The CFO 2022 Third Quarter Market Outlook

Most all major global stock markets fell sharply during the second quarter of 2022. All sectors of the MSCI ACWI (All Country World Index) declined during Q2, accelerating a broad selloff that commenced shortly after the start of 2022. Rising inflation, higher interest rates and the war in Ukraine combined with slowing global economic growth and fears of potential recessions to push the U.S., Europe and Japan into bear market territory. The S&P 500 Index of U.S. stocks fell -16.5% in the second quarter and -20.6% for 2022 through June, experiencing its worst first half of any year since 1970. The Willshire 5000 Index and Nasdaq composite faired even worse, ending June 2022 down -21.5% and -29.5% respectively. If there is any glimmer of hope looking forward to the rest of 2022, it is that after quarterly declines of -15% or more, the S&P 500 Index has historically rebounded by a median of +13% over the next two quarters and by a +25.1% median gain over the next 12 months. While those historical statistics from Ned Davis Research are encouraging, this time could be different. The main driver for the decline in stock prices through June was multiple compression, but consensus estimates for corporate earnings now face further downside risks from slowing economic growth and tightening financial conditions.

Index Returns for Asset Classes & Broad Market Index Averages (1)	2nd Quarter 2022	2022 YTD
30-Day US Treasury Bills	0.28%	0.36%
Barclays Long-Term US Treasury Bond	-11.93%	-21.25%
Bloomberg US Aggregate Bond Index	-4.69%	-10.35%
S & P 500 Composite Price Index	-16.45%	-20.58%
Dow Jones Industrials Price Index	-11.25%	-15.31%
Wilshire 5000 Total US Stock Mkt Index	-17.11%	-21.49%
MSCI EAFE Index of Foreign Markets	-14.51%	-19.57%
MSCI Emerging Markets Index	-11.34%	-17.47%
MSCI Europe Index	-14.49%	-20.79%
MSCI Japan Index	-14.63%	-20.27%
MSCI China Index	3.41%	-11.26%
SPDR GOLD Shares [GLD]	-6.54%	-0.37%
US Dollar ETF [UUP]	6.27%	9.07%
S & P GSCI (Commodity) Index	-2.07%	26.38%
(1) Source: MORNINGSTAR		

What has made 2022 challenging like 2008, as our table of the broad asset categories and financial market indices clearly shows, is that there have been few places to hide. The bond markets around the world tumbled as the Federal Reserve, the Bank of England and other central banks acted to tighten monetary policy. The Bloomberg US Aggregate Bond Index fell -10.4% during the first half, which is the worst annual start for the index since the data began in 1981. With inflation rising to levels not seen since the 1980s, the Fed increased its key interest rate by 50 basis points in May and then another 75 basis points at its June meeting — the largest single rate hike by our U.S. central bank since 1994. And inflation continues to march higher as the CPI jumped another +1.3% in June, the most since 2005 and the second most since early 1980. On an annual basis, headline CPI hit +9.1%, a new high since 1981, which promises to keep the Fed on its aggressive tightening path and likely to increase interest rates another 75 basis points at its upcoming July 2022 meeting. Only the US Dollar, US Treasury Bills, and Commodities provided any shelter from the global stock and bond market carnage that has occurred during 2022. The U.S. Dollar Index was the top asset class in Q2. The war in Ukraine, slowdown in European economic activity, and shutdowns in China spurred a flight to safety into the greenback. US T-bills "appreciated" 0.3% in Q2, but the highest inflation in over 40 years really means that the real return was about -3%, the lowest since Q3 of 1947 [NDR]. For the first six months of 2022, commodities were the best asset class rising +26.4%, despite plunging -9.8% in June. Bitcoin was the worst performing "asset", crashing -58% through June 30.

The CFO 2022 Third Quarter Market Outlook [continued]

We wrote to our investors in our 2021 year-end report and again in our 2022 Q1 report: "*In short, inflation is **the** economic issue of 2022, and while the Fed has seemingly turned more "hawkish", we can only hope that they have not waited too long and that they can engineer the ever sought-after "soft landing"*. All eyes are trained on Fed policy actions as we move through 2022. Recent reports of economic data have confirmed that inflationary pressures have remained stubbornly higher and more persistent than most economists and analysts forecasted, believing that once the U.S. and global economy reopened from the COVID-19 pandemic, global production and supply chains would revert to pre-pandemic levels in a short period of time. That has simply not been the case. We have said that engineering a soft landing is a difficult policy outcome to achieve, and that the Fed needed to tighten quickly enough to keep long-dated inflation expectations anchored, but not so fast that the Fed tightening efforts would drive the U.S. economy into recession. We believe the Fed was late in launching tightening measures, including raising interest rates, and is "behind the curve". We expect the Fed to keep raising rates aggressively throughout 2022, with the Fed Funds rate peaking in mid-2023.

The primary issue right now for investors is whether the Fed and other global central banks can reduce inflation materially without triggering an economic recession. The expectations for a recession in the U.S. and Europe, however, have continued to escalate in recent weeks, reflecting the negative impacts of elevated inflation and the expected ongoing policy tightening by global central banks. The Conference Board's Leading Economic Index (LEI) fell -0.8% in June, its fourth consecutive decline, and down in five of the past six months. The actual LEI was also worse than the consensus forecast for a -0.5% decline that resulted from several factors including: Falling consumer optimism about future business conditions, the pickup in jobless claims, the decline in stock prices, and the shrinking new factory orders. Since 1969, the LEI has peaked a median of ten months ahead of a recession, and the LEI peaked in February, which raises the risk of a recession as soon as late 2022. Most recently, the S&P Global Flash U.S. Composite PMI dropped -4.8 points in July to 47.5, the lowest level since May 2020, as private sector activity shrank, with output declining in both services and manufacturing. The report also noted that the loss of momentum across the economy was the worst since 2009, excluding the pandemic. Along with the recent deterioration in leading indicators, business confidence regarding the growth outlook fell to its lowest level since September 2020 on worries about the impact of inflation and potential recession concerns [NDR].

In the short-term, the financial markets will be on recession watch. Any weaker-than-expected economic data or declines in energy and copper prices, and/or a sustained inversion of the yield curve would all be interpreted as evidence that a recession is coming. Please review the chart from Ned Davis Research on the following page where NDR assigns **only** a 20% probability that the Fed "pivots correctly" with its ongoing tightening policies to avoid a recession. While we agree that the "goldilocks" outcome is very unlikely, we also think that the odds for the "Too Hot" versus "Too Cold" scenarios should be reversed, because we believe that there is a greater than 50% probability that we are in a short-lived bear-market rally that will end within the next 4 to 8 weeks during Q3 of 2022. In summary, the investment landscape will remain very difficult in Q3 until the outlook for inflation and growth become clearer, and this economic backdrop argues for a cautious investment strategy in the near term. We remain very data-dependent and will alter investment and allocation policies as economic conditions warrant.

Please do not hesitate to call us directly with any questions that you may have about your portfolio strategy for your accounts.

The CFO Capital Management Team, July 25, 2022

30% too hot, 50% too cold, 20% just right

Jay Powell and the Three Bears

Scenario	Odds	Short Description	Market Direction	What to Watch
Too Hot	30%	Inflation stays high, Fed tightens, forces recession in 2022	Bear resumes in early in 2H	Supply chains, geopolitics, labor market
Too Cold	50%	Inflation moderates, Fed slows pace, economy falls into recession in 2023	Bear rally in 2H, then bear resumes into 2023	Inflation expectations, yield curve, commodity prices, Growth/Value
Just Right	20%	Fed pivots correctly, avoids recession	Bear close to over	Investor sentiment, breadth thrusts

Ned Davis Research T_SSF22_28.1