THE PRIVATE CLIENT GROUP
BALANCING LIFE & WEALTH

# ECONOMIC & MARKET INSIGHTS

## An Executive Summary for July 2022

The recent GDP release marked the second consecutive quarter of negative growth. This intensified the debate about whether the U.S. is in a recession. Putting aside the technical declaration of a 'recession', the unusual circumstances of the pandemic and the subsequent government response make this a cycle unlike any other. Although some economic factors are either in or moving towards a recessionary direction (yield curve inversion, pace and magnitude of fed funds rate increases), the labor market remains robust and there are limited areas of clear excess in the economy. The rates market quickly digested the recent GDP data as support for the Fed to pivot its hiking schedule sooner than anticipated. This was evidenced by the 10-Year treasury yield going from ~3.5% to ~2.7% in just 33 trading days. Risk assets also rallied, benefiting from lower rates and the anticipation of less restrictive financial conditions in the future.

There are numerous signs that the economy is slowing from its COVID-based recovery. While CPI may have peaked, June's 9.1% reading was the highest level since 1981. Purchasing Managers Indexes (PMIs) for both manufacturing and services are well below peaks reached in mid-to-late 2021, with early indications that they could fall into contractionary territory in future months. The pace of home price increases has come down after an incredible run from 2020 onwards. Amongst a dynamic economic backdrop, the Fed proceeded with another 75-basis point rate increase in July – quelling fears that a larger magnitude hike was possible. This brought the fed funds upper bound to 2.5%, a far cry from near-zero levels from earlier this year.

Despite slower growth domestically, things are perhaps more worrisome overseas. In Europe, similarly elevated inflation figures triggered the first European Central Bank (ECB) rate hike in over a decade. Besides tightening financial conditions, the region also faces political uncertainty (collapse of the Italian government), a weakening currency (USD/Euro parity), and a looming energy crisis (uncertain Russian natural gas and oil supplies). The looming energy crisis could be particularly impactful to manufacturing-oriented economies like Germany, where a significant rise in energy costs would make them less competitive. All these factors intensify recessionary risks for Europe. Areas of Asia also have unique headwinds to cope with. The Bank of Japan (BoJ) has been one of the few developed market central banks to stay committed to accommodative monetary policy. These actions have contributed to the yen reaching its lowest level against the U.S. dollar since the late 1990s. China continues to grapple with severe COVID restrictions and is working through areas of excess within the property market. That said, Chinese policymakers are likely to employ more supportive economic measures when many other nations are doing the opposite.

Equities shrugged off disappointing economic data in the hopes that the Fed and other major central banks wouldn't need to employ as restrictive tightening measures to fend off inflation as once feared. In the U.S., the S&P 500 Index had its best month since November of 2020. Small-caps and growth stocks bucked their trend of relative underperformance versus large-caps and value shares, respectively. The best performing sectors over the month (consumer discretionary, IT) included those that were among the bottom performers year-to-date. International equities also rose, but to a lesser degree than their U.S. counterparts. One exception is emerging market equities which were roughly flat for the month and were dragged down by the difficult performance of Chinese equities. Valuations have bounced off recent lows but remain well under highs from last year. In particular, non-U.S. equity market valuations are towards the lower end of recent history but come with additional risks.

Fixed income assets performed favorably, benefiting from both lower rates and tighter spreads. A risk-on sentiment helped credit-sensitive assets outperform, although most areas of the fixed income market generated a positive return. The treasury yield curve became more inverted with rising short-term yields and flatter long-term yields. A recovery in municipals has diminished their relative value compared with treasuries, although portions of the curve still offer compelling risk/rewards. Limited new supply over the summer months should also continue to support the municipal market.

Heading into August, recessionary risks are front and center on investors' minds. While the headlines are daunting, it's important to maintain a balanced view of economic conditions. The Fed appears to be making progress in its effort to limit growth to combat inflation, labor markets are still supportive, and there are few areas of excess in the economy. Asset markets are also forward-looking and to some extent, much of the recessionary risks may already be priced in. Additionally, the unusual circumstance of this cycle makes underwriting the future path of economic conditions more challenging than ever. As a result, it's essential to ensure that your portfolio is well aligned with long-term goals to protect against both downside and upside risks to the economy and markets.


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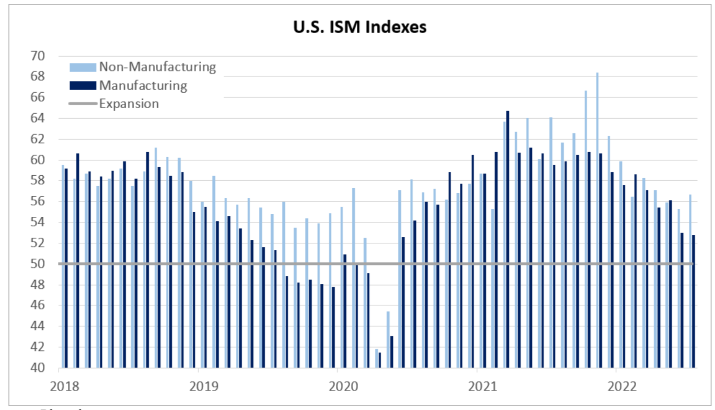


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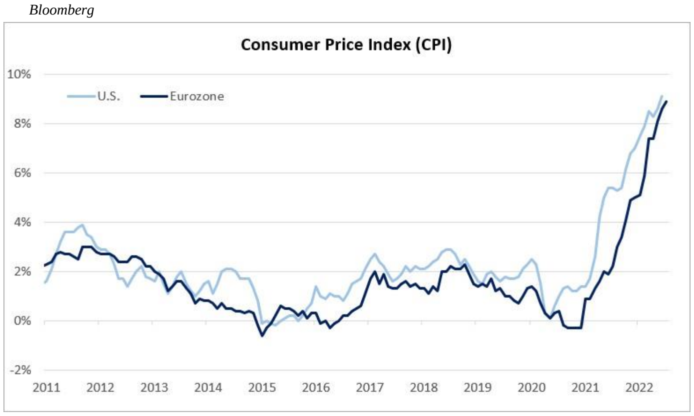
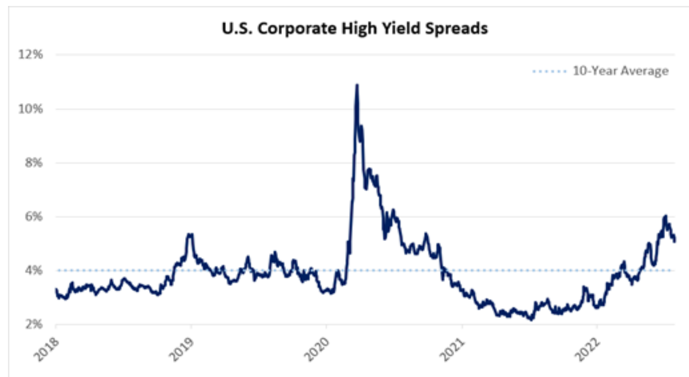



*U.S. Bureau of Labor Statistics*

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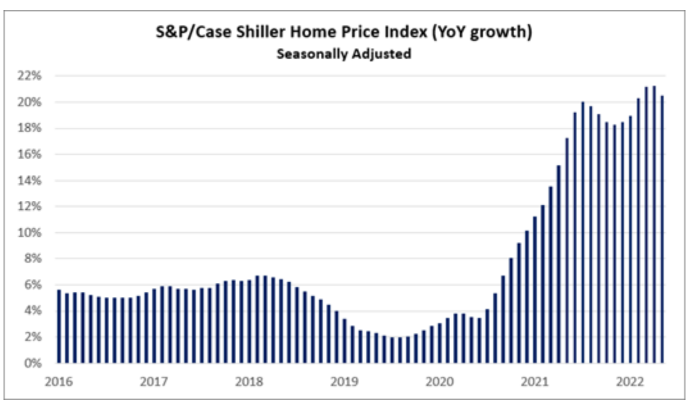
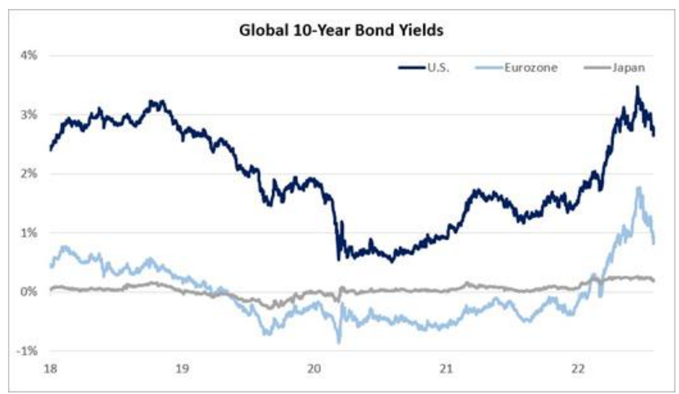



*S&P / Case Shiller*

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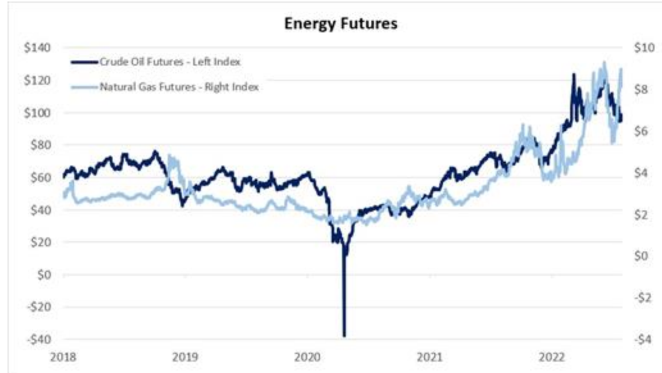
Energy Futures
$140
$120
$100
$80
$60
$40
$20
$0
-$20
-$40
$10
$8
$6
$4
$2
$0
-$2
-$4
Crude Oil Futures - Left Index
Natural Gas Futures - Right Index
2018
2019
2020
2021
2022

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