Beacon Trust
INNOVATING WEALTH STRATEGY

June 27, 2022

Beacon Weekly Investment Insights

The U.S. stock market staged a nice comeback during the 4-day week last week from a long stretch of losses, having declined in 10 of the previous 11 weeks. S&P 500 finished the week up 6.5%, while the Dow Jones Industrial Average rallied 5.4%, and the Nasdaq Composite surged by 7.5% as the major indices found some price stability during the week. It is not clear to us though whether the market has found “a” bottom or “the” bottom.

The highlight of the week was Federal Reserve Chairman Jerome Powell’s 2-day semi-annual testimony in front of the Senate Banking Committee and the House Committee on Financial Services. Investors looked for clues on how the head of monetary policy intends to fight decades-high inflation. Powell told the Congress that the central bank is “strongly committed” to bringing down the high inflation rate, which is hurting all Americans across income spectrums, and it has all of the “unconditional” tools and measures it needs to restore price stability.

The Fed has increased short-term borrowing costs in each of its past three meetings, including a 75bp rate hike earlier this month, the biggest single hike since 1994. The current Fed Funds Rate stands at 1.75% and it is projected to go up to 3.4% by the end of the year, according to the Fed forecasts. The pace of future interest rate increases will depend on the incoming economic data and evolving outlook for the U.S. economy. Counteracting Powell’s resolve on inflation are factors beyond the control of the Fed, such as the run-up in energy and food prices due to the war in Ukraine, as well as the Covid-related shutdowns in Chinese factories which are impacting supply chains around the world.

To provide a small relief to U.S. consumers, President Biden asked Congress to suspend the federal gasoline taxes for three months during the busy summer driving season and also asked the individual states to suspend their own gas taxes or provide other similar relief to consumers. The combined federal and state taxes make up approximately 10% of the price of gas.

Rising rates continue to hurt the U.S. housing markets. Sales of existing homes dropped 3.4% in May to an annualized rate of 5.4 million homes, the lowest reading since June 2020 during the early months of the Covid crisis. This reading is based on the real estate closings in May, representing sales contracts likely signed in March when mortgage rates were about 1.5% lower than the current rates, hence the impact of higher borrowing costs are not fully reflected in the housing data.

We often get the question of whether the housing market will crash like in the 2006-2009 period. While the higher price of home ownership will certainly continue to cool off from the record price gains we have seen over the past couple of years, we do not expect a crash since most homeowners have a healthy equity cushion and the lending standards and regulations are much stronger today than they were during the Great Financial Crisis more than a decade ago. In fact, total mortgage debt in the U.S. is now less than 43% of current home values, the lowest on record, and mortgage delinquencies are under 3%, also a record low.

We also hear from clients who inquire about a possible recession ahead as a result of the aggressive path of monetary policy tightening in order to rein in inflation. First, consumer spending, which is 70% of the U.S. economy, has been resilient due to high household savings, despite the low sentiment. In fact, it has been the only component of the U.S. GDP (other components being business investment, government spending, and net exports) that has contributed positively to the gross domestic product in each of the past 4 quarters. Moreover, job growth has been strong with the U.S. economy adding more than 400,000 new jobs in each of the past 12 months. Lastly, corporate earnings are expected grow by 8-10% range in 2022 and 2023. While the economy will likely slow down and corporate bankruptcies will increase, the recession may not be imminent and we believe, it will likely be a mild one when it eventually arrives. The current selloff we are seeing in U.S. equity markets is already discounting the possible recession ahead.

In other economic news, weekly jobless claims fell 2,000 to 229,000 for the prior week as labor market conditions remained tight with roughly 2 job openings for every unemployed person. The weekly claims have been inching higher from the March low of 166,000 though, as there are reports of isolated job cuts in the technology and housing sectors which are moderating.

University of Michigan's Consumer Sentiment survey was the last economic report released last week. As expected, it showed that sentiment fell to a record low reading of 50.0 due to persistently high inflation and high market volatility. This reading was 14% below the May print of 58.4. In a sliver of hope, consumers' inflation expectations dipped slightly from 5.4% to 5.3% over the next 12 months and from 3.3% to 3.1% over the next 5-10 years.

This week's most important data release will be the Personal Spending report on Thursday. Despite the record-low sentiment, the report is expected to show that total consumer spending increased by 0.5% last month in a sign consumption remains robust across goods and services despite rising prices across. As the second quarter comes to an end, we will also be watching the durable goods report on Monday, Case-Shiller home price index on Tuesday, and ISM manufacturing data on Friday.

Market Scorecard:	**6/24/2022**	**YTD Price Change**
Dow Jones Industrial Average	31,500.68	(13.31)%
S&P 500 Index	3,911.74	(17.93)%
NASDAQ Composite	11,607.62	(25.81)%
Russell 1000 Growth Index	2,302.95	(25.11)%
Russell 1000 Value Index	1,463.52	(11.61)%
Russell 2000 Small Cap Index	1,765.74	(21.36)%
MSCI EAFE Index	1,874.19	(19.77)%
US 10 Year Treasury Yield	3.14%	162 basis points
WTI Crude Oil	$107.62	43.09%
Gold $/Oz.	1,830.30	0.09%

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