Beacon Trust
INNOVATING WEALTH STRATEGY

July 11, 2022

Beacon Weekly Investment Insights

Last week saw equity indices gain some ground, with the S&P 500 closing the short week up 1.9%. In last week's insights piece, we noted that the focus from a macroeconomic perspective has more recently shifted from the persistently high levels of inflation to slowing economic growth, with projections for 2nd quarter GDP now in negative territory. As the focus has shifted more towards concerns over slowing growth, high quality companies with strong cash flows and balance sheets that display above-average growth have performed better on a relative basis as of late. Investors tend to refocus on more growth oriented and high quality companies when slowing economic growth becomes a dominant concern. To that end, the tech heavy Nasdaq also finished the week in firmly positive territory, increasing by 4.6% for the week, meaningfully outpacing the S&P 500. We also noted last week that the difference between the yields on the 2-year and 10-year treasury continued to narrow, getting closer to inverting (the 2-year yield moving above the 10-year yield). The strong jobs report released last Friday (which we discuss in more detail below) served to increase treasury yields. The 2-year treasury yield increased the most, moving up to 3.11%, and did in fact move above the 10-year treasury yield of 3.08%.

As we have discussed in past write-ups, yield curve inversions are a closely watched potential indicator of a recession. Although not every yield curve inversion leads to a recession, every recession since 1955 (with one exception) has been preceded by an inverted yield curve. The expectation for the Fed to continue to aggressively increase short-term interest rates off the back of a strong jobs report and in an effort to combat high inflation, has led to this inversion of the 2-year and 10-year treasury yield curve. Although the difference between the 2-year treasury yield and the 10-year treasury yield is a popular measure for the yield curve, we believe that the difference between the yield on the 3-month treasury and the 10-year treasury is a more reliable measure on this front. This yield curve is not inverted, with the 3-month yield currently at 1.88% vs. 3.08% for the 10-year yield. In addition to this measure being included in the LEI (Leading Economic Indicators) Index which we closely follow, it is more indicative of the difference between what banks pay to depositors vs. what they earn on longer-term loans. Banks are not inclined to make loans/provide liquidity if the rate they receive on those loans is lower than the rate that they pay to depositors. Although not currently the case, it is not unlikely that this yield curve will invert if the projected path of interest rate hikes by the Fed comes to fruition.

If the yield curve inversion does in fact end up being a reliable indicator of a recession, there is typically a significant lag from the time the yield curve inverts, to the onset of a recession. The lag time has averaged about 22 months, and ranges anywhere from 6 months to up to 3 years. Furthermore, forward 1-year returns for the S&P 500 tend to be quite good following a yield curve inversion. The 1-year price return for the S&P 500 index was positive for 6 out of the last 8 yield curve inversions (as measured by the spread between 2-year and 10-year yields), with an average return of 11.5%. Likewise, forward 1-year returns have also been strong following a 20% drop from a market high. The S&P 500 has an average forward 1-year return of 15% in the seven times that stocks have dropped by 20% since 1957. As we have noted in the past, the S&P 500 has already entered bear market territory this year with a peak to trough drop of more than 20%. This, along with the significant volatility we have experienced on a day-to-day basis this year, continues to underscore the hazard in attempting to try and time markets. In the face of this market decline, we continue to espouse a diversified portfolio that is appropriate based on our client's specific goals and objectives, continuing to maintain sufficient cash balances to meet upcoming needs, and a long-term methodical approach to investing.

Factory Orders data was released last Tuesday with the report showing that new orders for U.S. manufactured goods increased more than expected in May, increasing by 1.6% after a 0.7% increase in April, and coming in ahead of expectations for a 0.5% increase. Last week also saw the release of the ISM Services index data, which did move slightly lower to 55.3 for June from 55.9 in May. However, the number came in above expectations of 54.3, and continues to point to growth in the services sector with a reading firmly above 50. The meeting minutes

from the June Fed meeting were released last Wednesday, which reaffirmed the focus on combating higher and more entrenched inflation via interest rate hikes. The Fed did not make mention of recession in their minutes. We also saw a variety of jobs data released last week, including job openings and the Labor Department's June payrolls report. The job opening's data showed 11.3 million job openings in May, which was down from 11.7 million in the prior month, but above forecasts for 11.3 million.

Following a number that came in above expectations in May, the June payrolls report released last Friday likewise showed an upside surprise for the month. Job creation came in above expectations with 372,000 jobs added in June, vs. the estimate of 265,000 jobs. The unemployment rate remained steady at 3.6%, where it has been for the last 3 months. An often cited technical definition for a recession is two successive quarters of negative GDP, which we may see with the upcoming 2nd quarter GDP report expected to be negative, after what was a negative print for the first quarter. Despite this, the jobs data continues to underscore a tight labor market with a steadily low unemployment rate, which stands in contrast to the mounting concerns over a recession. The labor force participation rate did decline to 62.2% from 62.3%, despite the expectation for this figure to increase in the June report. Average hourly earnings increased 0.3% for the month, in line with expectations. All in all, it was a solid jobs report that likely keeps the Fed on track to increase interest rates by another 0.75% at the July meeting. To that end, the futures market showed a 97% probability of a 0.75% interest rate increase in July subsequent to the release of the jobs report.

Inflation measures will come back into view for this week, with both the CPI (consumer price index) and PPI (producer price index) reports due out on Wednesday and Thursday, respectively. In addition, retail sales data, the Empire state manufacturing and Industrial production indices, as well as the University of Michigan consumer sentiment index data are all due out on Friday.

Market Scorecard:	**7/8/2022**	**YTD Price Change**
Dow Jones Industrial Average	31,338.15	(13.76)%
S&P 500 Index	3,899.38	(18.19)%
NASDAQ Composite	11,635.31	(25.63)%
Russell 1000 Growth Index	2,307.19	(24.97)%
Russell 1000 Value Index	1,449.76	(12.44)%
Russell 2000 Small Cap Index	1,769.36	(21.20)%
MSCI EAFE Index	1,849.48	(20.83)%
US 10 Year Treasury Yield	3.08%	157 basis points
WTI Crude Oil	$104.71	39.22%
Gold $/Oz.	1,742.30	(4.83)%

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