think that those who drink free (pay no taxes) should not be eligible to vote on who gets a rebate. Remember, they did not pay into the pot.