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Weekly Market Commentary
August 1st, 2022

Are we technically in a recession or not?

Last week markets faced a triple-whammy of data, including the July Federal Reserve rate decision, the second-quarter GDP (gross domestic product) reading, and the ongoing second-quarter earnings season, with a focus on large-cap technology. Overall, while data broadly seemed soft, market reaction was largely positive, perhaps reflecting results that were better than feared and markets that had priced in sluggish growth already. Here are three key takeaways from the week:

1) The U.S. economy is slowing, as evidenced by the GDP data, Fed commentary, and earnings results.

2) The Federal Reserve may now start to hike rates at a more gradual pace.

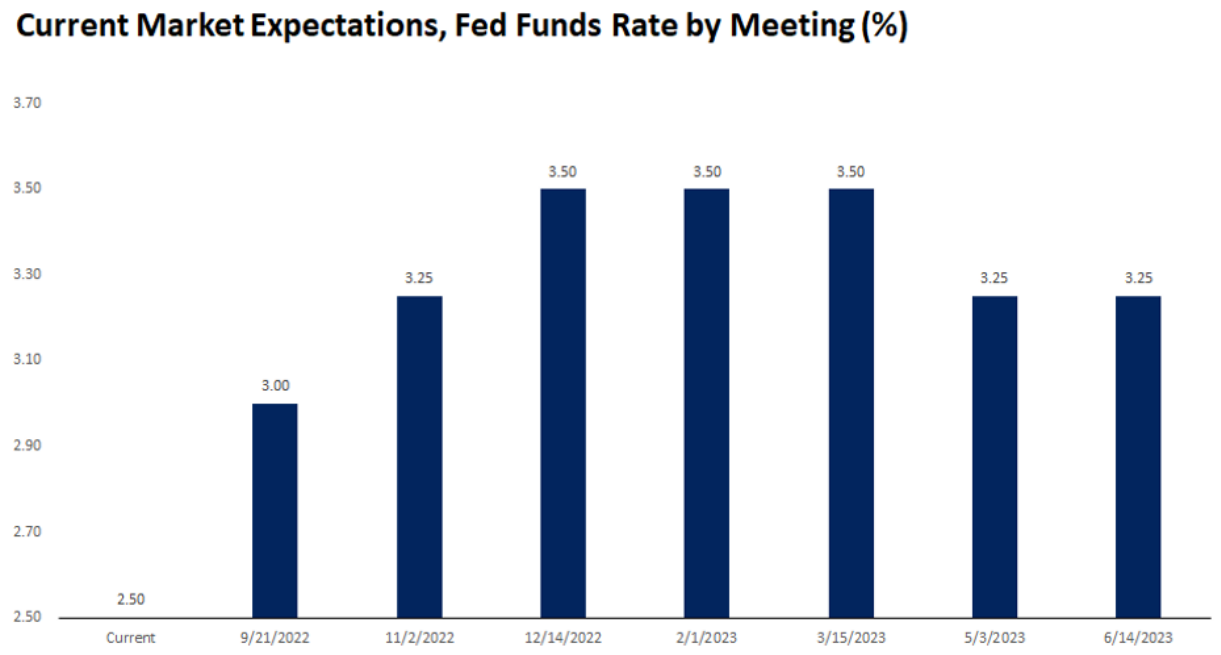
3) Markets did a lot of work to the downside ahead of softening economic and earnings data.

Had financial markets not been down substantially this year, there may have been more volatility this week, but with the S&P 500 Index down over 17% and the Nasdaq down close to 24%, markets perhaps de-risked and set a lower bar ahead of the data.

The July Fed meeting confirmed that future rate hikes will be data-dependent

As expected, the Federal Reserve raised rates this week by 75 basis points (0.75%), bringing the benchmark fed funds rate to about 2.5%. Fed Chair Jerome Powell noted in his commentary that the fed funds rate is now close to the Fed's estimate of a neutral rate, indicating an official end of the post-pandemic easy money policy. Perhaps more importantly, Powell referenced a fed funds range of 3.0%-3.5% by the end of the year. This would imply about 50-100 basis points more of tightening over the next three meetings this year, which means the pace of rate hikes could slow. (Markets currently anticipate a 50-basis-point hike in September, followed by two 25-basis-point hikes in November and December – see chart below) Markets, of course, cheered this notion of a more gradual Fed, with equity and bond markets closing sharply higher on Wednesday.

Figure 1. Markets expect a slower pace of rate increases ahead, followed by rate cuts in 2023



Source: FactSet.

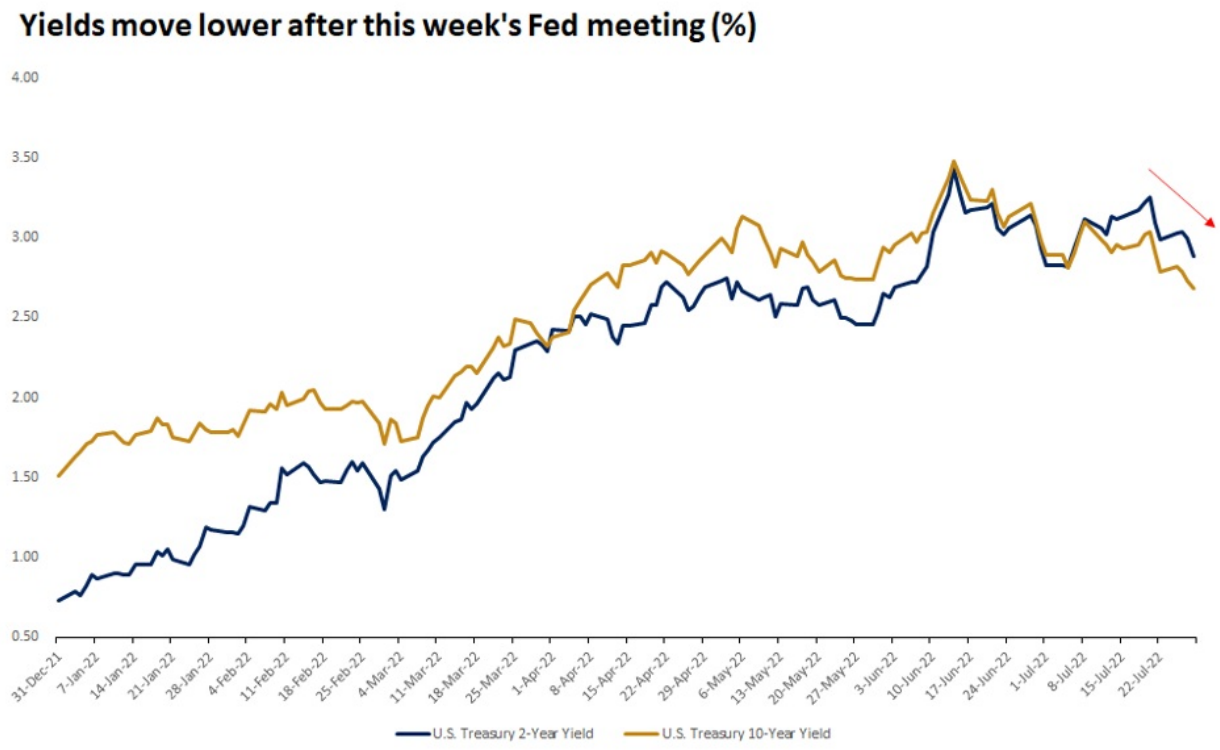
This chart displays the market's expectation for the future Federal Reserve, peaking at 3.5% in February of 2023 and gradually coming down after that.

However, Chair Powell also was clear to emphasize that the path of the Fed would now be data-dependent. And the key piece of data that it is tracking is inflation, both headline, and core inflation. While the Fed acknowledged some softening in commodity prices lately, it also noted that areas like energy prices are more volatile, driven in part by external factors like the crisis in Ukraine.

In addition, Powell highlighted that while the U.S. economy is slowing, he does not believe it is currently in a recession: "I do not think the U.S. is currently in a recession and the reason is there are too many areas of the economy that are performing too well. This is a very strong labor market. … It doesn't make sense that the economy would be in a recession with this kind of thing happening."

Perhaps the biggest signal after the Fed meeting was the sizable move lower in Treasury bond yields, likely reflecting the market view that inflation and growth may be slowing, and the Fed may move more gradually going forward. We have seen the two-year yield move lower by about 50 basis points and the 10-year yield by 75 since their mid-June highs. The move lower in yields has also supported the strong equity-market performance this month, particularly in growth-oriented and longer-duration sectors. However, we would expect yields to gradually move higher again as the Fed continues its rate hiking, but perhaps remain below their mid-June peaks.

Figure 2. After moving higher for much of the year, Treasury yields moved lower after the Fed meeting this week, reflecting softer growth and a potentially slower pace of hikes ahead



Source: FactSet, past performance is not a guarantee of future returns.

This chart shows U.S. treasury yields moving lower recently after the Federal Reserve's latest rate decision meeting.

GDP growth in the U.S. hit a technical recession – but the NBER may think otherwise

A second highly anticipated data release last week was the second-quarter U.S. GDP reading. This GDP reading came in at -0.9% quarter-over-quarter annualized, below the consensus estimate of a +0.8% reading. This was the second quarter in a row of a negative GDP reading in the U.S., which is largely considered a technical definition of a recession. Compared with the first quarter, the second-quarter figure clearly showed signs of slowing: consumption slowed to a pace of 1.0%, down from 1.8%, and residential investment fell sharply, down -14% compared with +0.4% growth last quarter

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Figure 3. Second-quarter GDP growth was -0.9%, driven in part by slower consumption and weaker residential investment

Quarter-over-quarter annualized growth

Quarter-over-quarter annualized growth	Q1 22	Q2 22
Personal Consumption Expenditure	1.8	1.0
Business Investment	10.0	(0.1)
Residential Investment	0.4	(14.0)
Government Expenditure	(2.9)	(1.9)
Exports	(4.8)	18.0
Imports	18.9	3.1
U.S. Real GDP	(1.6)	(0.9)

Source: FactSet.

This table shows growth in several key factors of the economy.

However, the official record-keeper of recessions in the U.S. is an independent committee known as NBER (National Bureau of Economic Research). The NBER

defines a recession more broadly, as "a significant decline in economic activity that is spread across the economy and lasts more than a few months." It is believed to monitor several economic factors, including nonfarm payrolls, consumption, and industrial production. While these measures are softening, the NBER may need to see further weakness, especially on the labor side, before officially declaring a U.S. recession.

Clearly, the U.S. economy is clearly slowing down to below-trend growth levels and could slow further in the months ahead. Keep in mind that the second-quarter GDP data is backward-looking and did not yet account for most of the Fed rate hikes. The full impact of Fed hiking and its quantitative-tightening program will likely be felt in the months ahead, particularly for the most interest-rate sensitive parts of the economy, like the housing market, which is already showing signs of weakening. Nonetheless, we continue to see little scope for a deep or prolonged recessionary period in the U.S., especially given the strong starting position of the labor market and consumers, which will provide some cushion against rising rates and a softer economic backdrop ahead.

(Source: oXYGen & Jones)

Markets For The Week

INDEX	CLOSE	WEEK
Dow Jones Industrial Average	32,845	3%
S&P 500 Index	4,130	4.3%
NASDAQ	12,391	4.7%
MSCI EAFE	1,915	.9%
10-yr Treasury Yield	2.66%	-.1%
Gold	$1,766	2.26%
Bonds	$104.13	.7%

Earnings Highlights This Week

Exxon and Chevron: Exxon and Chevron posted record profits during the second quarter of 2022 as high commodity prices boosted operations, and as the oil giants kept spending in check. Energy stocks' ascent follows a surge in oil and gas prices, which have jumped as Europe looks to move away from Russian fuel. Chevron shares gained 8% during morning trading on Wall Street, with Exxon advancing 4%.

Procter & Gamble: Procter & Gamble reported earnings that came in shy of Wall Street expectations as it faced rising commodity costs. The company's revenue came in above expectations as higher prices offset a slip in sales volume.

Roku: Roku shares plummeted more than 25% in extended trading. The company missed on the top and bottom for its second quarter.

Intel: Intel slashed its full-year guidance and turned in worse-than-expected quarterly results. The company launched new chips that compete with Nvidia's graphics cards

during the quarter. On Tuesday the U.S. House approved legislation Intel requested that would subsidize microprocessor manufacturing in the country.

Apple: Apple reported fiscal third-quarter earnings on Thursday that beat Wall Street expectations for sales and profit but showed slowing growth for the iPhone maker. Apple did not provide formal guidance for the quarter. "In terms of an outlook in the aggregate, we expect revenue to accelerate in the September quarter despite seeing some pockets of softness," Apple CEO Tim Cook told CNBC's Steve Kovach.

News and Notes

What Should You Do If You Win The Lottery?

What are the first things you should do if you hit the big numbers?

- This is not the time to get out your megaphone. Take a deep breath. Do NOT tell everyone you won.
- Typically, you have 90 days from one year to cash the ticket and you might want to sign the ticket so nobody else can claim it.
- Depending on your state you may be able to maintain anonymity, but you may want to consider setting up a P.O. Box.

What kind of taxes will the winner have to pay?

- It depends on…. if you take the lump sum or take the annuity
- The winner will get 1.02 billion dollars if they take the annuity in 30 payments over 29 years (taxes every year on the payment)
- If you take the lump sum, it will be roughly $603 million and after taxes (24% mandatory withholding), but ultimately 37% + state taxes you could walk away with $340 million.
- Most will take the lump sum, but if you are bad at managing the money you might take the annuity.

What should you do with the money once you get it?

- 33% of all lottery winners declare bankruptcy.
- If you are interested in reducing your tax hit, you could consider donor advised fund or setting up a family foundation.
- Look for conservative investments that may pay dividends or interest or real estate that produces cash flow, and get a financial plan done.
- You should work from the 4% rule. Withdraw no more than 4% every year.

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