SUMMIT FINANCIAL

Investment Newsletter

July 2022

The recent GDP release marked the second consecutive quarter of negative growth. This intensified the debate about whether the U.S. is in a recession. Putting aside the technical declaration of a 'recession', the unusual circumstances of the pandemic and the subsequent government response make this a cycle unlike any other. Although some economic factors are either in or moving towards a recessionary direction (yield curve inversion, pace and magnitude of fed funds rate increases), the labor market remains robust and there are limited areas of clear excess in the economy. The rates market quickly digested the recent GDP data as support for the Fed to pivot its hiking schedule sooner than anticipated. This was evidenced by the 10-Year treasury yield going from ~3.5% to ~2.7% in just 33 trading days. Risk assets also rallied, benefiting from lower rates and the anticipation of less restrictive financial conditions in the future.

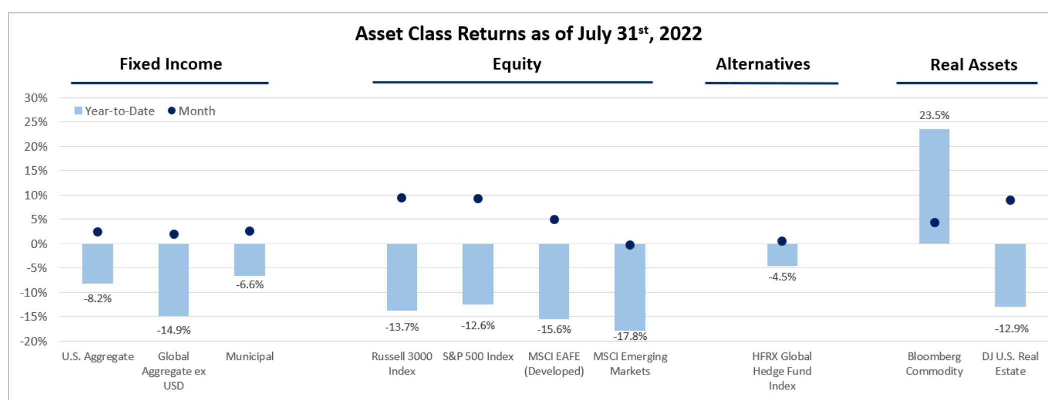
There are numerous signs that the economy is slowing from its COVID-based recovery. While CPI may have peaked, June's 9.1% reading was the highest level since 1981. Purchasing Managers Indexes (PMIs) for both manufacturing and services are well below peaks reached in mid-to-late 2021, with early indications that they could fall into contractionary territory in future months. The pace of home price increases has come down after an incredible run from 2020 onwards. Amongst a dynamic economic backdrop, the Fed proceeded with another 75-basis point rate increase in July – quelling fears that a larger magnitude hike was possible. This brought the fed funds upper bound to 2.5%, a far cry from near-zero levels from earlier this year.

Despite slower growth domestically, things are perhaps more worrisome overseas. In Europe, similarly elevated inflation figures triggered the first European Central Bank (ECB) rate hike in over a decade. Besides tightening financial conditions, the region also faces political uncertainty (collapse of the Italian government), a weakening currency (USD/Euro parity), and a looming energy crisis (uncertain Russian natural gas and oil supplies). The looming energy crisis could be particularly impactful to manufacturing-oriented economies like Germany, where a significant rise in energy costs would make them less competitive. All these factors intensify recessionary risks for Europe. Areas of Asia also have unique headwinds to cope with. The Bank of Japan (BoJ) has been one of the few developed market central banks to stay committed to accommodative monetary policy. These actions have contributed to the yen reaching its lowest level against the U.S. dollar since the late 1990s. China continues to grapple with severe COVID restrictions and is working through areas of excess within the property market. That said, Chinese policymakers are likely to employ more supportive economic measures when many other nations are doing the opposite.

Equities shrugged off disappointing economic data in the hopes that the Fed and other major central banks wouldn't need to employ as restrictive tightening measures to fend off inflation as once feared. In the U.S., the S&P 500 Index had its best month since November of 2020. Small-caps and growth stocks bucked their trend of relative underperformance versus large-caps and value shares, respectively. The best performing sectors over the month (consumer discretionary, IT) included those that were among the bottom performers year-to-date. International equities also rose, but to a lesser degree than their U.S. counterparts. One exception is emerging market equities which were roughly flat for the month and were dragged down by the difficult performance of Chinese equities. Valuations have bounced off recent lows but remain well under highs from last year. In particular, non-U.S. equity market valuations are towards the lower end of recent history but come with additional risks.

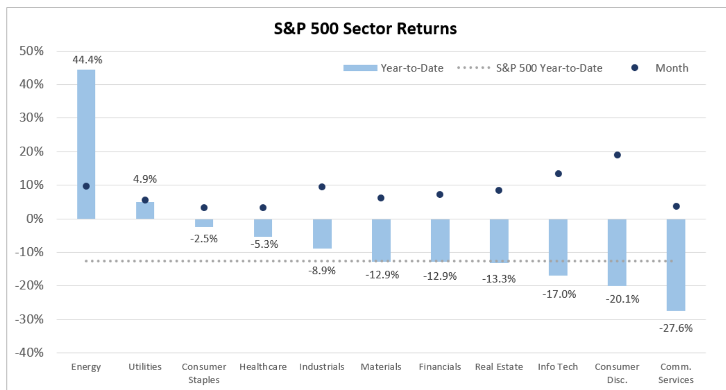
Fixed income assets performed favorably, benefiting from both lower rates and tighter spreads. A risk-on sentiment helped credit-sensitive assets outperform, although most areas of the fixed income market generated a positive return. The treasury yield curve became more inverted with rising short-term yields and flatter long-term yields. A recovery in municipals has diminished their relative value compared with treasuries, although portions of the curve still offer compelling risk/rewards. Limited new supply over the summer months should also continue to support the municipal market.

Heading into August, recessionary risks are front and center on investors' minds. While the headlines are daunting, it's important to maintain a balanced view of economic conditions. The Fed appears to be making progress in its effort to limit growth to combat inflation, labor markets are still supportive, and there are few areas of excess in the economy. Asset markets are also forward-looking and to some extent, much of the recessionary risks may already be priced in. Additionally, the unusual circumstance of this cycle makes underwriting the future path of economic conditions more challenging than ever. As a result, it's essential to ensure that your portfolio is well aligned with long-term goals to protect against both downside and upside risks to the economy and markets.

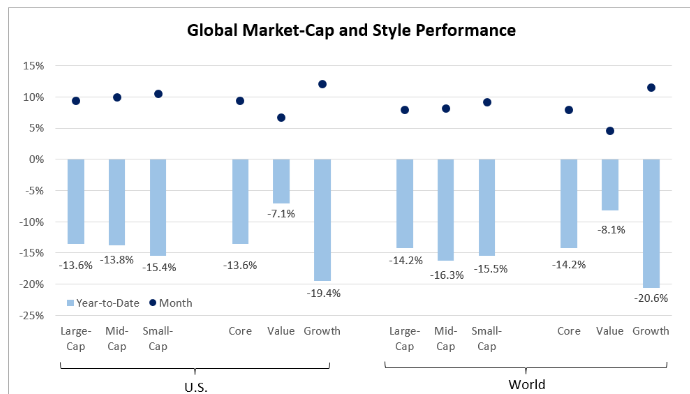


Morningstar & Hedge Fund Research, Inc.; Bond indices from Bloomberg

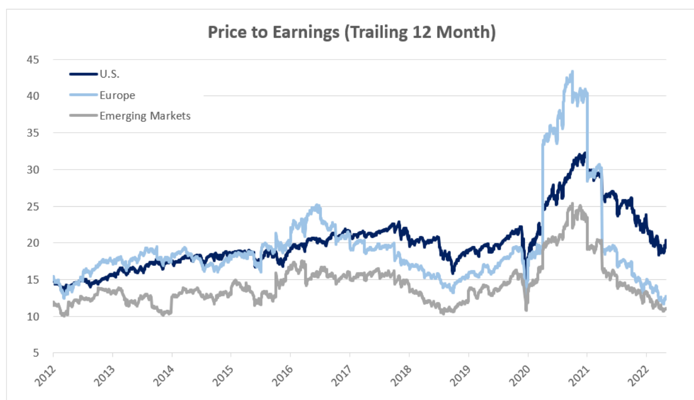
08052022-0576



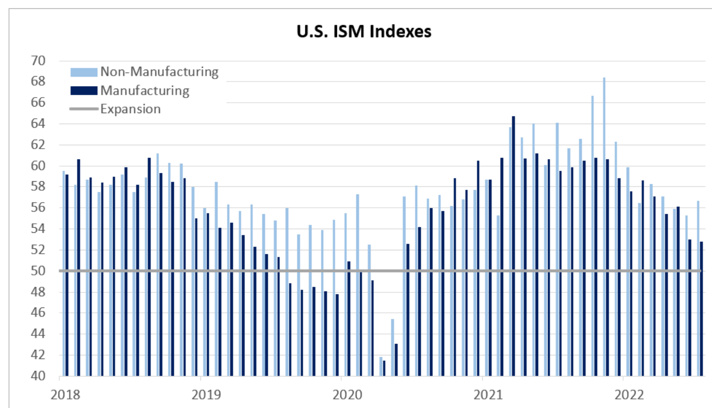
Bloomberg



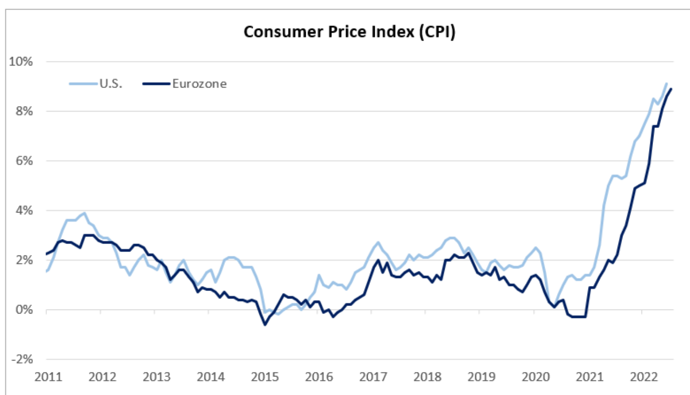
Bloomberg; U.S. indices from Russell and world indices from MSCI



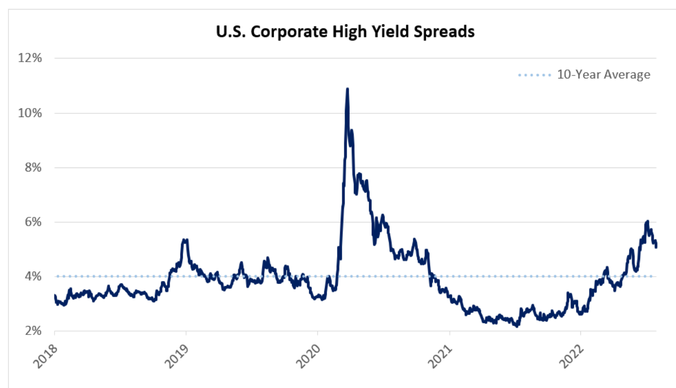
Bloomberg



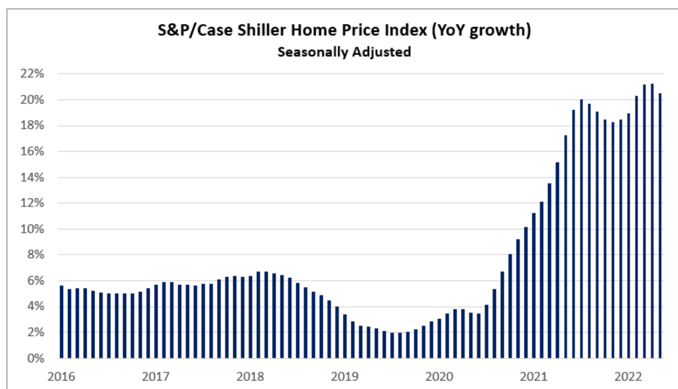
Bloomberg



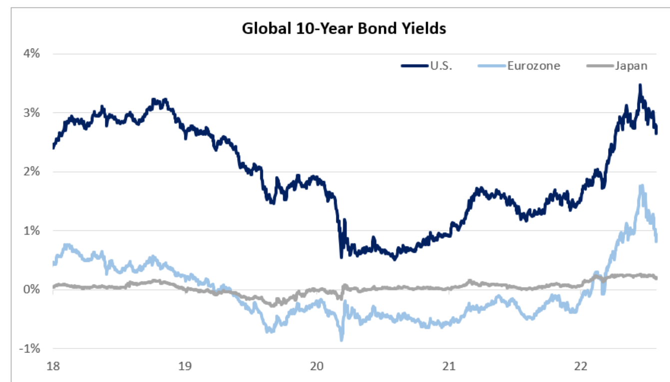
U.S. Bureau of Labor Statistics



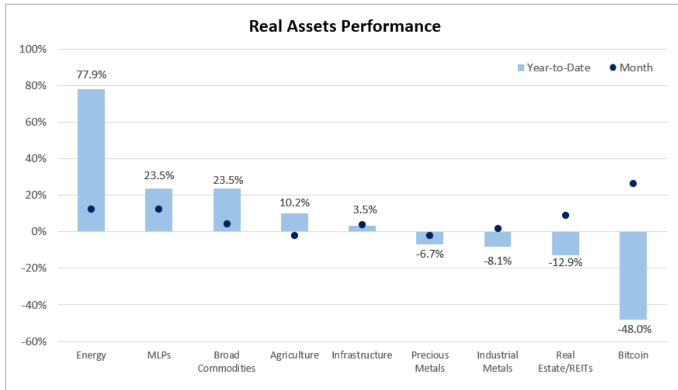
Bloomberg



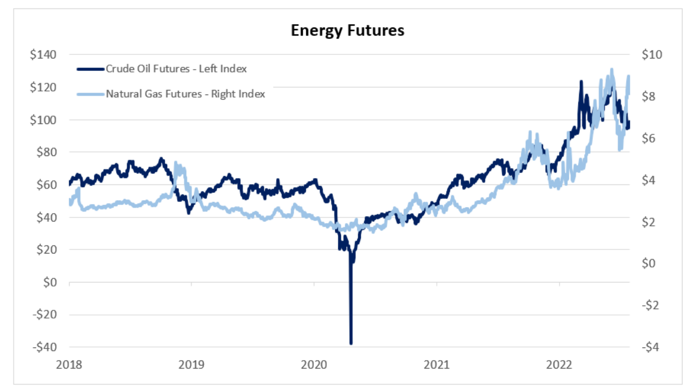
S&P / Case Shiller



Bloomberg



Bloomberg



Bloomberg

Disclaimer

This commentary was written by Craig Amico, CFA®, CIPM®, Associate Director of Investment Management, Noreen Brown, CFA®, Deputy Chief Investment Officer, and Steven Melnick, CFA®, Associate Director of Investment Management at Summit Financial, LLC., an SEC Registered Investment Adviser ("Summit"), headquartered at 4 Campus Drive, Parsippany, NJ 07054, Tel. 973-285-3600. It is provided for your information and guidance and is not intended as specific advice and does not constitute an offer to sell securities. Summit is an investment adviser and offers asset management and financial planning services. Indices are unmanaged and cannot be invested into directly. The Russell 3000 Index measures the performance of the largest 3,000 U.S. companies representing approximately 98% of the investable U.S. equity market. The Russell 3000 Index is constructed to provide a comprehensive, unbiased and stable barometer of the broad market and is completely reconstituted annually to ensure new and growing equities are reflected; The Russell 2000 Index measures the performance of the small cap segment of the U.S. equity universe. It is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership; The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000 Index representing approximately 90% of the total market capitalization of that index. It includes approximately 1,000 of the largest securities based on a combination of their market-cap and current index membership; The Russell Midcap Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap Index is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The Russell Midcap Index represents approximately 31% of the total market capitalization of the Russell 1000 companies; the S&P 500 Index is a market capitalization-weighted Index of 500 widely held stocks often used as a proxy for the stock market. It measures the movement of the largest issues. Standard and Poor's chooses the member companies for the 500 based on market size, liquidity and industry group representation. Included are the stocks of eleven different sectors; the MSCI EAFE Index (Europe, Australasia, Far East) captures large- and mid-cap representation across developed markets countries around the world excluding the U.S. and Canada. The index covers approximately 85% of the free float-adjusted market capitalization in each country; the MSCI Emerging Markets Index captures large- and mid-cap representation across emerging markets countries across the world. The index covers approximately 85% of the free float-adjusted market capitalization in each country; The MSCI World Index captures large- and mid-cap representation across developed markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country; the Bloomberg Commodity Index reflects commodity futures price movements and is calculated on an excess return basis. The index rebalances annually weighted 2/3 by trading volume and 1/3 by world production, and weight-caps are applied at the commodity, sector, and group level for diversification. Roll period typically occurs from the 6th-10th business day based on the roll schedule; the Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency); the Bloomberg Barclays Global Aggregate Ex U.S. Index is a measure of investment-grade debt from twenty-four local currency markets. This multi-currency benchmark includes Treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers. Bonds issued in U.S. dollars are excluded; the Bloomberg Barclays Municipal Bond Index covers the U.S. dollar-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds; the Dow Jones U.S. Real Estate Index measures the performance of real estate investment trusts (REITs) and other companies that invest directly or indirectly in U.S. real estate through development, management, or ownership, including property agencies; The Bloomberg Barclays U.S. Corporate High-Yield Index measures the U.S. dollar-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded; The HFRX Global Hedge Fund Index is comprised of funds representing the overall hedge fund universe. Constituent funds include but are not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, even driven, macro, merger arbitrage, and relative value arbitrage. The underlying strategies are asset weighted based on the distribution of assets in the hedge fund industry; The S&P Case-Shiller Home Price Index measures the value of single-family housing within the U.S. The index is a composite of single-family home price indices for the nine U.S. Census divisions. Leading economic indicators (LEI) are statistics that precede economic events. They predict the next phase of the business cycle. The OECD Composite leading indicators (CLIs), designed to anticipate turning points in economic activity relative to trend, continue to strengthen in most major economies. The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The Consumer Confidence Index is a measure based on a survey administered by The Conference Board that reflects prevailing business conditions and likely developments for the months ahead. This monthly report details consumer attitude, buying intentions, vacation plans and consumer expectations for inflation, stock prices and interest rates. A Treasury Bill (T-Bill) is a short-term U.S. government debt obligation backed by the Treasury Department with a maturity of one year or less. The ISM manufacturing index, also known as the purchasing managers' index (PMI), is a monthly indicator of U.S. economic activity based on a survey of executives covering all North American Industry Classification System's businesses in the manufacturing sector. The ISM Non-Manufacturing Index is a monthly indicator of U.S. economic activity based on a survey of executives covering all North American Industry Classification System's businesses in the services (or non-manufacturing) sector. Data in this newsletter is obtained from sources which we, and our suppliers believe to be reliable, but we do not warrant or guarantee the timeliness or accuracy of this information. Consult your financial professional before making any investment decision. Past performance is no guarantee of future results. Diversification/asset allocation does not ensure a profit or guarantee against a loss. Economic and market forecasts presented herein reflect our judgment as of the date of this presentation and are subject to change without notice. These forecasts are subject to high levels of uncertainty that may affect actual performance. Accordingly, these forecasts should be viewed as merely representative of a broad range of possible outcomes. These forecasts are estimated, based on assumptions, and are subject to significant revision and may change materially as economic and market conditions change. These forecasts do not take into account the specific investment objectives, restrictions, tax and financial situation or other needs of any specific client.