

KEY TAKEAWAYS

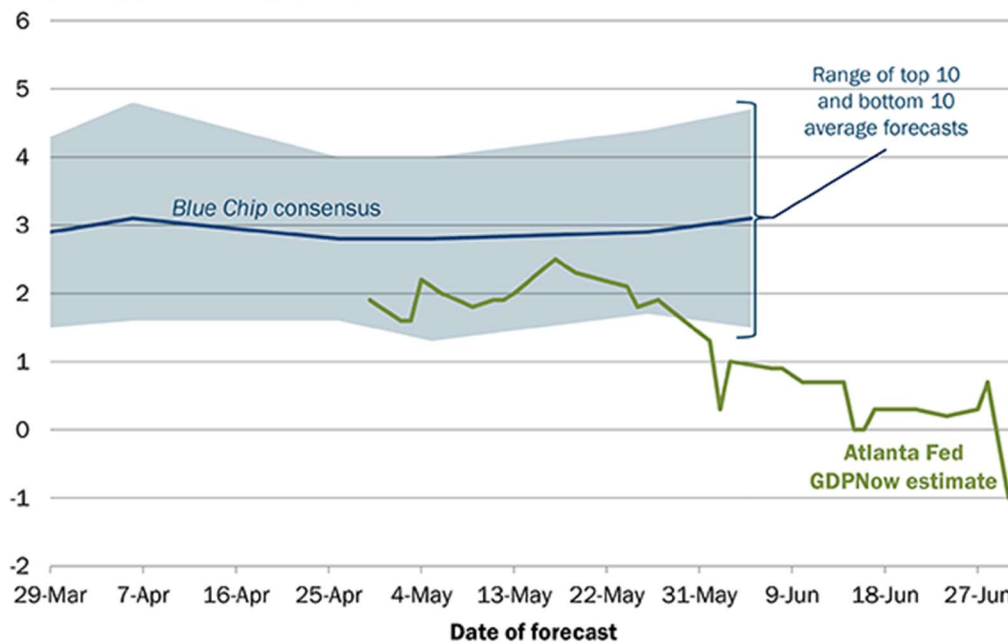
- The heavy losses of 2022 continued into June as the tug-of-war between current inflation and a potential recession, because of continued Fed interest rate hikes, took center stage.
- Interest rates spiked mid-month to almost 3.50% on the 10-year Treasury Bond, the highest rate in over a decade on another hot CPI print.
- The Russia/Ukraine conflict continues to show no signs of ending, but the “talk” about recession put a dent in oil prices for the first monthly decline since November.

The U.S. Economy

The final look at 1st quarter GDP was again weaker than the last print of -1.5%, coming in at -1.6%, with weakness in spending and strength in inflation, the wrong combo of a healthy economy. Most economist are still looking for recession to not hit until 2023, though technically it looks more likely to be happening right now. The 2nd quarter estimate for the Blue-Chip consensus is still at +3%, however the GDPNow estimate from incoming data is at -1%. It looks like the incoming data is agreeing that the 2nd quarter is going about the same as the 1st quarter. The big question, is the weakness simply a normal economy less the massive fiscal stimulus or is something more serious brewing. Maybe that is the disconnect between the economist and the incoming data. We will know more in a few weeks.

Evolution of Atlanta Fed GDPNow real GDP estimate for 2022: Q2

Quarterly percent change (SAAR)



Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.

Source: <https://www.frbatlanta.org/cqer/research/gdpnow>

Stocks and Bonds

Interest rates continued spiking through mid-month as high inflation numbers continued to print, though nearly round tripped during the second half of the month as recession concerns grew louder. Continued weak economic data coupled with broad and some sharp declines in commodities shifted the focus from inflation to recession. The shift resulted in a substantial rally in bond prices the second half of the month as investors fled to safety. The Fed funds market continues to price in another 75-bps rate hike in July, though is starting to contemplate only 50 bps. The path forward still sees continued increases in interest rates, though the steepness has waned. Additionally, the markets are now starting to price in rate cuts in early 2023. The longer maturity Treasury rates destabilized mid-month but regained their footing as the month ended. Unfortunately, the early month damage was too much to overcome for High-quality fixed income, as measured by the iShares US Aggregate Bond ETF, declined -1.56% for the month. The U.S. 10-year Treasury bond yield ended the month at 2.97%, up from May's close of 2.84%, but down significantly from the mid-month high of 3.48%.

The Dow Jones Industrial Average declined -6.71%, the S&P 500 dropped -8.39%, and the small cap Russell 2000 fell -8.37%. The international markets traded in a similar fashion to the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index sank -9.16%, and the MSCI Emerging Markets iShares Core ETF Index declined -6.27%.

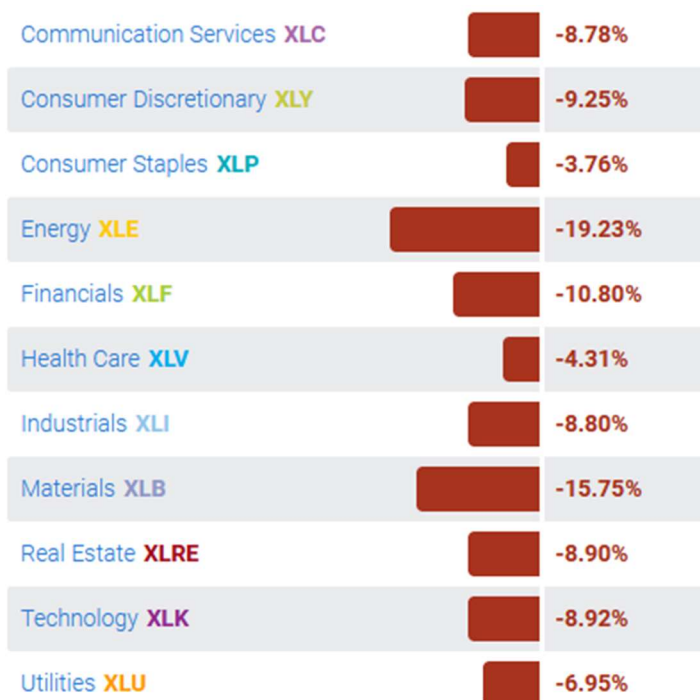
In June, we had the bad and downright ugly in the market, with every sector red.

The bad performers were...

- Consumer Staples: -3.76%
- Healthcare: -4.31%

The ugly performers were...

- Energy: -19.23%
- Materials: -15.75%
- Financials: -10.80%



Source: <https://www.sectorspdr.com/sectorspdr/tools/sector-tracker>

Oil Report

The oil market continued climbing higher early in the month, as demand destruction from high prices still hadn't taken hold and China was bringing more demand online with easing Covid restrictions. The increasing tightness narrative started losing its power as the month wore on and increased signs that demand destruction from high prices finally hit a tipping point. Additionally, continued weakness in global economic data spurred further demand concerns as the potential recession calls got more attention. The current NYMEX WTI Crude Oil futures settled at \$105.76 and posted a loss of almost 8% from the prior month close of \$114.67 a barrel. The weakness in oil spilled over to RBOB gasoline, which dropped almost 10% vs May's close and approximately \$0.65 from June's highs. Economic slowing may put a band aid on high prices for the time being, but the issues of shutting off Russian energy as well as the West's war on fossil fuels does not appear to be going away. Once growth resumes, without major technological changes, energy costs will be poised to quickly regain losses. This tightness could also be heightened by Hurricane season as so much natural gas is produced in the Gulf of Mexico.

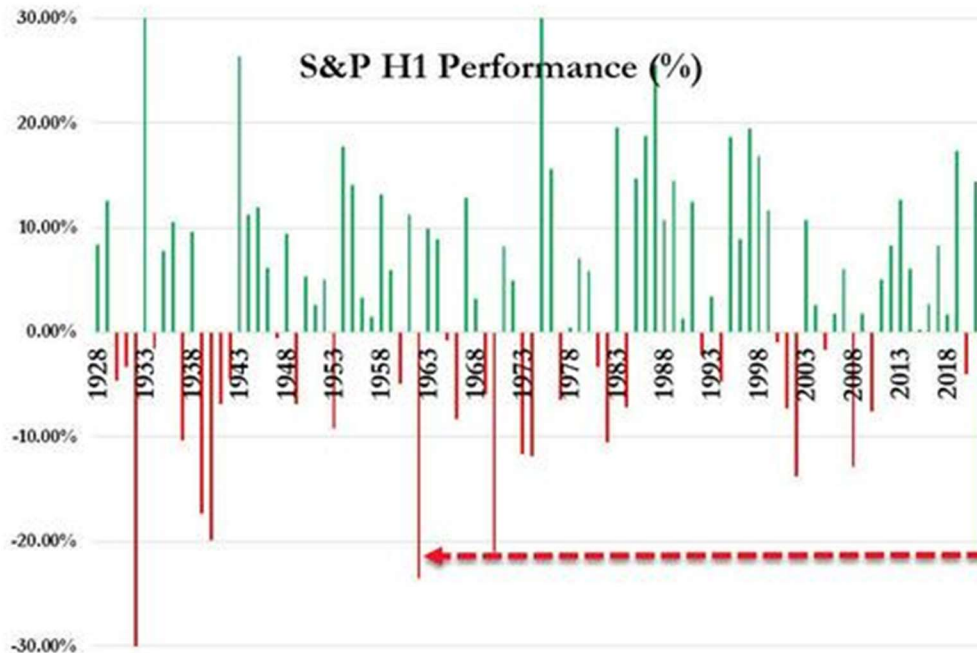
The Rest of the Data

The May ISM Manufacturing Index increased 0.7 points to 56.1 from April's reading of 55.4. Further, the ISM Services Index decreased to 55.9 in May from April's print of 57.1. The prices paid component for both the Manufacturing and Services surveys eased modestly but remained at very elevated levels. Any reading above 50 generally indicates improving conditions. Consumer confidence declined to 98.7 in June, which compares to a downwardly revised figure of 103.2 in May. The unemployment rate again held steady at 3.6% and the economy added a decent 390,000 jobs in May, which was the 1st month of less than 400k+ of job adds in a year. The Consumer Price Index for All Urban Consumers (CPI-U) was up +1.0% in May, on a seasonally adjusted basis, as inflation reaccelerated from last month's slowing. Over the last 12 months, the All-Items Index increased to +8.6% on a non-seasonally adjusted basis, unceremoniously regaining 40-year highs. The CPI ex Food and Energy, decreased again to 6.0% from last month's 6.2%. The Fed continues to discuss the strong labor market and the need to reduce demand to rein in inflationary pressures, which seems is code for recession. The above data indicates the economy is still on good footing, though continues to miss expectations. Quantitative Tightening began June 1st, at first rates continued to rise, but the flight to safety bid eventually overwhelmed Fed selling and brought rates lower. We will continue to monitor the ebbs and flows of inflation risk vs recession risk.

Summary

The sector performance of the equity markets clearly illustrates the shift in focus from inflation, i.e., the Energy sector up 16% in May, to recession fears with the Energy sector down 19% this month. Bond performance had a similar experience. The Fed speakers continue to speak of the need to re-anchor inflation expectations, i.e., sticking to their guns like Fed Volcker did in the early 1980's. The Fed meeting at the end of July will be a pivotal test of the resolve of the Fed. Do they stay the course in the face of weakening economic data causing more short-term pain, but likely healthier long-term prospects? Or do they summon Fed Burns from the mid-70's who pulled back from rate hikes and left us worse off for the balance of the decade? Which set the stage for Fed Volcker to say short term pain

be dammed, we need to re-anchor inflation expectations regardless of the cost. The first half of 2022 has been brutal across the board, nothing to sugar coat here. As seen in the chart below, the S&P 500 had the worst first half start in 60 years, bonds are off to their worst start ever. It will be interesting to see how the last half of the year unfolds.



Source : <https://www.zerohedge.com/markets/first-half-fubar-stocks-worst-60-years-bonds-bitcoin-worst-ever>

However, as uncertain as that is, we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/war vs. waning growth expectations, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. If the markets continue to decline, we will reallocate the overweight that occurs in Fixed Income back into equities. The decline in equity markets has triggered the rules-based defense mechanisms to reduce the risk of the portfolio via the dynamic investment vehicles that have been deployed. Further, if the equity markets get too extended on the downside, some of the vehicles will reallocate some capital back into their respective equity exposures.

These dynamic tools have been engaged, a couple of times during the increase in volatility. At month end a portion of equity has shifted to Treasury Bills for U.S. Large and Mid-Cap, as well as Developed International.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.



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