# From the Curb

Letter to Clients
Quarter Ending June 30, 2022

The S&P 500 stock index continued to decline in the second quarter, hitting the lowest level since December 2020. High inflation, sharp increases in interest rates, rising recession risks, and ongoing geopolitical unrest continued to cause concerns for investors. Adding to investor worries was the massive COVID-related lockdown in China which impacted approximately 300 million people and represented nearly 80% of China's economic output. This sharp drop in economic activity not only increased the chances of a global recession but also compounded global supply chain problems. In sum, the factors that pressured assets in the first quarter, also weighed on markets in the second quarter. And, until the impact of some of these issues become clearer, we expect markets to remain volatile.

All four major stock indices, in addition to the major bond indices, posted negative returns for the second straight quarter. As in the first quarter, rising rates and growing fears of an economic slowdown fueled the continued rotation from high valuation, growth-sensitive stocks to sectors of the market that are viewed as being more resilient to rising rates and slowing economic growth. By market capitalization, large-cap stocks again outperformed small-cap stocks, as investors sought out high quality and financially strong companies with pricing power. Small-cap stocks, typically more reliant on debt financing to sustain their businesses, have become less attractive to investors as their earnings could decrease due to the impact of higher rates.

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 negatives have been priced into the market, opening the possibility for positive surprises as we move forward in 2022. We believe company fundamentals will be a key factor in whether investors are able to regain their appetite for stocks and expect that we will gain some clarity over the next few months.

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 becomes likely the Federal Reserve will hike rates less than currently planned, and that could be a materially positive catalyst for markets.

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 market 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 solid 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.

We understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. 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.

Therefore, it is critical for you to stay invested, remain patient, and stick to the plan, as we've worked with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline.