Northport Investment Management, LLC
A Registered Investment Adviser

Market Commentary – 2nd Quarter 2022

U.S. stocks continued to decline in the second quarter, as global markets closed out their worst first half of a year in decades. Accelerating inflation and rising interest rates contributed to the equity rout. All of the three major U.S. stock market indices posted their second straight quarterly losses. The last time that happened was in 2015 for the S&P 500 and the Dow, and 2016 for the NASDAQ Composite. This quarter, the Dow fell 11.3%, the S&P 500 declined 16.5%, and the NASDAQ Composite posted a loss of 22.4%. For the first half of 2022, the Dow fell 15.3%, its worst first half of a year since 1962. The S&P 500 stock index declined 20.6% (-20.0% with dividends), its worst first half of a year since 1970. The NASDAQ Composite lost 29.4%, marking its worst first half of any year.

Mid-cap, small-cap, international and emerging market stock returns are all performing as poorly as the S&P 500 benchmark, in the second quarter, and year-to-date. All eleven S&P 500 sectors were negative for the second quarter. Consumer Discretionary (-26.3%) and Communication Services (-20.9%) were the worst sectors for Q2. Consumer Staples (-5.2%) and Utilities (-5.7%) were the best. Year-to-date, ten of the eleven S&P 500 sectors are negative, with eight declining over 17%. The Energy (+29.2%) and Utilities (-2.0%) sectors are the best. The Consumer Discretionary (-33.1%) and Communication Services (-30.5%) sectors are the worst. Value stocks are significantly outperforming Growth stocks year-to-date.

Bonds had another down quarter, setting negative records of their own. Investment-grade taxable bonds, as measured by our benchmark Bloomberg Aggregate Bond Index (-10.4% return year-to-date), posted their worst start to a year in history. Municipal bonds, also deeply in the red, faired only slightly better than taxable bonds. Interest rates rose during the quarter. The benchmark ten-year Treasury note yield closed the quarter at 2.97%, up from its 2.33% yield at the end of Q1 2022. This is below the near 3.5% yield that it achieved in mid-June however, as fear of an economic downturn increased demand for guaranteed returns offered by Treasuries. The Federal Reserve has a very challenging task of quelling inflation by raising interest rates, while not tanking the U.S. economy. The Fed's interest rate increases to date appear to be making some progress against inflation, but there are more rate increases coming. Until there is more clarity regarding where the Fed will eventually end, bonds are not compelling investments.

As illustrated by the market statistics above, there has been nowhere to hide this year. Generating quarterly performance reports containing negative returns is not a pleasant task. One can take solace however in that we started 2022 after spectacular recent performance that created unexpectedly lofty account levels. Also, our quality, dividend paying, value-oriented stocks are outperforming the S&P 500 benchmark in Q2 2022, and year-to-date, as they tend to do in tough times. Our long-term, from-inception, returns remain excellent. We have experienced temporary negative volatility before (internet bubble of 2000-2002, real estate bubble of 2008, pandemic of 2020) and we've come out better than before.

The S&P 500 is now officially in a technical bear market, having fallen 20% from a previous high. Technology shares have led the way down, falling over thirty percent from their peak. Tech shares have a disproportionate effect on the broad stock market indices because of their large weighting. Even after their fall, Tech shares are still more than twenty percent higher than they were pre-pandemic. This indicates a market reset of growth, brought on by higher interest rates. The stock market is simply repricing some of the outsized gains posted in the second half of 2020 and throughout 2021. U.S. stocks more than doubled since the pandemic bear market low. The current twenty percent retracement is not welcomed, nor pleasant, but we are not any worse off than where we were two years ago.

A pending U.S. economic recession is now the big question. Will the U.S. economy fall into recession? A recession is defined as two consecutive quarters of negative economic growth. I worry that this could become a self-fulfilling prophecy. It is impossible to escape the negative headlines that always accompany stock market declines. These fear narratives affect consumer confidence, and our economy is consumer driven. Sentiment can override fundamentals. If a recession occurs, how severe will it be? I believe that, most likely, the U.S. economy will experience a relatively mild recession, in 2023. Although concerns over inflation, the war in Ukraine, oil prices, supply chains, and virus outbreaks exist, I do not subscribe to the current sense of dread. History shows that, although we do not know how long this bear market will last, we do know that periods of weak stock market returns are almost always followed by periods of strong returns. Sticking to our investment discipline and not panicking is the way to go. Around one third of the stock market's best days have occurred within the first two months of a new bull market. This can only be confirmed with the benefit of hindsight; we don't want to be on the sidelines when this happens.

John M. Grib, CFA, CFP®