

## Beacon Weekly Investment Insights

U.S. equity markets finally broke the 7 week downward streak last week in a long-awaited relief rally, with all three major equity indices, S&P 500, Dow Jones Industrial Average, and the Nasdaq Composite rising over 6% for the week. The main catalysts for the rally were the release of the “Fed minutes” and a slight decline in a key inflation measure that we discuss below.

FOMC (Federal Open Market Committee) minutes were released from their May 3-4 meeting when they raised short-term borrowing costs by 50bps. The minutes confirmed that the Fed officials were ready to move forward with multiple 50bp rate hikes to contain inflation. Raising rates more than market anticipates from the “neutral rate”, which is currently pegged around 2.5%, to “restrictive” territory shows Fed’s commitment to contain inflation, while potentially contributing to the risk of recession. Equity markets liked the former and actually rallied on the report. Long-term Treasury bond yields declined to 2.75% on the news.

The Fed’s preferred measure of inflation, the personal consumption expenditures index (PCE), was also released last week. The core PCE, which excludes the volatile food and energy prices, jumped 4.9% in April, in line with the estimates and down from 5.2% in March. While the number is still elevated, the month-over-month decline could be an indication that price pressures could be starting to ease. The overall PCE index, including food and energy prices, accelerated by 6.3%, also lower than the previous month’s reading of 6.6%. The decline in the level of inflation from the 40-year highs generated some relief for the financial markets and it was perceived to be positive for stocks.

S&P global manufacturing PMI (Purchasing Managers’ Index) continued to decline to 57.5 in May, a 3 month low, vs the 57.6 estimate and lower than the 59.2 reading last month. S&P global services PMI also declined and registered at 53.5, a 4 month low, lower than both the 55.1 estimate and the 55.6 reading in the prior month. The composite index came in at 53.8 vs 56.0 in the prior month. While both the manufacturing and the services readings indicate an expansion, it is a slower than expected expansion amid inflationary pressures, supply chain bottlenecks and weaker demand growth.

Another area of slowdown is the housing sector. Sales of newly built homes declined sharply to an annualized rate of 591,000 against an expectation of 750,000 new homes built as a result of higher mortgage rates and a sharp increase in home prices over the past two years, making a home purchase unaffordable to many Americans. This is the slowest pace of new home sales since the start of the Covid pandemic in early 2020. Slower sales led to an increase in inventory to a 9 month supply. As a rule of thumb, a 6 month supply is considered a healthy level balancing supply and demand of new homes. Pending home sales, another measure of the housing sector, also declined six months in a row, down 3.9% in April from March.

The second estimate of the first quarter U.S. GDP showed a slight downward revision to -1.5% from the initially reported -1.4%. Weak business and private investment failed to offset strong consumer spending. We expect the second quarter economic activity to improve and GDP growth to rebound as some of the factors holding back growth in the first quarter, such as the Omicron variant and supply chain issues, subside in the current quarter.

The last economic reading of a very busy week was the University of Michigan consumer sentiment, which fell to a reading of 58.4 in May, the lowest level in more than 10 years. Economists were expecting a reading of 59.1. The drop in sentiment was largely driven by negative views on inflation and current buying conditions for houses and durables.

In overseas events, we are watching the pending default by Russia on their foreign denominated debt for the first time since the Bolshevik Revolution in 1917, which may have an impact on risk premiums across the globe. U.S.

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Treasury Department banned the Russian Central Bank from using U.S. banks to make the interest payments to American investors in U.S. dollars; that could potentially force Russia into default. Russia will argue that it is not in default since the payments were set aside but it was prevented from making the payments. It will have a 30-day grace period before being declared in default.

On the company front, we saw continued warnings from U.S. retailers and online advertisers about weakening demand by American consumers. Retail inventories continued to build up as consumers cut down on spending due to high inflation. Abercrombie & Fitch, Best Buy and Dick's Sporting Goods followed up on the Walmart and Target misses in the prior week. Snap, a social media company, saw its shares crater last week, as it warned investors about a cutback in digital ad spending caused by rising inflation, the supply chain challenges, and the war in Ukraine. Snap's weak outlook on the macro environment and disappointing guidance not only caused a 40% drop in the company's stock, but also sent shock waves across other social media and digital advertising companies.

Despite the negative news and the noise, we would like to remind all clients that market corrections and bear markets are essential parts of equity investing. Although timing is always uncertain, they are inevitable. Sometimes they feel like the bottom is dropping out. Investment time horizons could contract significantly and the market volatility could induce panic. Those who try to time the markets and hit the alarm button often miss out on the eventual recovery in stock prices as the stock markets generally turn around at a high speed and without any notice. Last week's sharp rally on the back of the aforementioned good news on inflation is the latest example of the unpredictable nature of the equity markets. Volatile times are the ultimate tests of behavioral biases.

As we have iterated repeatedly in the past, we at Beacon Trust are long-term investors and will never attempt to call the bottom. At the risk of looking foolish over the short-term when stocks drop in price, we maintain our strategic and fundamental outlook at all times. We constantly take advantage of lower prices on investments that we would like to initiate or add to opportunistically. We actively rebalance the portfolios. We harvest any significant losses to offset the tax liability on current or future capital gains. We remain broadly diversified across different asset classes, investment styles, sectors, industries, market caps, and geographies. It is this investment discipline that sets the stage for successful portfolio outcomes over the long run.

Looking ahead to this 4-day week when we will close out the month, the May employment report on Friday will be the most important data on the calendar. The consensus view is the addition of 325,000 new jobs in nonfarm payrolls. Case-Shiller home price index, consumer confidence, ISM manufacturing PMI, ISM services PMI, and the JOLTS report (Job Openings and Labor Turnover Survey) are the other important economic releases for the week. The JOLTS report is expected to show 11.4 million U.S. job openings, and only 5.9 million unemployed Americans to fill them in a sign of continued tightness in the labor markets.

<b>Market Scorecard:</b>	<b>5/27/2022</b>	<b>YTD Price Change</b>
Dow Jones Industrial Average	33,212.96	(8.60)%
S&P 500 Index	4,158.24	(12.76)%
NASDAQ Composite	12,313.13	(22.46)%
Russell 1000 Growth Index	2,407.19	(21.72)%
Russell 1000 Value Index	1,580.85	(4.52)%
Russell 2000 Small Cap Index	1,887.90	(15.92)%
MSCI EAFE Index	2,035.83	(12.85)%
US 10 Year Treasury Yield	2.75%	123 basis points
WTI Crude Oil	\$115.07	53.00%
Gold \$/Oz.	1,851.30	1.24%



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