Cambridge ADVISORS inc.
INVESTMENT MANAGERS

INVESTMENT PERSPECTIVE JUNE 2022

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MARKET COMMENTARY

Stocks had their worst first half of the year performance since 1970; and a balanced portfolio of 60% stocks and 40% bonds had its worst first half performance ever. Large cap stocks in the S&P 500 fell -16.10% during the quarter and finished near bear market territory with a -19.96% loss for the first half of 2022. Small cap stocks in the Russell 2000 Index lost -17.20% in the quarter and -23.43% year-to-date. International stocks also had losses; developed market stocks were down -14.51% for the quarter and -19.57% for the half while emerging market stocks were down -11.45% for the quarter and -17.63% year-to-date. Bond returns also suffered as yields continued to surge. The Barclays U.S. Aggregate Bond Index was down -4.69% for the quarter bringing its year-to-date return down to -10.35%.

No sector was spared from negative returns this quarter. Energy is still up 31.8% year-to-date but no other sector has had a positive return on a year-to-date basis. Utilities and consumer staples were the next best performing sectors but had losses of -0.6% and -5.6% respectively for the first half. After years of outperformance, growth has struggled the most in 2022 with the consumer discretionary, communication services and technology sectors recording losses of -32.8%, -30.2% and -26.9% respectively. Unfortunately, these sectors are some of the biggest weightings in the S&P 500.

Investors have been trying to figure out whether we are in a recession, going into a recession or if we will escape a recession. First quarter US GDP growth was -1.6%. Recently, analysts have been revising second quarter estimates lower. If second quarter GDP growth ends up being negative (as the Federal Reserve Bank of Atlanta is now projecting), we would satisfy the definition of two consecutive quarters of negative growth. Other analysts acknowledge that recession risks are increasing but say we may avoid a recession due to pent up demand, higher wages and a very low unemployment rate. David Kelly, chief strategist at JPMorgan, still has positive growth projected for second quarter but says the risks pick up in the third quarter. However, he notes that if we do have a recession, he would expect it to be mild.

In November, the US inflation rate reached its highest level in 40 years. Since then it has continued to rise and as of May has been running at a year-over-year rate of 8.6%. Some of the inflation is transitory as it is unlikely that oil prices will continue to have the same year-over-year increase. Inflation pressures should also ease as supply chain disruptions are worked through. The Fed uses the PCE Core Deflator (which excludes the volatile food and energy components) as its inflation measure and that measure has been declining since peaking in February. Some other areas of inflation such as rent equivalents and wages could be more structural and result in stickier inflation that lasts longer. Commodities have been the worst performer over the past fifteen years but the Bloomberg Commodity Index had gains of 27% in 2021 and is up 18% so far in 2022. Commodities have been a hedge against inflation in past periods of high inflation which may explain their recent attraction by investors.

Corporate earnings growth is also expected to slow this year. According to Zacks Investment Research, current projections are for 2.5% year over year growth for second quarter and full year earnings growth of 9.2%. The energy sector is responsible for the growth—if energy was excluded, second quarter earnings would be projected to be down -4.8% and up

2022 BENCHMARK RATES OF RETURN

INDEX	SECOND QUARTER	YTD
S&P 500	-16.10%	-19.96%
Russell 2000	-17.20%	-23.43%
International	-14.51%	-19.57%
Fixed Income	-4.69%	-10.35%
JPMorgan Diversified*	-10.88%	-15.50%

*25% S&P 500 large cap stocks,10% Russell 2000 small cap stocks, 15% MSCI EAFE international stocks, 5% MSCI EME emerging market stocks, 5% REITs, 25% Barclays US aggregate bonds, and 5% each in short term Treasuries, high yield global bonds, and commodities.

We value our relationship with you, and we are always available to meet with you in person or by phone. Please do not hesitate to call or email us with any questions that you may have. Also, if your situation has changed, please contact your advisor so we can determine if any changes are needed in your account.

just 3.8% for the full year. Some earnings estimates have been revised lower but Zacks questions if it has been enough to reflect the growing concerns of a recession and aggressive Fed tightening cycle.

At its March meeting, the Fed announced its first interest rate hike since December 2018 and raised the Fed Funds rate 25 basis points. In May they raised by 50 basis points and in June, they raised another 75 basis points. The June increase was the largest interest rate hike in 28 years (since 1994). The 10-year Treasury bond yield rose from 2.33% at the end of March up to nearly 3.5% in mid-June before falling back to 2.97% at the end of the quarter. This resulted in negative returns for the Aggregate Bond Index as declines in bond prices greatly outweighed the interest earned on bonds. The Fed is planning additional rate hikes until the Fed Funds rate is at 3.25%-3.5% at year end. They expect the Fed Funds Rate to be 3.75% to 4% by the end of 2023. If longer-term yields don't follow, we could see the yield curve invert (which can be a signal of a coming recession). Some analysts believe that these increases are too aggressive and think the Fed will actually start to cut rates next year in an attempt to head off a recession. With rising yields, bonds will not likely be a safe haven for the rest of 2022 but bond investors may have an attractive buying opportunity to lock in higher yields in early 2023.

Stocks are likely to remain volatile in 2022 as recession fears, inflation concerns, rising interest rates and the Russia/Ukraine conflict continue. Strategas notes that of the conditions found near a market low, we've only met 4 of 9 and we've not met signs of a durable rally. It is a mid-term election year and current projections are that Republicans will retake the house and senate resulting in a split government. With division, it will be more difficult to pass legislation such as increases in taxes or sweeping green energy reforms. The markets tend to respond favorably to gridlock as some uncertainty is erased.

Investors may need to look to new or non-traditional methods to reduce risk in portfolios. Short-term bonds will adjust faster than long-term bonds to higher yields so reducing duration of a bond portfolio is one strategy. We also continue to explore opportunities in newer asset classes. "Target outcome" or "buffer" ETFs allow investors to take part in stock market appreciation but also provide some protection if stock prices fall. Adding asset classes such as commodities and digital currency can also reduce risk through diversification. Digital currency is growing in popularity and becoming more accepted both as a currency and an investment and it has had low correlation to other asset classes. As a risk asset, it has sold off greatly during the quarter. Structured products may also provide opportunities to earn a higher income stream than available in bonds for investors who can withstand some risk.

We continue to encourage investors not to try to time the market or chase returns but to align your investment portfolio with your risk tolerance. We use Riskalyze software to help us measure your risk tolerance so we can help ensure you have the appropriate risk in your accounts. We compare your risk score to the risk score of your investment portfolio to see if adjustments might be necessary. If you are unsure about the risk in your portfolio or have any questions, please talk to your advisor.

Question: Should I convert my traditional IRA to a Roth IRA?

With the market down nearly 20%, now may be a good time to convert a traditional IRA to a Roth IRA. By doing so, the recovery from market lows would be captured in an account where no tax will ever be due on the gain. Other factors to consider include your current and future expected tax brackets, age and life expectancy, and resources available to pay the tax due on the conversion. If you would like to explore this option, please consult with your advisor. We have software that helps us evaluate and compare your options.

CAMBRIDGE ADVISORS NEWS

In our industry, consolidation is a continuing trend but we believe it is in our best interests and our clients' best interests to remain independent at this time. We believe the way we do things is best in class with the systems we use, the people we have and the services we provide, and we want to continue moving forward and remain in control of our future.

Thank you for the trust you place in Cambridge Advisors. It's the people we serve that make us want to keep working and growing and striving to find more and better ways to help you reach your financial goals. We value our relationships with each of you and we appreciate the referrals you have made to us so that we can help your family, friends and others who are important to you. If you know someone who could benefit from our services, please do not keep us a secret!

As a reminder, Cambridge Advisors is fully open and meeting with clients in person. We can also participate in video chat meetings if you prefer.