ARIES
WEALTH MANAGEMENT

July 2022

The first half of 2022 has been one of little reprieve for the markets. As of June 30th, global equities, as measured by the MSCI All Country World Index, were down almost 16% for the second quarter and approximately 20% year-to-date. Fixed income markets have offered little protection, as we will discuss further below.

Interest Rates & Inflation

Movements in the prices of fixed income securities is driven by changes in underlying interest rates, which are impacted by growth rates and inflation levels. As we have discussed in previous communications, interest rates have steadily increased over the past twelve months. Additionally, inflation has been sticky and has remained elevated, which has largely caused this sharp rise in interest rates. This has led to higher rates for mortgages, consumer loans, and corporate borrowing. Over the past twelve months, the national 30-year mortgage rate has risen from sub-3% to over 5.5%. The rise in rates has also impacted the fixed income markets, with the Bloomberg U.S. Aggregate Bond index was down almost 5% for the quarter and 10% year-to-date. This has created a challenging first half for a balanced and diversified portfolio.

These inflation dynamics have left the Federal Reserve with two unattractive options: 1) aggressively tighten monetary policy and likely force a U.S. (and possible global) recession, or 2) continue to support the economy but risk elevated and potentially increasing inflation, causing more pain for consumers. While the Fed cannot control the supply issues with commodities such as oil, raising interest rates will impact demand. While it takes time for the tightening to filter into economic activity, commodity prices will likely decline, albeit with lower equity prices (as we have experienced) and lower economic growth (ongoing).

According to the Atlanta Fed's forecast, second quarter GDP growth is expected to decline by approximately 2%, which follows the reported first quarter decline of 1.6%. If second quarter estimates become reality, this would represent a technical recession. However, the pain associated with recessions has likely yet to be experienced, as employment remains tight and job losses few (albeit growing).

Looking forward, there are several additional factors to consider.

Earnings Estimates

Earnings estimates, which tend to be correlated with stock prices, remain elevated. According to Factset, as of July 1st the expected earnings growth for S&P 500 companies in 2022 has *increased* to 10.2% from 9.6% at the end of the first quarter. We would expect that either the stock market will rise to reflect the higher underlying profits generated by these companies, *or* these estimates are inflated and earnings will come down due to higher labor costs and lower revenue growth due to the slowing economy.

Volatility

As shown in *Figure 1*, the VIX, a measure of anticipated future stock market volatility, has steadily trended upward over the past twelve months. While we have yet to see this spike to levels consistent with specific event-driven bouts of volatility in the past (i.e., Covid drawdown), the bear market bounces have been brief and have done little to provide any extended relief over the first six months of the year.

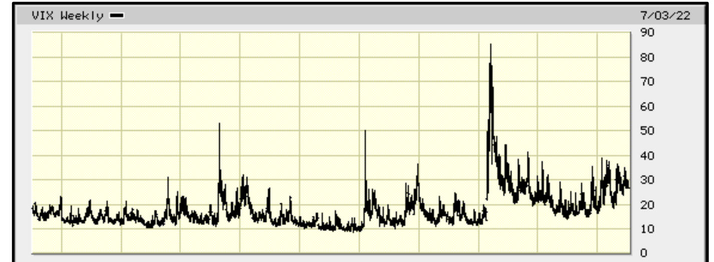

Figure 1 – VIX
Source: bigcharts.com

Sentiment

Investor sentiment remains heavily bearish when looking across media outlets, polls, and publications. At times, this can serve as a reliable contrarian indicator that has marked short- or long-term bottoms in markets. *However*, investor positioning is not consistent with many of these headlines. As shown in *Figure 2*, investor equity positioning (as a percentage of total balance sheet) remains just below short-term highs and materially higher than historical trends. This bears watching in the coming weeks and months.

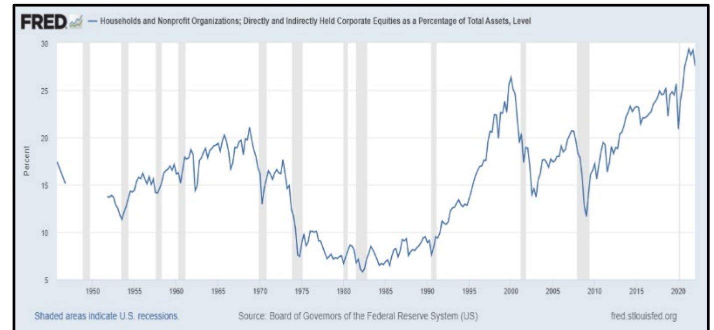

Figure 2 – Investor Equity Positioning
Source: fred.stlouisfed.org

As with all historical bear markets, time horizon and risk management remain crucial elements of prudently managing portfolios and wealth plans. Attractive opportunities have and will continue to present themselves as a result of these drawdowns. More importantly, constructing and revisiting your long-term cash flow and wealth plan *prior* to bear markets has put many at ease and leads to more constructive personal results. Lastly, as we intently focus on after-tax results, we will continue to harvest losses in portfolios *throughout* the year to facilitate efficient tax planning (depending on your personal situation).

We hope you have a wonderful summer and look forward to connecting soon.

- Jason, Micah, Victoria, & Tim