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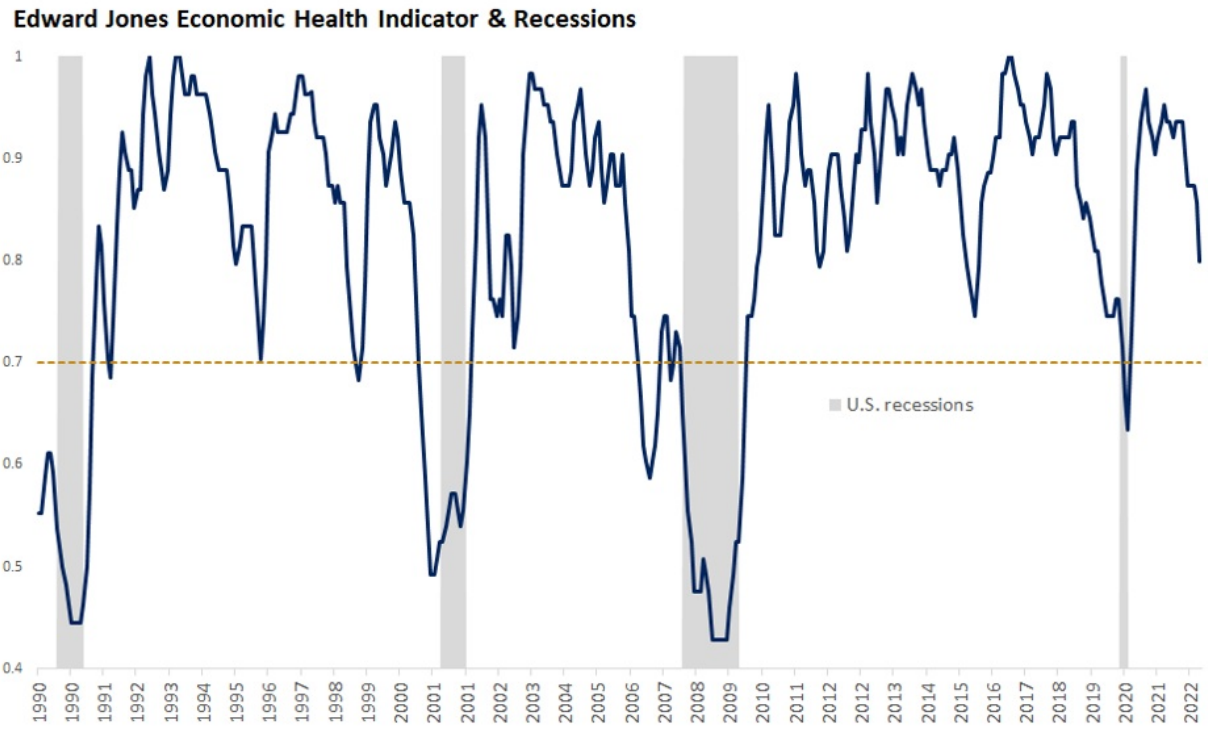
Weekly Market Commentary
June 20th, 2022

Are The Markets Finally Starting To Signal Headwinds?

Our Economic Health Indicator Is Signaling Increasing Headwinds

Our cycle model has moved lower recently, and while it's not consistent with a more assured recession, several of the signals we monitor tell us we're enduring a late-cycle phase. It's worth emphasizing that conditions are still similar to 2011 and 2016, which proved to be mid-cycle slowdowns. And while it is still quite feasible that the economy can avoid an outright recession, the eye of the needle that the Fed is trying to thread (driving inflation lower without tipping a contraction) has narrowed.



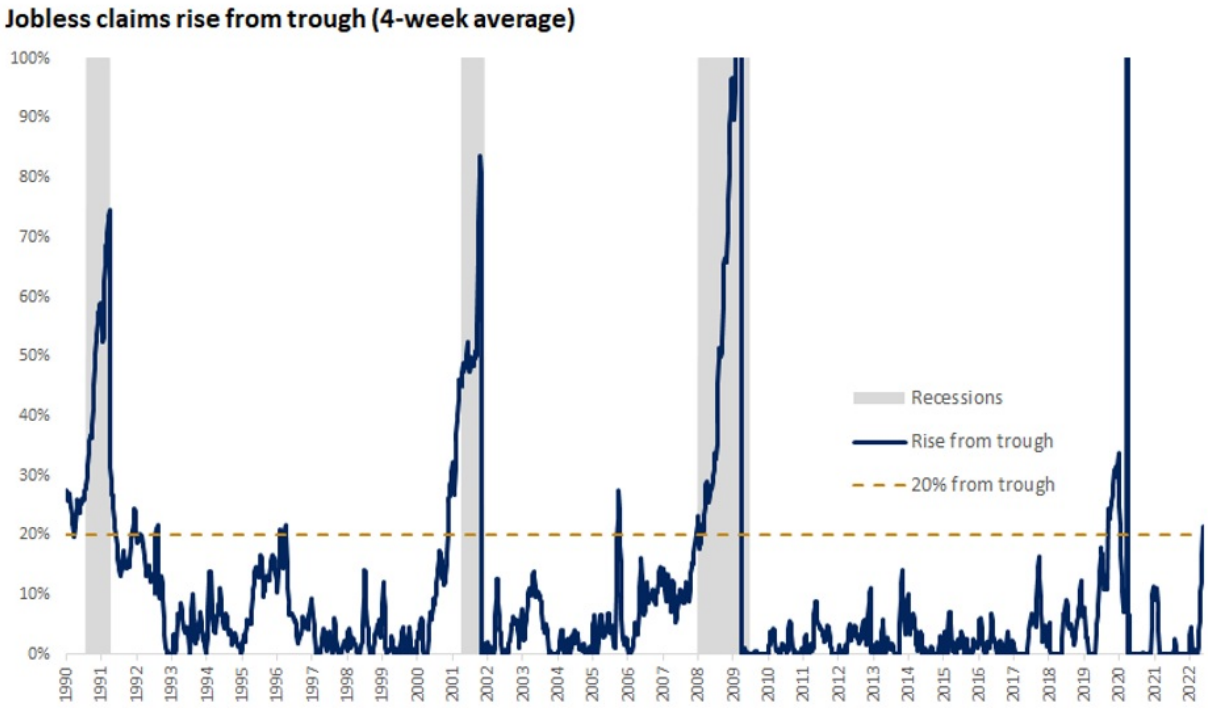
What's changed?

Labor market: still healthy, but jobless claims have turned higher

The labor market still looks strong, as job growth has continued at a solid rate through May. Even with more workers rejoining the labor force this year, the job market remains tight, with nearly twice as many openings as unemployed people. And despite investor worries about an imminent recession, the unemployment rate has fallen this year and continues to hover near record lows, at 3.6%. For perspective, the U.S. economy has always fallen into recession whenever the three-month average

unemployment rate (U3) has risen by more than 0.3%.

With unemployment being a lagging indicator of the market cycle, we pay close attention to the more timely applications for U.S. state unemployment insurance or initial jobless claims. Jobless claims tend to lead to major inflection points in the unemployment rate by six to nine months and have historically risen by 25% before the economy entered a recession. While claims remain low, they have been on an uptrend since April, rising about 20% from their low. As companies look for ways to defend profitability amid slowing demand and rising costs, you should expect to see some moderation in job growth in the months ahead, with the progression of jobless claims being an important gauge to pay attention to.



Source: FactSet

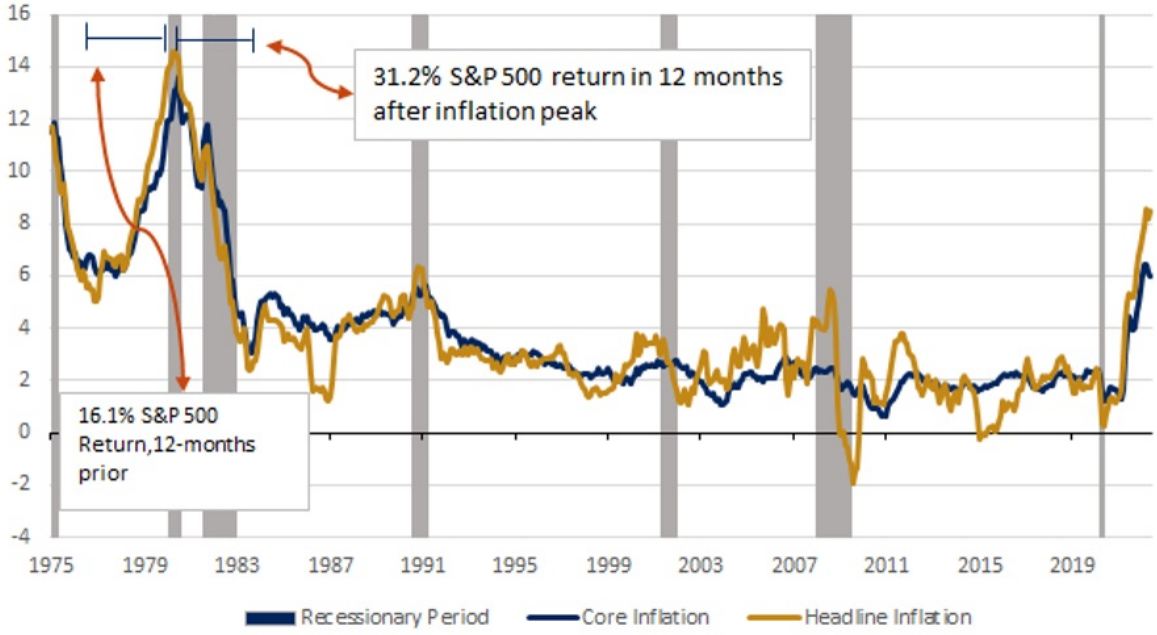
This chart shows that jobless claims have risen from their 4-week trough.

Inflation: Ongoing consumer price pressures as commodities remain elevated

Coming into this year, it was expected supply bottlenecks to begin to clear in the second half. This, along with a shift from goods to services spending and favorable year-over-year comparisons, formed our view that core inflation would trend lower over the year (and thus take the heat off the Fed to tighten into recession). This has played out to a degree with evidence, such as the latest PMI surveys signaling early signs of incremental improvement in supply chains, supporting our view that core inflation (which excludes food and energy prices and informs central-bank policy) is moderating. But this moderation has been too slow.

Meanwhile, the market and the Fed, insofar as it impacts inflation expectations, have now become more focused on headline inflation, which remains elevated. Geopolitical factors (war in Ukraine, COVID-19 lockdowns in China) – which were not part of our outlook coming into 2022 – are keeping headline inflation higher for longer. Unfortunately, Fed tightening can do little to drive oil and food supply higher, which is adding to the discomfort around the outlook for consumer spending, as this raises the risk of crowding out discretionary spending.

Markets Performed Well as Inflation was Peaking in the Early-80s



Source: FactSet, the S&P 500 is an unmanaged index and cannot be invested in directly. Past returns are not a guarantee of future results.

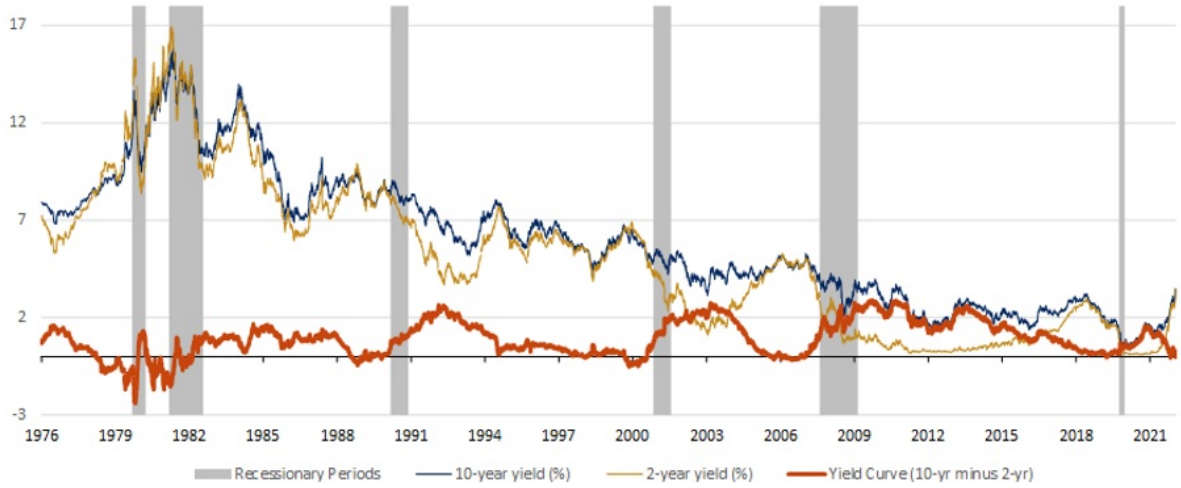
This chart shows that markets can perform well after a peak in inflation has taken place.

Yield curve: flattening as Fed tightening threatens GDP growth

The yield curve (10-year rates minus two-year rates) has flattened dramatically in recent days as short-term rates spiked to reflect larger anticipated rate hikes from the Fed while longer-term rates rose less – an indication of an outlook for weaker economic growth.

Coming into June, we held the view that the year-to-date jump in interest rates was largely pricing in a necessary amount of Fed tightening that would transpire this year. But with headline inflation remaining stickier for longer, the recognition that the Fed will ramp up its rate hikes in the coming months produced a sharp reaction in the bond market. Our expectations have been for 10-year rates to peak out around 3.5%. With the move in the last two weeks bringing 10-year yields above 3.2% (topping 3.4% at one point last week), there could be a bit more upside to longer-term rates. However, it is still the view that the bulk of the move higher is behind us.

Yield curve has flattened as rates reflect increased Fed tightening and slower growth



Source: FactSet, past returns are not a guarantee of future results.

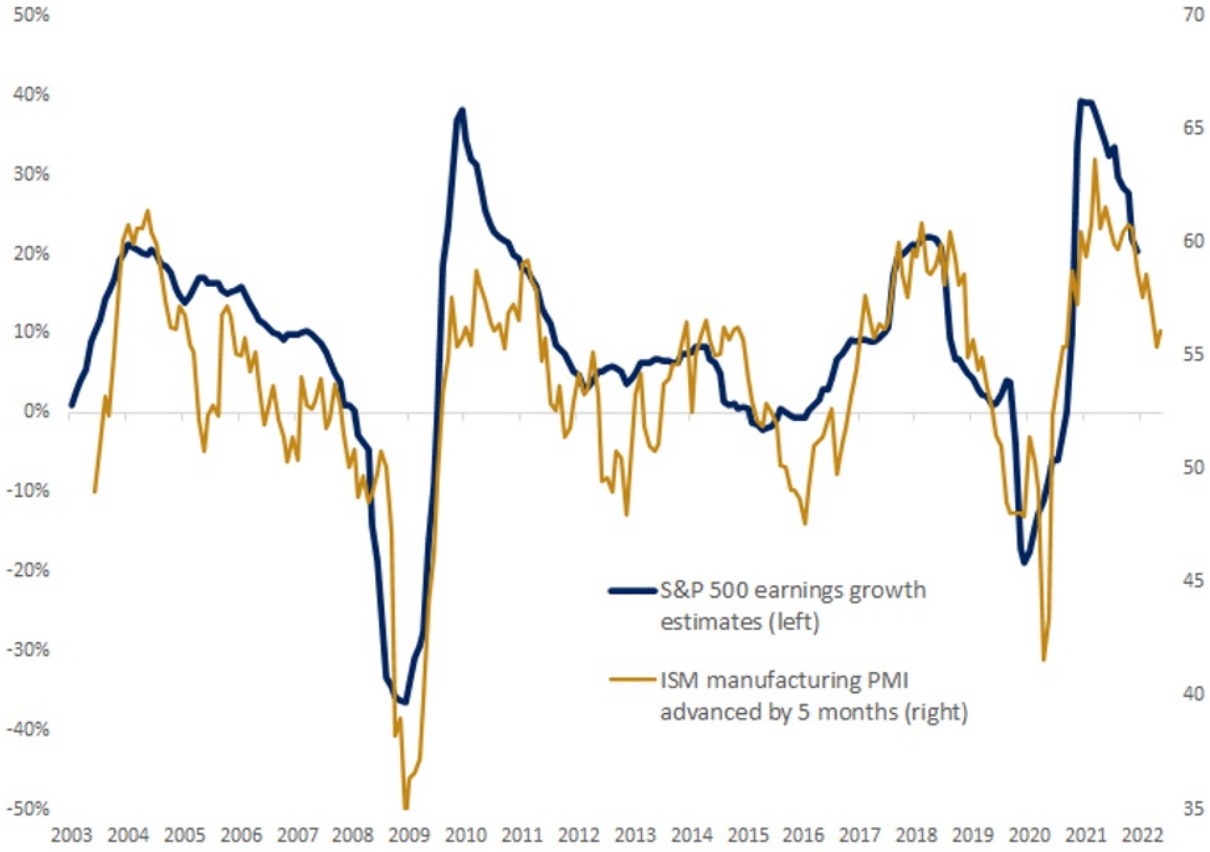
This chart shows that the gap between the 2- & 10-year treasury yields has narrowed as inflation and growth concerns rise.

Corporate earnings: Rising, but profitability likely to be challenged by higher costs

The first-quarter earnings results and forward guidance provided some reassurance that corporate earnings can still grow at a solid pace this year, partly offsetting the headwind of declining valuations. Despite some high-profile earnings misses in the tech space, consensus still expects the S&P 500 earnings to grow 10.5% this year and 9.2% in 2023.

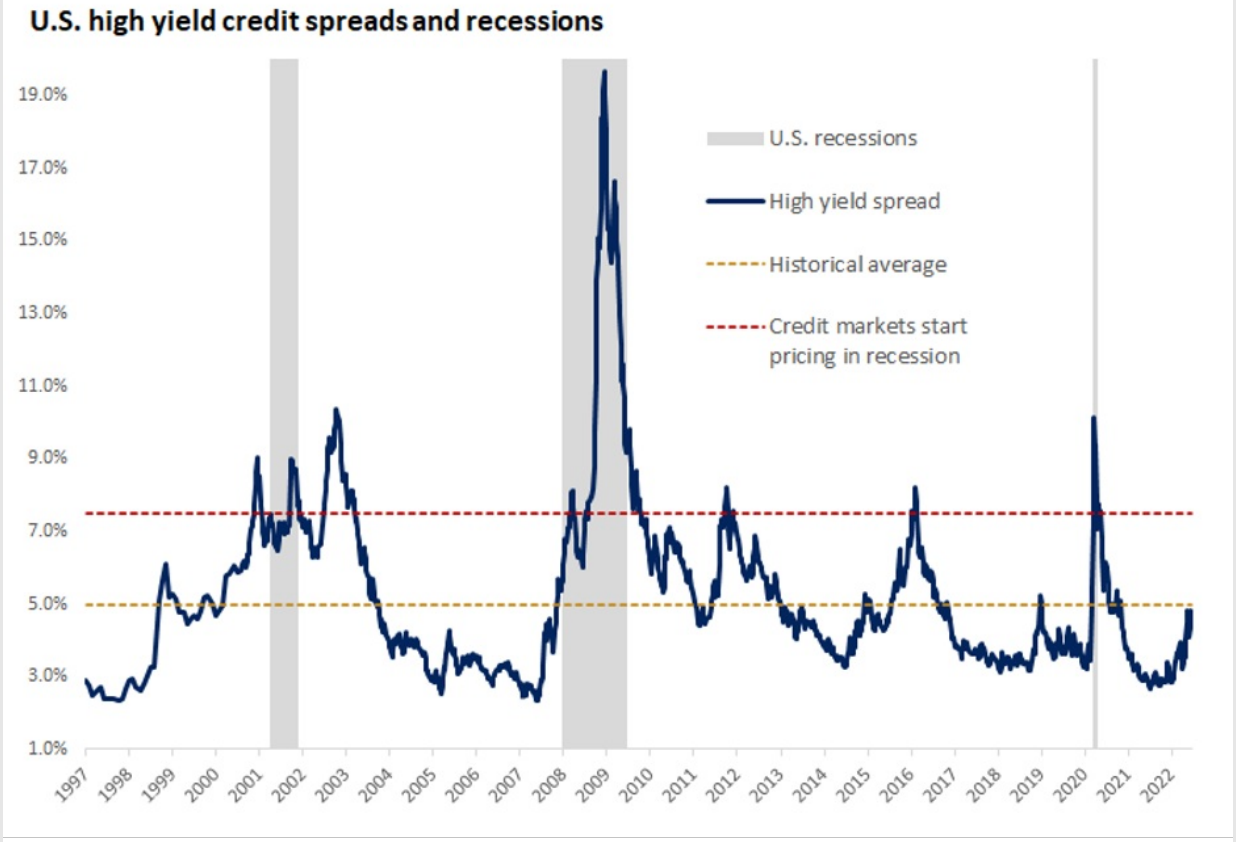
Based on the softening of some leading indicators of economic activity, like the Purchasing Managers' Index, and because of the fast-rising labor and material costs, we think that earnings estimates might need to come down some to reflect the more challenging backdrop. That said, you shouldn't expect profits to decline from last year, as resilient demand and strong pricing power provide support. But the likely necessary process of revising earnings expectations lower will weigh on sentiment in the quarters ahead.

Earnings growth to remain positive but slow in the quarters ahead



Source: FactSet

This chart shows the connection between corporate earnings growth and the PMI



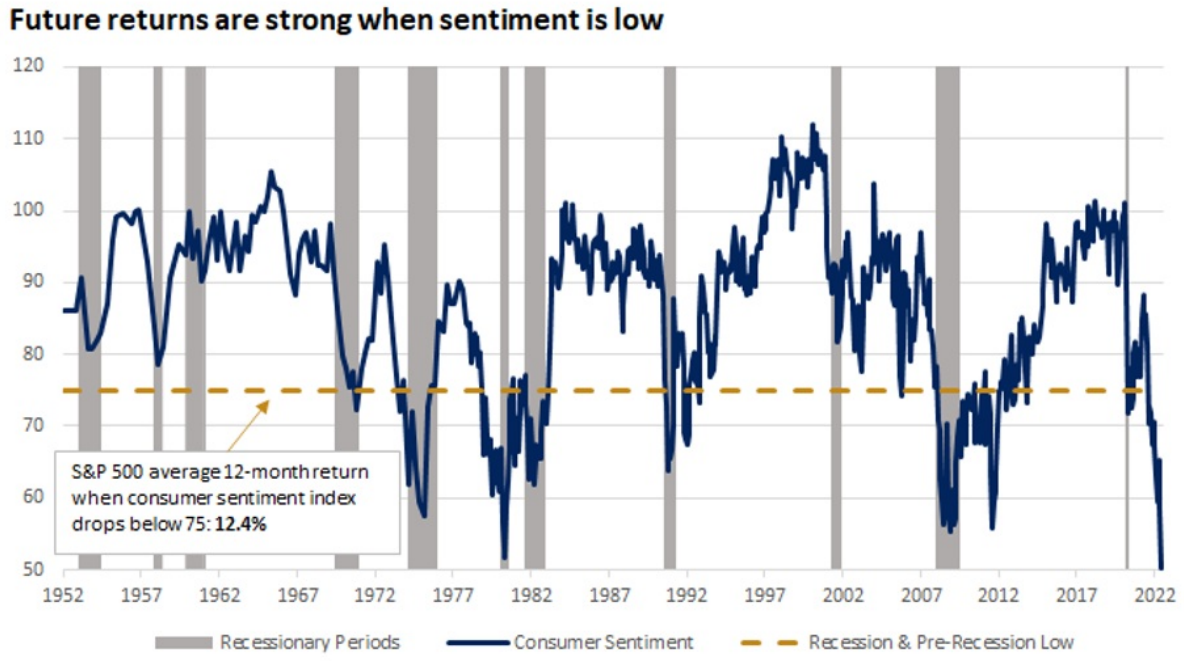
Source: FactSet

This chart shows that credit spreads have recently risen and started to price in a recession ahead.

Sentiment: consumer and investor moods have soured

Consumer confidence has been sapped by inflation worries, with the June reading of the University of Michigan Consumer Sentiment Index coming in at the lowest on record. Other reliable economic indicators, such as labor-market health, are much more aligned with strength than weakness, but the prominence and pervasiveness of the inflation story seem to be pushing us toward an environment in which consumer worry poses a self-fulfilling element to economic weakness. We believe a recession would require a notable uptick in unemployment (historically the unemployment rate rises by 0.5%, on average, ahead of recessions). With twice as many job openings as unemployed people, there is a credible case for unemployment to remain low for an extended period. But you are starting to see small signs of freezes and layoffs which could begin to add to consumer caution. With household spending comprising 70% of GDP, consumer incomes and attitudes are currently representing opposing forces to consumption habits.

Investor sentiment already reflects a high degree of pessimism, which we think improves the prospects for better returns ahead as widespread pessimism is a traditional component of a market bottom. Stock-market valuations (price-to-earnings) have already dropped by an amount that is consistent with a recession. A good portion of the pain has already been experienced. Some downward revisions to corporate earnings are coming as profit margins are impacted by rising input costs. But earnings growth should remain positive, thanks to reasonably healthy revenue growth, which can provide a pillar of support for a return of optimism as we move through the year.



Source: FactSet, the S&P 500 is an unmanaged index and cannot be invested in directly. Past returns are not a guarantee of future results.

This chart shows that stock market returns are normally strong after periods of low consumer sentiment.

(Source: oXYGen & Jones)

Markets For The Week

INDEX	CLOSE	WEEK
Dow Jones Industrial Average	29,889	-4.8%
S&P 500 Index	3,675	-5.8%
NASDAQ	10,798	-4.8%
MSCI EAFE	1,847	2.0%
10-yr Treasury Yield	3.23%	.1%
Gold	$1,840	-1.34%
Bonds	$100.40	-.9%

Source: Reuters/Wall Street Journal

$5 For A Gallon Of Gas- You Might As Well Get Rewards For It (source:USAToday/Motley Fool)

Gas prices have reached a new record high with the national average price now topping $5 per gallon for the first time. And unfortunately, things are likely to get worse before they get better: prices are projected to continue climbing in the coming months.

Since it's more expensive to fill up your tank with every passing week, it wouldn't be a surprise if you were struggling with the costs of commuting. But the good news is, a

new credit card could help defray at least some of this added expense, making it easier to cope with the high cost of gas.

How can a credit card help you deal with rising gas prices?

As gas prices climb, using the right credit card to pay at the pump will be more important than ever.

That's because some credit cards offer extra bonus points, miles, or cash back if you make purchases at gas stations. By contrast, other cards may offer bonus cash for other types of spending such as for restaurants – but not give you additional rewards if you fill up your vehicle.

Since gas prices are much higher than they have been in the past, the extra bonus rewards could make a big impact. Say, for example, you use around 560 gallons of gas per year, which is a reasonable estimate for how many gallons the average person goes through.

If gas is around $5 a gallon and you use 560 gallons per year, this could mean spending about $2,800 annually at gas stations. If your credit card offers just 1% back on gas purchases, you would end up with about $28 per year in card rewards.

But if your card offers 5% back at gas stations, you could find yourself with total rewards of around $140 – assuming the bonus rewards apply on all gas purchases throughout the year. That's a lot more money that gets put back in your wallet thanks to a change in which card you use.

Should you sign up for a gas card?

Now, the example above is just one hypothetical, and you'll need to consider several different issues when deciding whether to get a gas credit card.

First and foremost, you'll need to research card options and see if you could get approved for one that offers bonus rewards for gas. You'll also want to read the fine print, such as whether there is a limit on how much spending is eligible for the bonus. Finding the right gas card will be critical to getting generous-enough rewards that you can offset some of your added gas costs.

Second, you'll want to think about how much gas you actually use. If you rarely drive and you don't use a lot of gas at all, then it may not be worth signing up for a gas card since the extra rewards wouldn't end up doing much for you.

Finally, you'll want to compare any rewards your new card will offer to your current card – and compare other expenses such as annual fees as well. If you find that you can do better and get rewarded more with a new card, then there's typically little downside to applying as long as you don't mind an inquiry on your credit record for a few years. The extra rewards will add up quickly with how high gas prices are, and the bonus your card issuer gives helps to at least reduce your spending on fuel a little bit during these unprecedented times.

Earnings Highlights This Week

Adobe: Like some other large software companies, Adobe pointed to foreign-exchange rates when it announced its latest forecast. The company announced higher

prices for some Creative Cloud subscriptions in the quarter.

Oracle: Oracle exceeded estimates on the top and bottom lines for its fiscal fourth quarter. CEO Safra Catz said in a statement that the company saw a "major increase in demand" for cloud infrastructure.

News and Notes

What Money Lessons Did You Learn From Your Parents?

Teach your children to start saving money early?

- They learn important principles about how their money grows but let they also make some mistakes.
    - Investing: Apps like *Robinhood* and *Acorns* are great places to get started investing.
    - Allowances: BusyKid allows you to assign out chores and pay allowance when they are done.
- We are big fans of the kids 'earning' money vs. 'giving' them money- teaching the value of a dollar.

A big bank account or a big paycheck can't buy big happiness?

- You should always be using the acid test for new purchases?
    - Do I want it?
    - Do I need it?
    - Can I afford it?
- Will you remember the things you own or the things you did down the road? (buying stuff vs. experiences)
- Save 1/3rd of every raise that you get- don't fall into lifestyle inflation .

The best investment is in yourself?

- What's a bigger asset….your house, your 401(k), or all of the income you will earn over your lifetime?
- It's important you continue to invest in your skills, education, and competencies to grow your income.
- Get multiple streams of income vs. one stream of income. At some point get your child to start a side hustle business even if it is selling some stuff online.

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directly in this index. All indexes referenced are unmanaged. The volatility of indexes could be materially different from that of a client's portfolio. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.

You cannot invest directly in an index. The Dow Jones Global ex-U.S. Index covers approximately 95% of the market capitalization of the 45 developed and emerging countries included in the Index. The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market. The Bloomberg Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14, 1998. The DJ Equity All REIT Total Return Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones. The Dow Jones Industrial Average (DJIA), commonly known as "The Dow," is an index representing 30 stock of companies maintained and reviewed by the editors of The Wall Street Journal. The NASDAQ Composite is an unmanaged index of securities traded on the NASDAQ system. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets. Yahoo! Finance is the source for any reference to the performance of an index between two specific periods. The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage is often obtainable in commodity trading and can work against you as well as for you. The use of leverage can lead to large losses as well as gains.

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