CAPITAL INVESTMENT
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Q3 Market Commentary:
Inflation, Higher Rates, and Recession Risks Push Stocks and Bonds Lower in the Second Quarter

The S&P 500 continued to decline in the second quarter, hitting the lowest level since December 2020 as still-high inflation, sharp increases in interest rates, rising recession risks, and ongoing geopolitical unrest pressured stocks and other assets. The markets have experienced numerous macro-and micro-economic headwinds through the first six months of the year, and they have legitimately pressured asset prices. With sentiment very negative now, both the consumer and investor remain stretched, and a lot of potential "bad news" has been at least partially priced into stocks and bonds at these levels, again creating the opportunity for potential positive surprises.

Key Focus Points

1. Q1 2022 GDP revised to -1.6%
2. On June 10th, the May CPI report showed inflation had not yet peaked as CPI rose 8.6% year-over-year, the highest reading since 1982.
3. Market volatility was compounded when the Federal Reserve increased interest rates by 75 basis points on June 15th, the biggest rate hike since 1994.
4. On July 13th, the June CPI report showed inflation had not yet peaked as CPI rose 9.1% year -over-year, the highest reading on record.

Key Dates Ahead

1. July 12th – mid August Q2 2022 Earnings Reports
2. July 27th – next Fed Meeting Announcement (expected to be 75 bps increase)
3. July 28th – First reading of the Q2 2022 GDP which is flat to negative (if it is negative, then it means that we are already in recession)

In sum, the factors that pressured stocks in the first quarter, including high inflation, sharply higher interest rates, geopolitical unrest, and rising recession fears, also weighed on stocks in the second quarter and until investors get relief from these headwinds, markets will remain volatile.

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Second Quarter Performance Review

All four major stock indices posted negative returns for the second straight quarter, and like in the first quarter, the tech-heavy Nasdaq underperformed primarily thanks to rising interest rates while the Dow Jones Industrial Average relatively outperformed. Also, like the first quarter, rising rates and growing fears of an economic slowdown fueled the continued rotation from high valuation, growth-sensitive tech stocks to sectors of the market that are more resilient to rising rates and slowing economic growth.

From an investment style standpoint, both value and growth registered losses for the second quarter, a departure from the first quarter where value posted a positive return. However, value did again handily outperform growth on a relative basis in the second quarter. On a sector level, all 11 S&P 500 sectors finished the second quarter with negative returns. Relative outperformers included traditionally defensive sectors such as utilities, consumer staples, and healthcare, which are historically less sensitive to a potential economic slowdown, and the quarterly losses for these sectors were modest. Energy was also a relative outperformer thanks to high oil and gas prices for much of the second quarter, although a late-June drop in energy commodities caused the energy sector to finish the quarter with a small loss.

US Equity Indexes	Q2 Return	YTD
S&P 500	-17.41%	-19.96%
DJ Industrial Average	-12.17%	-14.44%
NASDAQ 100	-23.50%	-29.22%
S&P MidCap 400	-16.62%	-19.54%
Russell 2000	-18.02%	-23.43%

Source: YCharts

International Equity Indexes	Q2 Return	YTD
MSCI EAFE TR USD (Foreign Developed)	-15.15%	-19.25%
MSCI EM TR USD (Emerging Markets)	-11.92%	-17.47%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	-14.34%	-18.15%

Source: YCharts

Commodity Indexes	Q2 Return	YTD
S&P GSCI (Broad-Based Commodities)	-1.62%	35.80%
WTI Crude Oil	-1.78%	41.43%
Gold Price	-5.88%	-1.28%

Source: YCharts/Koyfin.com

US Bond Indexes	Q2 Return	YTD
BBgBarc US Agg Bond	-4.63%	-10.35%
BBgBarc US T-Bill 1-3 Mon	0.12%	0.16%
ICE US T-Bond 7-10 Year	-4.00%	-10.53%
BBgBarc US MBS (Mortgage-backed)	-3.98%	-8.78%
BBgBarc Municipal	-2.77%	-8.98%
BBgBarc US Corporate Invest Grade	-7.16%	-14.39%
BBgBarc US Corporate High Yield	-9.78%	-14.19%

Source: YCharts

Third Quarter Market Outlook

The market headwinds of high inflation, sharply rising interest rates, growing recession risks and extreme geopolitical uncertainty pushed both stocks and bonds sharply lower through the first six months of the year. While the volatility and market declines of the first six months of 2022 have been unsettling and painful, the S&P 500 now sits at much more historically attractive valuation levels. And at current prices, a lot of negativities have been priced into the market, opening the possibility of positive surprises as we move forward in 2022. Opportunities continue to present themselves daily during this downturn. Our view is to use the volatility as a friend instead of a foe. Our primary focus at this point is positioning for an effective recovery.

At Capital Investment Services, we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. Successful investing is a marathon, not a sprint. It’s critical for you to stay invested, remain patient, and stick to the plan.

We understand that the first 6 months of 2022 have been challenging. However, it is essential to remain objective amid the volatility. Rest assured that our entire team remains dedicated to helping you successfully navigate this market environment. Please do not hesitate to contact us with any questions or to schedule a portfolio review.

Sincerely,

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