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Market Stats & Commentary

Market Vital Signs as of 7/31/2022

Stock Indexes	July	YTD	1 Year
S&P 500	9.22%	-12.58%	-4.64%
Dow Jones Industrial Average	6.82%	-8.60%	-4.14%
NASDAQ Composite	12.35%	-20.80%	-15.55%
Russell Mid Cap Index	9.87%	-13.83%	-9.83%
Russell 2000 Small Cap Index	10.44%	-15.43%	-14.29%
MSCI EAFE Developed Int'l Index	4.98%	-15.56%	-14.32%
MSCI Emerging Markets Index	-0.25%	-17.83%	-20.09%
Bond Indexes			
BBgBarc US Aggregate Bond Index	2.44%	-8.16%	-9.12%
BBgBarc US Corp High Yield Bond Index	5.93%	-9.12%	-7.98%
Interest Rates			
	7/31/22	12/31/21	7/31/2021
Fed Funds Target Range	2.50%	0.00%	0.00%
10 Yr U.S. Treasury Rate	2.64%	1.51%	1.23%

Data courtesy of Raymond James

July was as good as June was bad, which is saying a lot. Stocks rallied across the board with the exception of emerging markets and bond indexes posted a positive month as intermediate and long term interest rates fell sharply.

Does this rally signal a major shift in the markets? Probably not. My view is that June was unreasonably bad and July reversed that. The reason for much of the negative returns this year is rising interest rates and until that narrative changes excess volatility will likely remain.

I delayed writing this commentary until after the jobs report was released Friday morning August 5th so I could have the benefit of that data for color commentary. I'm glad I did because it reinforced my comment from last month – it's a little weird out there. Economists were expecting the jobs number to come in somewhere around +250k and it came out at +528k. As for the unemployment rate, it actually *fell* from 3.6% to 3.5% month over month. While the economy has clearly slowed, the labor market is still incredibly strong and consumers are still spending. June national retail sales were up 1% month over month and the ex-autos number was also up 1%. Both rose at the fastest pace since March.

The U.S. economy may be riding a tightrope on the edge of recession at this point, but it is difficult to see a really bad economy with 3.5% unemployment. The jobs data also takes a lot of air out of a view which had been forming in the market that the Fed may be done raising rates sooner than expected. I continue to believe the market has done some of the Fed's work for it and that the rate hikes will be less aggressive for the remainder of the year, but I don't think they are done yet.

What's The Deal With Bonds? Should I Still Own Them?

I got that question from a client in response to last month's commentary. He wanted to know my perspective and thought other clients may be wondering the same thing. Here goes...

August 9, 2022

Investors tend to look at bonds like they look at spinach. You know some amount of it is good for you but when you are thinking about what you want for dinner, spinach is probably not the first thing that comes to mind. You eat enough to be healthy and then move on to more appetizing things on the menu. Bonds are the spinach of the investment world.

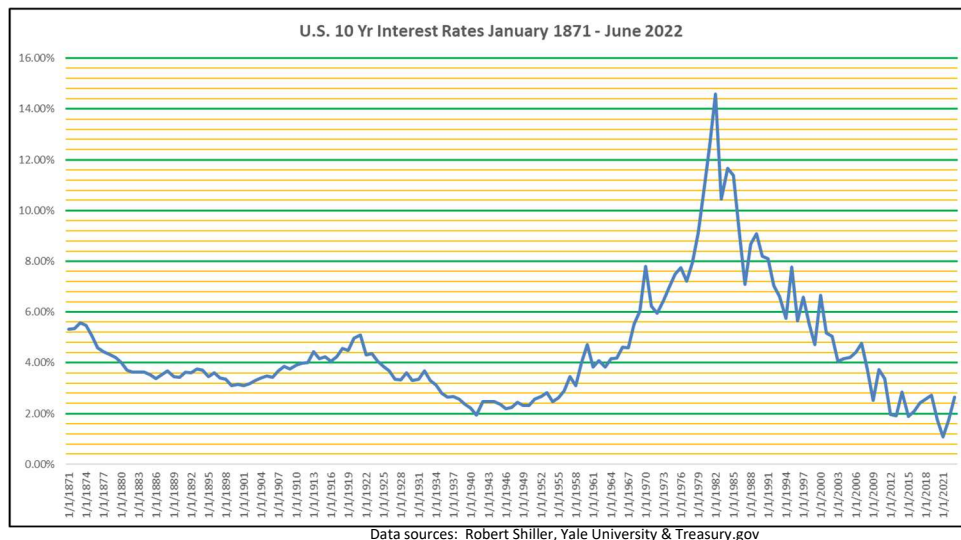
Bonds have historically provided lower but more predictable returns than stocks and they tend to be much less volatile than stocks. They also have a low correlation to stocks. However, contrary to what many people think, the aggregate bond index does have a **slight positive correlation** to the S&P 500 (currently .11 over the last 15 years). This means that saying when stocks go down, bonds go up is incorrect. Bonds do, however, typically experience significantly less severe drawdowns than stocks. A terrible year in the bond market looks very different than a terrible year in the stock market. For frame of reference, here are some stats from a Vanguard white paper:

Historical Index Risk / Return 1926 - 2019			
	Best Year	Worst Year	Average Annual Return
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Source: <https://advisors.vanguard.com/VGApp/iip/advisor/csa/analysisTools/portfolioAnalytics/historicalRiskReturn>

So, over the long term, bonds have definitely provided a buffer when against losses. This year, however, has been a little different. Stocks and bonds both have the same problem – interest rates going up. Bonds have done better than stocks this year, *but not that much better*. The S&P 500 and the bond index finished July down 12.58% & down 8.16% respectively. As a result, bond investors have suffered almost as much as stock investors as interest rate levels have been reset.

Interest rates have been in a long term downtrend for 40 years now, which has provided a consistent boost to bond total returns (when interest rates go down, bond prices go up and visa versa). But interest rates can only go so low for so long and at some point there has to be a reversion to the mean. What we have seen this year has been a large and fast mean reversion. But that begs the question – what is the mean? Most current investors’ view of rates was shaped by what happened in the 1970’s and 1980’s, and if you use the last 50 years as your frame of reference you probably think interest rates are still below average. Maybe, maybe not. Instead of 50 years, let’s go back 150 years.



This chart has surprised everyone I have shown it to as I have updated it over the years. When you just look at the visual of the chart, it is not the level of current rates that seems abnormal – it is what happened in the 1970’s and 1980’s. **Prior to the late 1960’s, rates never averaged over 6% in any given year for roughly 100 years.** In case you are wondering, the average over that time frame is 4.46% and I’m guessing that is much lower than many people would have thought prior to

seeing the chart.

In mid-June the U.S. 10 yr rate got up to 3.47% before coming back down a bit over the next few weeks. My current view is the 3.5% probably represents a ceiling for the 10 yr rate, at least in the near term. Assuming that holds, the bond market has already endured much of the damage from the rate reset. It does not, however, mean bonds will have the same return over the next 40 years that it has had in the prior 40. That is almost statistically impossible. But that doesn’t mean they will be bad, at least from an absolute view. Will they keep up with inflation? Maybe, if inflation trends toward the Federal Reserve’s 2% target in the not too distant future.

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Finally, to answer the client question, yes, most investors should have at least some bond exposure to dampen volatility. Will bonds average a 6% return over the next 10 years? Probably not, but you still need to eat some portfolio spinach.

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Disclosures, Disclaimers & Other Assorted Compliance Fun

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Investing involves risk and you may incur a profit or loss regardless of strategy selected. Past performance does not guarantee future results. Future investment performance cannot be guaranteed, investment yields will fluctuate with market conditions. Prior to making an investment decision, please consult with your financial advisor about your individual situation.

Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary.

Index Descriptions

S&P 500: Representing approximately 80% of the investable U.S. equity market, the S&P 500 measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested.

Dow Jones Industrial Average Total Return: The Dow Jones Industrial Average is a composite of 30 stocks spread among a wide variety of industries, such as financial services, industrials, consumer services, technology, health care, oil & gas, consumer goods, telecommunications, and basic materials. The index represents approximately 23.8% of the U.S. market, and is price weighted (component weightings are affected by changes in the stocks' prices). Maintained by the Averages Committee, components are added and deleted on an as-needed basis.

Russell Midcap: A subset of the Russell 1000 index, the Russell Midcap index measures the performance of the mid-cap segment of the U.S. equity universe. Based on a combination of their market cap and current index membership, includes approximately 800 of the smallest securities which represents approximately 31% of the total market capitalization of the Russell 1000 companies. The index is created to provide a full and unbiased indicator of the mid-cap segment.

Russell 2000: Based on a combination of their market cap and current index membership, this index is comprised of approximately 2,000 of the smaller securities from the Russell 3000. Representing approximately 10% of the Russell 3000, the index is created to provide a full and unbiased indicator of the small cap segment.

MSCI EAFE (Europe, Australasia, Far East) Index: A free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. As of June 2, 2014, the index consists of 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

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Bloomberg Barclays U.S. Aggregate (BCAG): A representation of SEC-registered, taxable, and dollar denominated securities. The index covers the U.S. investment grade fixed rate bond market, with index components for asset-backed securities, government and corporate securities, and mortgage pass-through securities. Must be rated investment grade (Baa3/BBB- or higher) by at least two of the following rating agencies: Moody's, S&P, Fitch; regardless of call features have at least one year to final maturity, and have an outstanding par value amount of at least \$250 million.

Bloomberg Barclays U.S. Corporate High Yield: Covers the universe of fixed rate, non-investment grade debt which includes corporate (Industrial, Utility, and Finance both U.S. and non-U.S. corporations) and non-corporate sectors. The index also includes Eurobonds and debt issues from countries designated as emerging markets (sovereign rating of Baa1/BBB+/BBB+ and below using the middle of Moody's, S&P, and Fitch) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included. Must publicly issue, dollar-denominated and non-convertible, fixed rate (may carry a coupon that steps up or changes according to a predetermined schedule), and be rated high-yield (Ba1 or BB+ or lower) by at least two of the following: Moody's, S&P, and Fitch. Also, must have an outstanding par value of at least \$150 million and regardless of call features have at least one year to final maturity.

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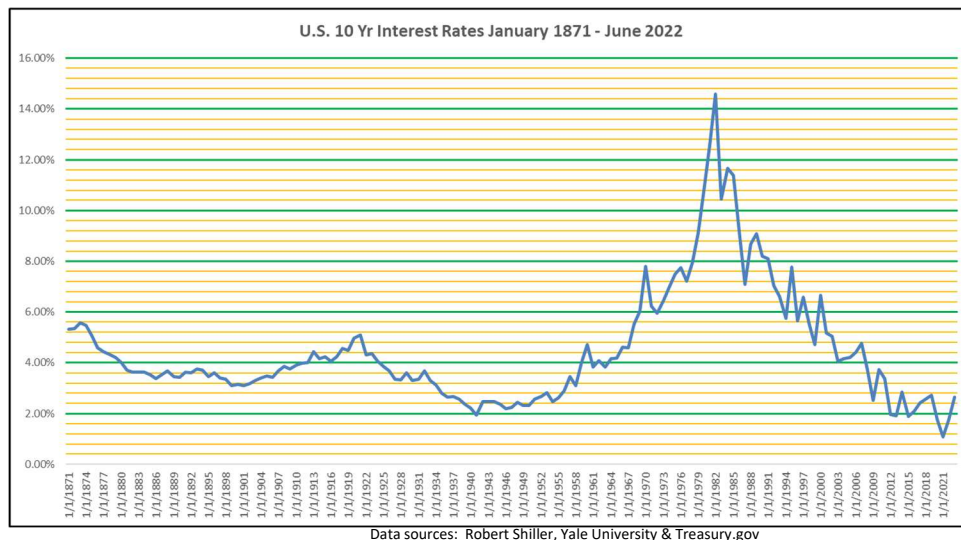
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