The first half of 2022 has undoubtedly been one of the most difficult periods for investing in our collective lifetime. With the S&P 500 down nearly 20% and the Bloomberg US Aggregate Bond Index down over 10%, market participants have had few places to hide and the typical conventions of a 60/40 stock and bond portfolio were completely upended. Equities, government bonds, investment grade corporate bonds, high yield bonds and REITs all approached, or surpassed their worst historical six-month performance over the past 40 years and only commodities served as a ballast (though even they are 12% off of their YTD high, recently). While unsurprising that investment markets have corrected after a period of record low interest rates and turbo-charged growth, the speed and ferocity of the selloff is what has caught everyone off guard.

Inflation has been the catalyst for much of the markets' unease, with prices rising across the board. Previously confined to durable goods i.e., cars, appliances, electronics, furniture, pricing pressure has spread to encompass nearly every aspect of consumers' lives. Food, energy and housing/rents are all up in double digits, year-over-year and what was once viewed as "transitory" has now become more firmly entrenched, or "sticky." While we last wrote that inflation showed signs of peaking in March, that prediction was premature and recent CPI prints have yet exceeded expectations. Nonetheless, more recent reports show significant softening in food/groceries, energy and retailer inventories, as supply chains begin to normalize and consumers cut back amid the pinch of higher prices.

The persistent inflation picture has caused central banks to adopt increasingly hawkish positions, with the Fed hiking rates 0.5% in May, 0.75% in June and now a 1% move in July is on the table. Their stated intention is to end the year with rates between 3.25-3.5% (a 1.5-1.75% increase from the current level), though markets are pricing in the probability of a 3.5-3.75% range, currently. The pace and magnitude of these moves has created unprecedented volatility in the investment markets and has raised the specter of a recession, if the Fed cannot achieve a 'soft landing;' in reality, a recession may be an inevitability. A recession is merely a technical definition however, what really matters is how severe a contraction will be. Given the current state of the labor market, the relative health of both consumer and corporate balance sheets and the significant repricing of financial assets that has already occurred, we are inclined to believe that such an event will be mild.

While the investing landscape has created a myriad of challenges in 2022, much remains to be seen. Corporate earnings have held up quite well thus far, though market bears are sounding alarm bells that earnings estimates are overly elevated and must be revised to reflect the current landscape; we will know shortly, as Q2 earnings reports come in over the next few weeks. Our suspicion is that we may well see a mixed bag, though not an out-and-out negative tenor. Nevertheless, with equities down 20% on the year and the S&P 500 now trading at its historical 10-year average, valuations are much more compelling. Volatility will undoubtedly persist and the

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market could very well see another leg down, yet we believe the fundamentals are much healthier now, given the repricing that we've seen. Our strategy of owning high-quality companies, with good cash generation, low debt and above-average growth prospects remains intact. The market will normalize, but trying the guess the bottom, or time entry points is foolhardy.

While inflation and the Fed's aggressive policy have been headwinds thus far, they've finally created an opportunity in the fixed income space to realize meaningful nominal yields and achieve returns that are in line with our long-term goals. After 10+ years of rock bottom interest rates and extremely tight spreads relative to government bonds, the corporate bond market looks rather attractive, going forward. We are actively looking to allocate cash and fixed income fund investments into a bond ladder structure that can ensure healthy total returns over the next 2-7 years.

As always, don't hesitate to check in with us if you have questions or would like to review. We look forward to hearing from you and hope that you are enjoying the summer!

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