LSAM LIFESTYLE ASSET MANAGEMENT

Market Commentary

June 2022

Equity and Bond Market Update

(as of June 7, 2022)

Index	YTD	1-Year
Dow Jones Industrial Average TR	-7.8%	-2.7%
S&P 500 Total Return Index	-12.1%	-0.2%
Russell 2000 Total Return Index	-14.1%	-15.1%
MSCI EAFE Index (net)	-11.7%	-12.0%
MSCI Emerging Markets Index (net)	-13.1%	-21.3%
Barclays US Aggregate Bond TR	-9.6%	-9.0%

Recent Economic Indicators

	Statistic	Data as of
Unemployment Rate	3.6%	May 2022
Gross Domestic Product (GDP)	-1.5%	Q1 2022
Consumer Price Index (CPI)	+0.3%	Apr 2022
Consumer Confidence (1985=100)	106.4	May 2022
30-year fixed mortgage rate	5.46%	6/7/2022
Housing Starts (single family)	1,100,000	Apr 2022
10-Year Treasury Yield	2.98%	6/7/2022

The broad market S&P 500 Index has retraced some of its losses since hitting an intra-day low on May 20th, currently trading over 9% above that level. The index has been trading in a range between approximately 4,100 and 4,160 over the last 8 trading sessions, and is currently at the top of this range. This is an important level of the index since there is a strong resistance for the index to break above it. Should the index do so, we could see a strong continued move upwards at least to the 4,300 to 4,400 range. This may happen in the next couple of days if the market is pleased with the CPI inflation release on Friday this week, which we will discuss below.

All major equity markets have been moving closely in tandem this year, with the S&P 500 large-cap index, Russell 2000 small-cap index, MSCI EAFE foreign developed market index, and MSCI EM emerging market index all currently trading within two percentage points of each other below where we began the year. The broad bond market has still not offered much balanced protection, also down almost -10% in 2022. At this point in the year, only the broad-based commodities asset class, and the Energy and Utilities sectors have provided any upside.

As mentioned, on this Friday the 10th, we will get the monthly release of Consumer Price Index numbers from the US Bureau of Labor Statistics. This release will reflect information gathered from May. Last month's release showed a slight moderation in rising prices, with the annualized inflation rate decreasing from 8.5% in March to 8.3% in April. In order for the CPI number to at least remain stable at the April 8.3% number, we'll have to get a monthly rate close to 0.7%, which is right where the average monthly increase has been over the last twelve months. Anything below 0.7% should bring the overall CPI number down, which would reflect two straight months of price moderation. You can never predict exactly how the market will immediately react, but if we do see moderation, it would be a positive sign and could confirm that we peaked in percentage increase terms in March.

This will be a very closely watched release. Obviously, the main components of CPI that have been driving most of our recent price increases have been food items and energy, which typically have a high correlation to each other. Prices for energy commodities, such as gasoline and fuel oil, are up a whopping +45% over the last year. At-home food prices have risen almost +11% overall over the same period. Stripping out these two components, we get a still very hot CPI of 6.2% over the last twelve months, so these items are not the only ones driving increases. Used car prices, for example, have been very hot over the last twelve months, rising almost 23%, although we have seen some moderation in these prices since February this year.

The Federal Reserve actually prefers watching another method of inflation calculation, the Personal Consumption Expenditures (PCE) Index which has also been on a run over the last year and has a high correlation to the CPI number. Since we have achieved what the Fed considers "full employment" in labor, price increases are what they are currently focused on controlling. The speed, magnitude and longevity of Fed interest rate hike forecasts have been primarily dependent on these price increase statistics. A moderation of both CPI and PCE would translate into an estimate that they will stick to the plan they broadcasted at their last meeting in May, which would mean 50bps rate hikes at the next two meetings in mid-June and late-July, and a continuation of 25bps hikes throughout the rest of 2022, putting the

Major Market Indices Price Return (YTD through June 7, 2022)

target rate just under 3% by years end. This is the expectation at this time, and we will need to get past the coming months' inflation data to cool current market jitters about a hawkish Fed that will drive us into a hard landing from easy money policies of years past.

Lastly, the consensus at this time for the outcome of this year's mid-term elections are that Republicans will take majorities in both the House and the Senate. Some are forecasting that Republicans may end up with anywhere between a 37 to 47 seat majority in the House, and only need to flip one seat in the Senate to attain a majority. Clearly, the more Republicans can attain in November, the more gridlocked the U.S. government will be for the next two years, and markets have historically liked this. According to CFRA Research, in 13% of the years over the last 77 years, there has been a Democratic president and a unified Republican Congress, and the average yearly return for the S&P 500 during these times was +13.0%, well above the +9.3% average return for the entire period. Even if the Democrats were to retain control over the Senate, the average return for years with that government makeup was +13.6%. Ironically, gridlock means certainty and status quo, which the market prefers.

Always keep in mind that fear, panic, and optimism are not investment strategies, but rather emotions that drive short-term markets.

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Sources:

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