

SUMMER 2022

As our nation celebrated the 246th anniversary of our independence, the stock market, as measured by the Standard & Poor's 500 Index (S&P 500), marked its own dubious milestone. In the first half of 2022 the S&P 500 declined by 20.6%, the worst first half performance in 52 years. While the market events of 1970 predate even our long tenure in the investment business, many of us do recall that not so long ago, March 2020, the S&P 500 declined by 32% in a much shorter period. That may be cold comfort when reviewing account statements this month, but it does illustrate that, however dramatic, recovery from market declines such as these is ultimately inevitable.

The current mood of the markets may reflect the fractured mood of the country and the many challenges we face. Inflation, at least in energy, food and housing, is crippling consumers and while unemployment remains very low, slow growing wages are not keeping pace with rising prices. Many analysts are predicting a recession either this year or next and some, like Jeremy Siegel of the Wharton School, believe we are in one now. On June 28th on CNBC, Dr. Siegel said we are now in a mild recession as he expects the second quarter GDP (Gross Domestic Product) data to be negative as it was in the first quarter of 2022. He allows that this is a unique recession with unemployment at 3.6% and he is concerned that the Federal Reserve may overreact to the current inflation data and continue to raise interest rates even as inflation may not be as bad as it appears. While energy and food prices remain stubbornly high, other important commodity prices such as copper and lumber are well below their respective highs. This does not necessarily bode well for the economy as copper prices are often viewed as a predictor of economic activity, but it may indicate that inflation pressures may abate.

The Federal Reserve is trying to unwind an era of unprecedented monetary (Fed) and fiscal (Congress) stimulus without severely damaging the economy. The actions taken by the Fed and Congress to offset the pandemic slowdown may prove to have been excessive and many are criticizing the Fed for waiting too long to begin raising interest rates and reining in monetary stimulus. As Dr. Siegel suggested, if we are already in a recession, however mild, perhaps the Fed needs to proceed very cautiously. The recent decline in the yield of the 2- and 10-year Treasury Notes reflects the market's concern about a meaningful slowdown.

We are also due for 2nd quarter earnings results in the next few weeks and the guidance provided by companies for the next few quarters may give a very good indication of the direction of the economy. Internationally, things seem to be improving in China while European economies remain vulnerable due to the war in Ukraine and the continuing disruption in energy supplies. The earnings results will also offer some indication of possible earnings levels for the full year and allow investors to refine estimates for the S&P 500 for 2022-2023. Currently, Argus Research in their June 23, 2022 Market Digest, had the S&P 500 trading at a Price/Earnings (P/E) ratio of 15.8X their estimate of 2022-2023 earnings, down from an average level of 19.8X for the five years from 2017-2021. Obviously, these numbers are subject to revision, but it is an indication of how valuations have changed in this market decline.

The stalwart stocks of the last few years have not been spared in this decline as market leaders such as Apple, Alphabet, Microsoft, and Amazon are all down more than 20%. Value oriented stocks such as J.P. Morgan, down 27.7% year to date, have also been hit hard. Energy, consumer staples and some health care stocks have fared better on a relative basis. While we expect more volatility and have no idea where the stock market will go in the short term, many of these industry leaders are certainly more attractive than they were at the beginning of the year. Small cap stocks, foreign developed and emerging market stocks have all declined as well, giving long term investors an opportunity to add to positions in these sectors where and if appropriate.

There are many uncertainties hindering the markets and, outside our narrow world of investing, the country and world face extraordinary challenges. We remain optimistic that progress will be made in many areas and that seemingly insurmountable challenges will be met. We expect the stock market to recover in time and continue to be a place for solid long term returns for patient investors.

John C. Knox, CFA

John C. Downing, CFA

The views expressed herein are those of Knox & Downing Advisors and not necessarily those of the Advisory Services Network, LLC. This material is for informational purposes only. This is neither a solicitation nor a recommendation to purchase or sell an investment and should not be relied upon as such. The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. The Dow Jones Industrial Average (DJIA) is a price weighted average of thirty actively traded blue chip stocks. The term "Nasdaq" is also used to refer to the Nasdaq Composite, an index of more than 3,000 stocks listed on the Nasdaq exchange that includes the world's foremost technology and biotech giants such as Apple, Google, Microsoft, Oracle, Amazon and Intel. Indexes are unmanaged and do not incur management fees, costs or expenses. It is not possible to invest directly in an index. Returns are shown without deductions of advisory fees, trading fees or internal management fund expenses. The deduction of such fees and expenses, and the compounding effect of such fees over time, will reduce returns over time. Return numbers, unless indicated, are through June 30, 2022.