RMH Market Watch – Are We There Yet?

What a Great Question to Ask

Brings back all sorts of memories from when we were kids, to today as we run our businesses and get asked this question with regards to the Economy, and the Stock and Bond markets.

First a little family history, when our children were around ages 4 & 8 we embarked on two road trips to Nova Scotia on back to back summers. We asked the kids to help out around the car, clean up the car, good behaviour, (you all know the drill) and in return we would pay them $0.10/hour they could use as spending money. Well around 2 days into the first trip the bickering was getting to a large crescendo, the warnings were being ignored; finally they were told all the money they earned was being forfeited! Immediately, as in a planned attack on Kathy and I, the bawling started, I looked over at Kathy as she was driving we both started silently laughing and neither one of us could look at each other for the next 30 minutes. The rest of the road trips, never a problem.

To me the parallel to today is similar with one difference, the US Federal Reserve **(FED)** after allowing inflation to get out of their control is giving warnings they will keep increasing interest rates until they possibly put the economy into recession and create joblessness as their solution to controlling inflation. **The difference is that they do not control the "purse strings", Congress does!** Looking back in US history, Congress has shown they never met a spending program they didn't like (the perils of having to be elected).

Back to the question "**Are We There Yet"**, the answer quite simply is no, however we are a lot closer than we were 6 months ago. Markets do not like uncertainty, and the Fed is clearly showing they are actively engaged in raising interest rates to slow the economy. In the markets opinion another rate hike of 0.75% is almost guaranteed for the September **FED** meeting, with possibly another one in November of this year. While this might seem disconcerting, the markets typically look out 6 – 12 months, and see the same interest rates declining.

Typically, after recessions the idea is that this is an excellent point to add to equity positions. Why, recessions slow inflation, and a less aggressive Fed. I think we will see some turbulence ahead of us for the remainder of the month of August. In the Northeast where a lot of major firms trading desks are located, school typically starts after Labor Day, senior executives take the last 2 weeks of August off with instructions to the trading desk, "no phone calls to me, and don't lose any money". That just guarantees lack of liquidity in the trading markets (as junior traders understand career risk), allowing other firms to push the markets around with less capital needed, magnifying the subsequent moves (a quick profit taking exercise). In addition we will probably see more volatility for the months of September/October as the FED digests what is happening in the markets and we have an election in November.

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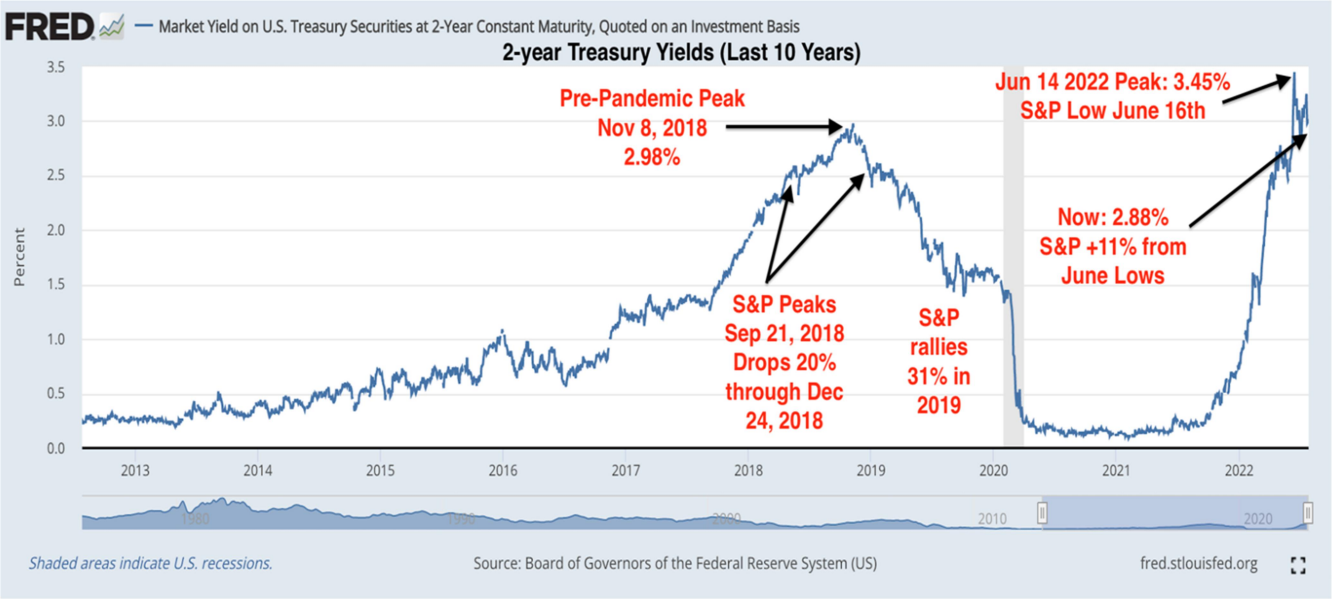
The best comment I have seen concerning **FED** actions comes courtesy of a comment from **Nick Reece, CFA of the Merk Business Cycle Report for July 22, 2022:** *"However, any recession that does potentially come in the next year or so is, in my view, likely to be of similar depth and duration to the recession of the early 1990s (i.e., shallow and short). And a soft landing that's eventually characterized as a mid-cycle slowdown rather than a recession is still possible. I think the Fed pivot will happen sooner than many expect. As priced by Eurodollar futures (expectations for 3-month LIBOR rates), the Fed hiking cycle peak has moved from June 2023 (two months ago), to March 2023 (a month ago), to December 2022 (currently). The Fed has not (yet) inverted the 3m10yr yield curve, which has always inverted prior to past recessions. Historically, 3m10yr inversion has been a necessary but not sufficient signal for a recession. In other words, 3m10yr inversions can be false positives."*

What really caught my eye was the following from the **FED voter, Esther George**: "*Moving interest rates too fast raises the prospect of oversteering... the adjustment has been significant. This is already a historically swift pace of rate increases for households and businesses to adapt to, and more abrupt changes in interest rates could create strains, either in the economy or financial markets, that would undermine the Fed's ability to deliver... some forecasts are predicting interest rate cuts as soon as next year. Such projections suggest to me that a rapid pace of rate increases brings about the risk of tightening policy more quickly than the economy and markets can adjust." She went on to imply that the Fed should be cautious about inverting the yield curve (e.g., on the 3m10y).* ***From Nick Reece, CFA of Merk:*** *Pretty dovish comments from someone once considered a "megahawk." In her dissenting vote last month, she also rightly reminded us (and her Fed colleagues) that monetary policy acts with a lag. Maybe the Fed will start looking through the windshield rather than the rearview mirror. They were behind the curve on tightening and may be behind the curve on easing as well.*

The chart below suggests what might happen to the S&P 500 based upon the movement of 2-Year US Treasury Yields.



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Signs of Optimism

Yes, I generally see the glass ½ full.

From the Bloomberg "BofA Survey Shows Full Investor Capitulation Amid Pessimism" the following:

- 58% of **Fund Managers** representing $722 Billion AUM, have stock levels last seen October of 2008
- Biggest risk they see are, global recession, hawkish central banks and systemic credit events.
- From April 30, 2022 – July 20, 2022, **Individual Investors** took $267B in funds from Equities (both mutual funds and ETF's), July 27th added just over $3.4B. We will see if the selling pressure is over.

How did the 2Q/2022 Earnings do and what does the rest of the year look like at this time?

From DataTrek and Factset, the following was observed with 87% of the companies reporting so far:

- 75 percent of those companies beat Wall Street earnings expectations. That is below the 1- and 5-year averages of 81 and 77 percent, respectively, but better than the 10-year long run average of 72 percent.
- Reporting companies have beaten revenue estimates by 3.5 percentage points. That is better than all recent trailing averages: 1-year (3.2 %), 5-year (1.8 %) and 10-year (1.1 %).
- 70 percent of S&P companies exceeded analysts' revenue estimates. That is below the trailing 1-year average (78 %) but above the 5-year (69 %) and 10-year (61 %) averages.

In a difficult year, the S&P 500 had good earnings through the 2Q/2022. I expect the same revenues for the rest of the year, however with higher costs, this should lower margins, and as a result earnings for all of 2022 will be the same or a little lower from these levels, which supports current stock market prices.

Looking ahead at the year 2023 for earnings, they are priced in at similar levels for the year 2022.

I saw the following table from Real Money as what to expect from the stockmarket with the first half of the year having a negative year for the S&P 500 down 21%. Lets hope the trend continues.

Bad Starts To A Year At Halftime Don't Always Mean More Trouble

S&P 500 Index Down >15% At End Of June (1928 - Current)

Date	YTD Return	S&P 500 Index Returns Rest Of Year
6/30/1932	-45.4%	56.2%
6/30/1939	-17.4%	14.7%
6/28/1940	-19.9%	6.0%
6/29/1962	-23.5%	15.3%
6/30/1970	-21.0%	26.5%
6/21/2022*	-21.0%	?
Average		23.7%
Median		15.3%
Higher		5
Count		5
% Higher		100.0%

Source: LPL Research, FactSet 06/21/2022 * The current quarter isn't over yet
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.
Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

Real Money

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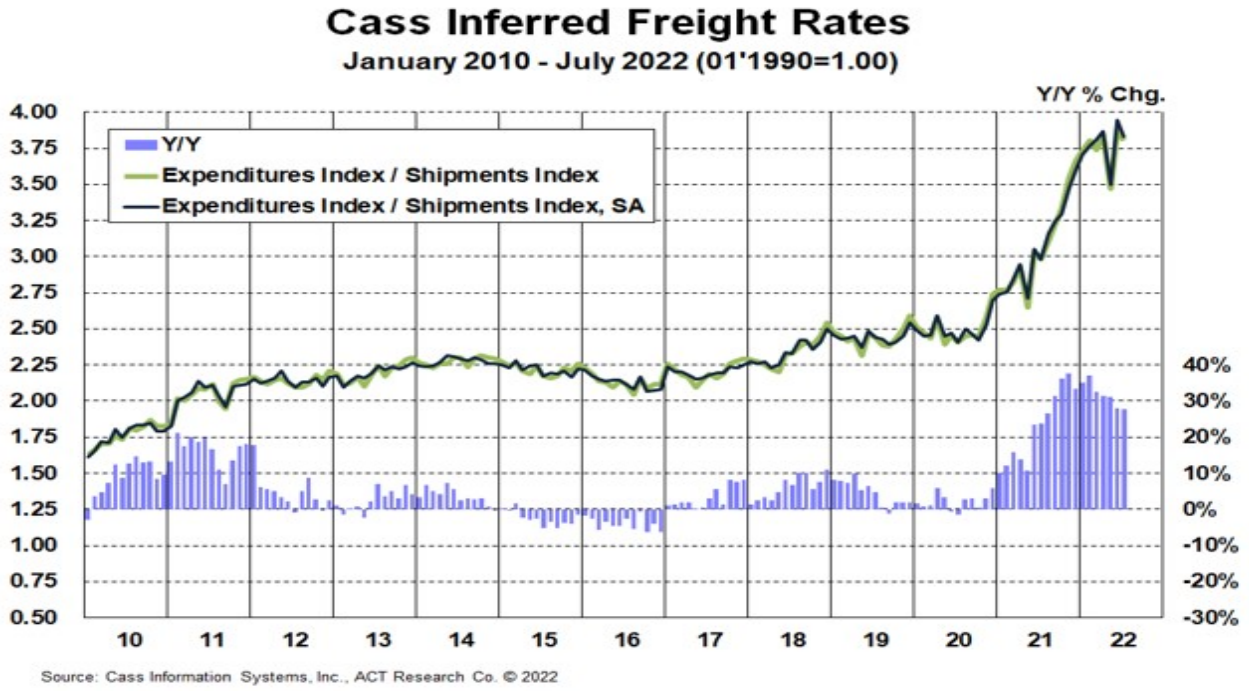
Cass Freight Index

While there was a major surge in Freight costs due to the pandemic, those costs seem to be flattening out, and potentially going lower. On a year over year basis, shipments are relatively stable as to be expected due to the pandemic being in the rear view mirror. Fuel costs have been an issue, as has been substitution for the mix of shipping. From the Cass Index July 2022, one of the great economic quotes is the following and you can see it apply in real time to the Freight Industry:

"This brings to mind some of our favorite axioms, like "the laws of supply and demand have yet to be repealed" and "the cure for high prices is high prices."

Looking at the chart below, I believe we will see lower freight rates going forward as costs start stabilizing. Fuel will continue to be a major concern, and labor is always an issue through turnover of drivers. I am sure all of you have noticed the "Drivers Wanted" signs on our trucks that we share the road with. No different than all of the other "help wanted , or we are hiring" signs across all of the economy.



In summary shippers are starting to see relief in shipping prices which should help the broader picture of inflation go lower.

In the chart below from 3Fourteen Research, the key to inflation going forward will be the cost of energy, cars and housing. With prices declining for cars and housing, energy will be the driving factor in inflation. This will be the Fed's biggest problem.

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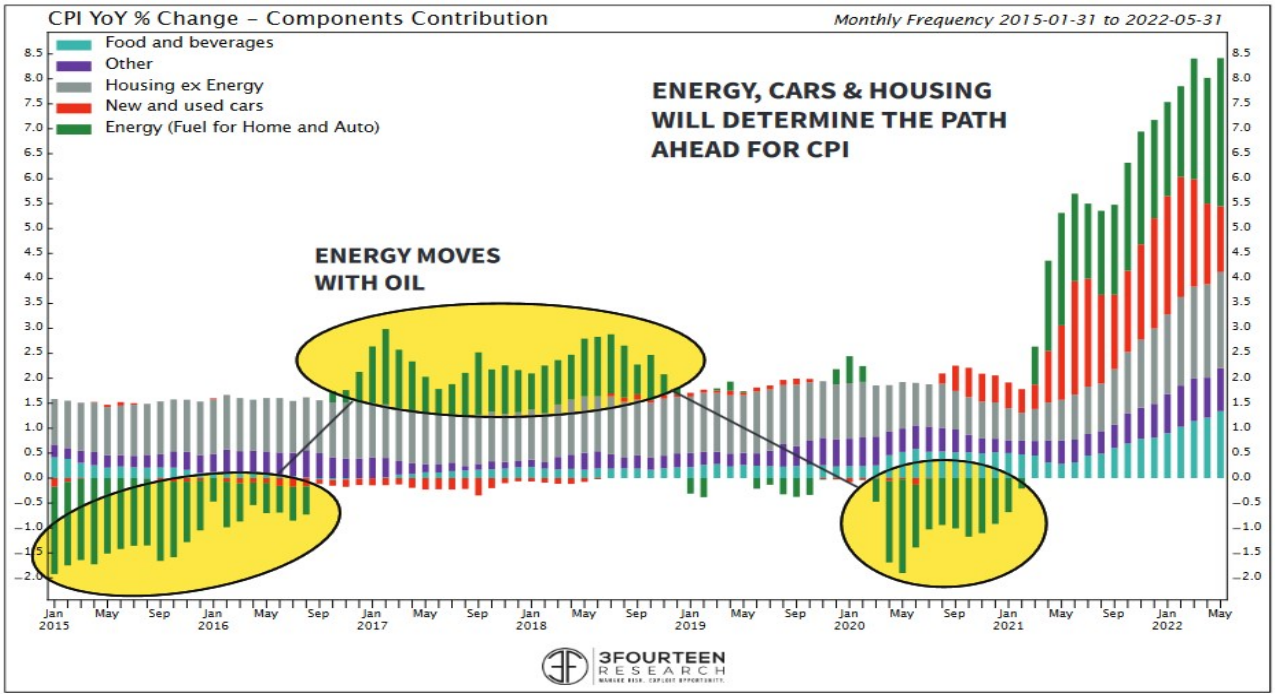

In summary to the question asked at the beginning of the article, **"Are We There Yet"**, the answer is no, however we are a lot closer than when this started at the beginning of the year.

If there are ever any topics you wish for us to explore, please let us know. ***We are here to help and guide you through these times.***

We thank you all for taking the time and reading "Market Watch." It is meant as an educational piece on the always evolving markets. It is something we plan on providing every month, and your feedback is very important to us.

On a personal note, RMH is now in the position to bring on new clients so please be sure to share this informational letter with whomever you wish. RMH's focus is on the customizable investment needs of individuals, families, and foundations. We enjoy working with our clients to better understand their goals, values, and passions for what is important in their lives. In expanding our client base, we look forward to working with people who share these same desires

Richard Mundinger, CFA
Ashlyn Brooke Tucker

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Cass Freight Index: https://www.cassinfo.com/freight-audit-payment/cass-transportation-indexes/july-2022
3Fourteen Research: **Dipping a Toe in the Water**, June 16, 2022

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