

MARKET PULSE

May 18, 2022

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- Equities fell today, led by declines in the consumer discretionary and consumer staples sectors.
- The S&P 500 fell by 4.04%, the Dow Jones Industrial Average (Dow) fell 3.57%, and the Nasdaq was down 4.73%.
- Non-U.S. markets were mixed: The DAX (Germany) was down 1.26%, and the Nikkei (Japan) rose 0.94%.
- Treasury yields fell with the U.S. 2-year Treasury settling at 2.67% and the U.S. 10-year at 2.89%.

CATALYSTS

- Stocks gave back yesterday's gains as earnings reports from some major retailers highlighted the impact that inflation and supply chain disruptions are having on corporate profits. The disappointing earnings outweighed the optimism from April's faster-than-expected retail sales growth. The main worry for investors remains that a hawkish Federal Reserve (Fed) may tip the U.S. economy into a recession in its effort to curb inflation. Fed Chair Jerome Powell on Tuesday indicated that the Fed will "keep pushing" until inflation comes down in a "clear and convincing way." The S&P 500 breached the critical 4,000 level in intraday trading, which also added to volatility as this is where the highest concentration of monthly options positions are struck ahead of Friday's expiration. The S&P 500 is on track to drop for the seventh straight week as a number of uncertainties continue to weigh on markets.
- *Inflation*: Can the Fed achieve a "soft landing," curbing inflation without causing a recession? Chair Powell believes there is a "good chance" for a "soft or softish" landing. The U.S. economy has had a soft landing in three of the last 10 rate hike cycles with the most recent following the 2015-2018 rate hikes.
- *S&P 500 Earnings*: As of today, 92% of S&P 500 companies have reported earnings with 76% beating expectations. The estimated earnings growth rate for the S&P 500 in the first quarter is 8.6%. The increase in analysts lowering estimates, and lower guidance for future earnings have brought into question the sustainability of earnings growth.
- *Ukraine*: Investors are wary that this is the start of a general weaponization of commodities. Finland and Sweden formally submitted NATO membership applications amid Russia's warnings that doing so would be a "mistake."
- *China*: The latest outbreak of COVID-19 cases has led to strict lockdowns and renewed worries of an economic slowdown and possible spillover effects to the global economy, particularly via prolonged supply chain disruptions.

INVESTMENT STRATEGY OUTLOOK

- We are in a period of intense uncertainty, with a wider range of potential outcomes. Volatility will likely be higher until there is further clarity on some of the items listed above. Clarity, or the lack thereof, on any one of these uncertainties could quickly lead to a sharp change in investor sentiment.
- We believe the U.S. economy will grow above trend in 2022, and earnings will be positive as the lingering effects of COVID-19 restrictions ease, supply chain issues resolve, and consumer spending remains strong. But given the uncertainty in the current environment, our conviction in this view is more muted than usual. In our portfolios, we are focusing further on quality and earnings stability.
- While we have entered a correction and may experience multiple periods of weakness during the year, we foresee the S&P 500 being higher a year from now. We don't expect interest rates to rise much higher, but above-trend economic growth and inflation will likely provide some upward pressure.

Past performance does not indicate future results. The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market. The Dow Jones Industrial Average is an index that shows how 30 large, publicly owned companies based in the United States have traded during a standard trading session in the stock market. The NASDAQ Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market, and Capital Market. The Nikkei 225 consists of the shares of the 225 largest companies in Japan. DAX Index consists of the 30 most actively traded German companies on the Frankfurt Stock Exchange.

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