MID-YEAR OUTLOOK

June 22, 2022

Given the market volatility of the last month, we feel it is appropriate to update you on our outlook. We have hosted several webinars and distributed various reports from Raymond James. Please check out our website under the Resources/Market & Economic Commentaries tab at: www.greenwealthmgt.com. Please note the comments in this letter are those of the Green Wealth Management Group.

Question: Are we headed into recession?

Answer: Not yet…

If you have been reading our Outlook letters, you know that we have been concerned about the US Money Supply and Inflation since early 2021. Last week, the Federal Open Market Committee (FOMC) voted to raise the Discount rate target by 75 basis points (0.75%) rather than 50 bps as most had expected. Since then, the tone of comments from the US Federal Reserve Bank (Fed) officials and Chairman Jay Powell have turned more "Hawkish" in fighting inflation. In testimony before Congress today (June 22nd) Chairman Powell stated that a "soft-landing" was "very challenging." The Fed is prepared to move sales of US Treasury bonds up to $90 billion dollars per month by September. The Fed appears to be willing to give up economic growth to reign in rising inflation.

Implications for investors: the Fed is no longer your friend. Raising rates by 75 basis points and increasing sales of Treasury bonds means the Fed isn't just lifting off the gas, they are putting on the brakes. **PLEASE READ ALL THE WAY TO THE END OF THIS LETTER TO SEE ACTIONS WE ARE GENERALLY RECOMMENDING.**

Impacts are already being seen.

- According to Freddie Mac, 30-year fixed mortgage rates have risen from average rate of 2.6% in May 2021 to 5.62% in May 2022 (before the recent Fed rate hike). This makes housing less affordable.
- Roughly 61% of companies making up the S&P 500 Index have revised their earnings guidance for the remainder of 2022 downward.
- There has been a string of company announcements regarding hiring freezes and staffing cuts. Inventory shortages are being resolved, but profit margins are being impacted.

Simply put, the Fed is tightening into a slowdown, raising the odds they will succeed in achieving a "soft-landing." The slowing economic backdrop makes us more cautious on risk assets. It is becoming apparent that inflation is impacting growth.

Recessions used to be defined as two consecutive quarters of decline in real (inflation adjusted) Gross Domestic Product (GDP). However, the National Bureau of Economic Research (NBER) now defines recession as:

"…a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale retail sales."

Because this modern measurement encompasses so many data points, (all of which are backwards looking and subject to revisions) it is common for the US to already be in a recession before the NBER makes it official. At this point, we believe any recession in the US will be mild (especially when compared to the Great Recession of 2008-2009).

Three famous stock market axiom's worth repeating:

1) **Don't fight the Fed:**
   Central banks (globally) are no longer our friend. The Fed is embarking on the most aggressive monetary tightening policy in many decades into an economy that is slowing from record levels. This does (in our view) increase the likelihood that a recession could begin in 2022 (rather than our previous belief of 2023-2024). In fact, the Atlanta Federal Reserve Bank just announced their forecast of 0% GDP growth for this quarter, so it is technically possible a recession has already begun. However, we anticipate relatively mild recession in the US but more severe in Europe and Asia.

   While they have many tools at their disposal, the two most common are the Discount Rate and Purchases or Sales of Treasury Bonds. The Discount Rate is the interest rate charged to commercial banks and other financial institutions for short-term loans they take from the Fed. As Fed Funds become more expensive, banks then charge their customers higher interest rates to borrow.

   For the past two years, the Fed has been the single largest purchaser of Treasury Bonds in the open market. When the Fed buys, they are essentially "printing money" by putting more cash into the financial system. When the Fed sells (as they are doing now), they are withdrawing cash from the financial system and shrinking the supply of money.

2) **Don't fight the Trend:**
   Monetary tightening by the Fed to get rising inflation under control and the war in Ukraine has soured investor sentiment resulting in downward pressure on stocks. Institutional investors are extremely Bearish. The current trend has been a rapid decline, but the market is showing signs of finding support. Individual investors continue to show an interest in buying.

3) **Beware of crowds at the Extremes:** this applies whether people are excessively optimistic or pessimistic. Things are rarely quite as good or quite as bad as they seem at that moment. History has shown that when most investors are selling, good buying opportunities are close at hand.

In our January 2022 Outlook, there were two primary downside risks we identified:

1) Geopolitical risks in Ukraine/Russia and China. (Comment: those risks were manifested very quickly.)
2) Fed Policy Error: The Fed would raise rates faster than the market expected or more than the market expected. (Comment: The Fed appears committed to doing whatever it takes to contain inflation.)

What do we expect from here?

1) We began this year with Consumer Savings rates at the highest levels in nearly 40 years. Higher prices at the gas pump and grocery store act as a tax on consumers and leaves them with less money for discretionary spending. In addition, stimulus checks are gone, and loan payments are restarting. Record consumer savings will be spent down as we return to "normal" levels. When that happens, companies may see a decline in demand (which is exactly what the Fed is trying to achieve in getting supply and demand back into "balance").
2) Corporate earnings estimates will come down somewhat. Inflation will impact company profit margins. Supply chain shortages are now turning into (in some cases) excess inventories. We now expect earnings growth on the S&P 500 to be up 7% year over year vs. 2022 (down from previous estimates of 10-12%).
3) Expect continued volatility in the markets over the summer. At this point, we still expect the stock market to end the year higher than current levels but keep your seat belts buckled.
4) Expect a milder recession in the US and more challenging conditions in Europe and Asia.

POSITIVES:

1) The US is now the strongest economy in the world and foreign capital inflows remain strong.
2) The US employment market remains strong with roughly 2 job openings for every worker seeking a job.
3) Overall, companies that make up the S&P 500 are flush with cash, as both dividend distributions and stock buybacks have set new all-time highs approximately two years after the onset of COVID-19.
4) Price/Earnings Ratios have declined to normal historic levels, and small-mid cap stocks are the cheapest we've seen in 20 years. From current levels, Small-Mid cap likely have less downside than large caps if recession materializes.
5) Historically, during "mild" recessions where the real economy is down 2.5%, the average decline on the S&P 500 is ~25%. The S&P 500 has already declined ~25% from peak to trough.
6) When the Fed pauses on rate hikes, we could see a substantial buying stampede.

Wild Cards that could result in a "Buying Stampede":

a. China reopens
b. War in Ukraine ends
c. Fed signals they are done tightening.

For our clients, we will always have conversations with you and obtain your approval before implementing any changes to ensure they are suitable and appropriate. The only exception is for trades in fully discretionary accounts.

Tactical actions we are recommending for most of our clients:

1) Cash Reserves: Having an adequate Cash Flow Reserve is a foundation of our planning and investment process. In our view, this is critically important during periods of extreme market volatility.
2) Revisit overall asset allocation and consider if any adjustments are warranted.

3) Continue to overweight Value stocks versus Growth stocks.
4) Continue to underweight Developed Foreign stocks and Emerging Markets.
5) Reduce/eliminate exposure to Treasury Inflation Protected Securities (TIPS). While inflation is likely to persist longer that the Fed would like, TIPS may have given most of the outperformance we are likely to see.
6) Reduce Commodities exposure to normal levels. Oil makes up a large percent of commodity pricing and is showing signs of topping out. As inflation forces wain, commodities are less likely to outperform.
7) Talk to us… if you have concerns, don't hesitate to let us know!

The process of rebalancing may result in tax consequences. Changes in tax laws or regulations may occur at any time and could substantially impact your situation. You should discuss any tax or legal matters with the appropriate professional.

Debt securities are subject to credit risk. A downgrade in an issuer's credit rating or other adverse news about an issuer can reduce the market value or that issuer's securities. The yield curve is a graphic depiction of the relationship between the yield on bonds of the same credit quality but different maturities. When interest rates rise, the market value of these bonds will decline, and vice versa.

Legislative and regulatory agendas are subject to change at the discretion of the leadership or as dictated by events.

The Standard & Poor's 500 (S&P 500) is an unmanaged index of 500 widely held stocks. This is an American stock market index based on the market capitalization of 500 large companies having a common listed on the NYSE or NASDAQ. The S&P 500 index components and their weightings are determined by S&P Dow Jones Indices. It is considered a bellwether Index for large cap investing. It is not possible to invest directly in an Index. Index returns to not include the impact of transactions costs, management fees or the impact of rebalancing and income taxes.