

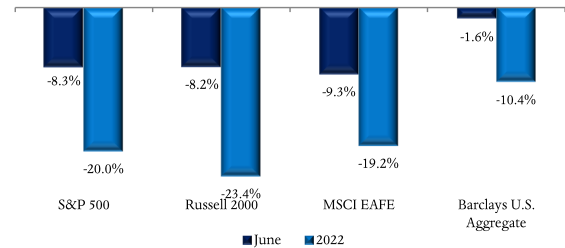


## MARKETS

June was the most challenging month of 2022 for global financial markets, leading to the poorest first half performance in over 50 years. Soaring inflation led to a much tighter monetary policy stance from the Federal Reserve, pressuring interest rates and valuations. Real incomes suffered and resulted in concerns that an economic slowdown is on the horizon. Meanwhile the war in Ukraine, and associated worries, continued.

The S&P 500 stock index tumbled from record levels at the start of the year (-8.3% in June; -16.1% in Q2 and -20.0% in H1 2022). It took the index 117 days to enter a bear market (defined as a 20% decline from the peak), 17 days shorter than the historical median. Notably, higher valued growth stocks significantly underperformed value stocks for the year-to-date period, -28% versus -14%, with the FANG stocks having lost nearly half their value since last November. Overseas equities also encountered turbulence, as seen by the MSCI EAFE index's rocky performance (June -9.3%; Q2 -14.3%; H1 2022 -19.2%). Major international stock averages fared better than their US counterparts thanks in part to lower valuations and weakening local currencies. The Euro Stoxx 600 index dropped -8.0% in June (-9.1% in Q2; -14.4% in H1 2022). Asian stock markets exhibited resilience with the Shanghai composite rising of late (+7.5% in June; +5.6% in Q2; -5.7% in H1). While Tokyo's Nikkei 225 index was less volatile (-3.1% in June; -4.9% in Q2; -7.3% in H1), on the back of a much weaker Yen.

Bonds have also been hit relatively hard this year, failing to produce their customary stability, as markets priced significant increases in interest rates, off very low levels. After the US CPI delivered yet another upside surprise in May, rising to a new 40-year high of 8.6%, the Fed announced a 75 basis point rate hike, the biggest since 1994. Chairman Powell indicated that similar increases



were possible at upcoming meetings, and stressed that failure to achieve the Fed's 2% inflation target was not an option. The US 10-year Treasury Note peaked at a yield of 3.48%, concurrent with the Fed's latest tightening, yet ended the month with a yield of 3.01%, an indication that inflation will be controlled. In this context, the Bloomberg Barclays US Aggregate bond index declined -1.6% in June (-4.7% in Q2; -10.4% in H1). High yield bond spreads widened significantly, leading the index down -6.8% in June (-10% in Q2; -14.0% in H1).

Commodities were one of the few sectors that posted gains during the first half of 2022, albeit trading well off their recent highs. Energy supply issues, exacerbated by the Russian invasion of Ukraine, initially elevated prices. However, we are starting to see signs of demand destruction as high levels of inflation are subduing global growth. Meanwhile, Russian oil production has yet to fall, as reduced European demand is being offset by sales to Asia. In this context WTI crude oil started the year at \$75.21 per barrel, rose as high as \$123.70 on March 8, and ended the first half at \$105.76.

## GEOPOLITICS

On the Ukrainian war front, Russia gained effective control of Luhansk, the first province to fall since it took over Crimea. That will allow Russia to refocus on occupying neighboring Donetsk, the other part of the Donbas region. This mineral-rich area bordering Russia has long been in the sights of President Vladimir Putin. In an effort to advance, Russian forces increased their

shelling of population centers along the front lines and sporadically elsewhere. Russia's progress has intensified the pressure on the US and Europe to provide more powerful weapons to Ukraine. The prognosis remains that of a drawn-out war with steady attrition by Ukraine.

An agreement allowing Finland and Sweden to become NATO members was achieved after successful negotiations with Turkey, which had lodged an objection. The two Nordic countries are now on a firm path to full membership.

### UNITED STATES

While unemployment remains low and wage growth strong, 8.6% annualized inflation has dampened economic optimism. The University of Michigan Consumer Sentiment Index plunged to a record low (since 1952). The Conference Board's consumer confidence survey has held up better, thanks to tight labor markets, but is also on a steep downward trajectory. The Producer Price Index rose +10.8% in May, with its finished goods component soaring +16.7%. As a result of loosening of the supply chain and building of inventories, manufacturing activity has begun to slow. Nevertheless, according to our research, inflation is likely to remain stubbornly above 5% for the foreseeable future. Specifically, as a result of the dislocation between supply and demand for labor (there are two job opening for every unemployed person), and the lag effect of rising Owners Equivalent Rent and Rent of Primary Residence (accounting for 30% of CPI), which lag by 12 months and are in steep upward trends.

It is therefore no surprise that the Federal Reserve has indicated that it is determined to get inflation under control, expecting to raise short-term interest rates to 3.8%. Further, Chairman Powell spoke of a \$2.5 to \$3.0 trillion target reduction in the Fed's \$9 trillion balance sheet, indicating a further liquidity drain from the monetary system. Lastly, the central bank forecasts that unemployment will need to rise above 4% to tamp inflation, potentially leading to a recession.

**June 2022 Economic Statistics**

	Jun-22	Dec-21	Dec-20
Federal Funds Target Rate	1.50 - 1.75%	0 - 0.25%	0 - 0.25%
Consumer Confidence Index	98.7	115.8	88.6
Manufacturing PMI Index	53.0%	58.7%	60.7%
Unemployment Rate	3.6% (est.)	3.9%	6.7%
JPY / USD	135.73	115.08	103.24
USD / EUR	1.0482	1.1368	1.2213
Gold / oz.	\$1,806.89	\$1,828.39	\$1,896.49
Oil (WTI) / bbl	\$105.76	\$75.21	\$48.52

There are already some signs that expectations for higher interest rates are starting to weigh on economic activity. With house prices almost 40% higher than at the start of 2020, and 30-year fixed mortgage rates having risen from below 3% to nearly 6%, homes have become much less affordable. Historically, the envisaged reduction in prospective buyers has almost always preceded an economic downturn. Thankfully, 95% of Americans today are on long-term fixed-rate mortgages, which should reduce the number of forced sellers. On top of this, there are far fewer homes available for sale today than during previous downturns.

### EUROPE

In Europe, consumer confidence has also fallen dramatically. The biggest risk to local economies being the reduction in gas supplies coming from Russia, which has driven prices up significantly, and is raising fears of outright shortages and potential rationing. As a result, Germany reported its first monthly trade deficit in three decades and regional business surveys have started to weaken. Economists have begun to forecast a contraction in the European economy over the course of the second half of 2022, potentially lasting until the summer of 2023.

Somewhat surprisingly, the market is pricing in significant rate rises from the European Central Bank. At the same time, the difference between the rate at which the Italian and German governments can borrow has widened materially, as it did in the run up to the euro-zone sovereign debt crisis about a decade ago. In reaction, the ECB indicated that it will formulate an anti-

fragmentation tool to limit the rise in peripheral European borrowing costs, allowing for an even transmission of its desired monetary policy across the eurozone, and thereby reinforcing the economic union.

Similar to global trends, UK employment remains strong yet consumer confidence has hit a record low as families feel the squeeze from negative real wage growth. Some households are also having to deal with rising mortgage costs at a time when budgets are challenged from higher food and energy prices. Roughly one half of UK home mortgages are at risk of indexing higher within two years, tracking rising interest rates, with the potential to pitch the economy into recession.

### ASIA

China's battle with Covid-19 continues, but recent data offers encouragement that the country's target of zero infections may no longer be necessary. This raises hopes that China may be able to move beyond the heavy restrictions that have severely affected local economic activity. Supporting evidence includes an expansion in manufacturing activity at the fastest pace in 13 months. However, with China's neighboring economies, as well as those in the West, softening, there is debate as to whether the world's second largest economy can avert a recession.

### OUTLOOK

Investor sentiment is reflective of the significant reduction in global monetary liquidity, necessary to battle inflation that is likely to remain persistent until economies shrink, dampening demand for goods and services. We foresee tighter liquidity and reduced demand as a natural correcting mechanism for previous excesses. While risks remain, investors should remember that markets have already fallen a long way and market timing can be detrimental to long-term investment success.

The good news is that equity valuations are now well below their post-1990 averages in every major region other than the US. In America, where growth has been more abundant, due to innovation and productivity, the Russell 1000 Growth Index trades on a price-to-earnings (P/E)

ratio of 21. On the other hand, lower growth segments of the market now trade at relatively cheap valuations compared with history, as seen by the Russell 1000 Value Index trading on a P/E multiple of 13. The key risk from here, with valuations having reset, is if company earnings disappoint relative to expectations. We, thus continue to recommend investing in quality businesses chosen by talented stock-pickers, and holding for the long-term.

Bond markets now expect short-term interest rates to rise to 3.4%, 3.0% and 1.6% in the US, UK and Europe, respectively, by next year. That increase in expectations for the path of interest rates has hurt fixed income returns. In addition there are elevated concerns of an impending recession due to the squeeze on consumers from higher prices and borrowing costs as the central banks seek to fight inflation. Real rates (nominal yields minus inflation) still appear too low. With inflation at elevated levels, and declining growth expectations, we feel that still-higher risk-free yields will be required to compensate for the potential volatility. As such, we continue to favor short duration maturities and believe the 2-year US Treasury Note, yielding near 3%, offers relative value for investors seeking capital preservation. In addition, select high yielding credits, where spreads have doubled, also offer interesting opportunities for risk-tolerant income oriented investors.

We remain conservative with regard to portfolio construction, favoring a portion of non-market correlated alternative assets as ballast. Consumer products oriented investments have also begun to offer compelling risk/reward characteristics. With regard to commodities, we are constructive on the agriculture sector, as input cost inflation remains a key driver. In addition, food security concerns are forcing governments of producing countries to control exports, keeping prices elevated. For long-term investors seeking to capitalize on disruptive technology trends we are focusing on attractive growth and venture opportunities in the fields of edu-tech and cybersecurity. We also believe that the ongoing gyrations in public equity markets are offering attractive entry points for our Nordic Technology and Innovation Fund.

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Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal.