withum WEALTH MANAGEMENT

Summer, 2022

The Bear Market Arrives:

Navigating a Tumultuous Investment Landscape

Q2 2022 Review

Stock market rocking headlines did not ease up in Q2, and volatility increased as the year trudged on. Indices around the globe decreased meaningfully for the second quarter and the first half of the year.

The second quarter saw worries regarding the Russia/Ukraine conflict fade from media coverage and attention shift to the stubbornly high inflation which the war exacerbated. The Fed was late to the game and is now playing catch up, having to raise rates 25bps, 50bps and then 75bps in consecutive meetings to dampen consumer demand.

Equity markets are not buying the hope of a "soft landing" – a situation where the Fed raises rates to curb demand enough to slow inflation, but not too much to cause a recession. With interest rates rapidly on the rise, bond investments, often seen as a haven in times of equity market stress, are also not performing well. Even gold, viewed as the ultimate haven asset in times of panic, has been a poor investment as the dollar has strengthened.

Despite a historically poor first half for nearly all asset classes, market disappointments provide opportunities for value creation; tax loss harvesting, Roth conversions, review and recommitment to your customized financial plan. Market dislocations almost always provide opportunities to reposition portfolios for future growth.

Are we in a recession?

A primary worry of investors is whether we are in or entering a recession. Most believe the definition of a recession is two consecutive quarters of negative growth in real gross domestic product (GDP). However, the National Bureau of Economic Research has the final say, as they declare when recessions start and end. Real GDP (net of inflation) decreased at an annual rate of 1.6% in the first quarter, however nominal growth was 6%.

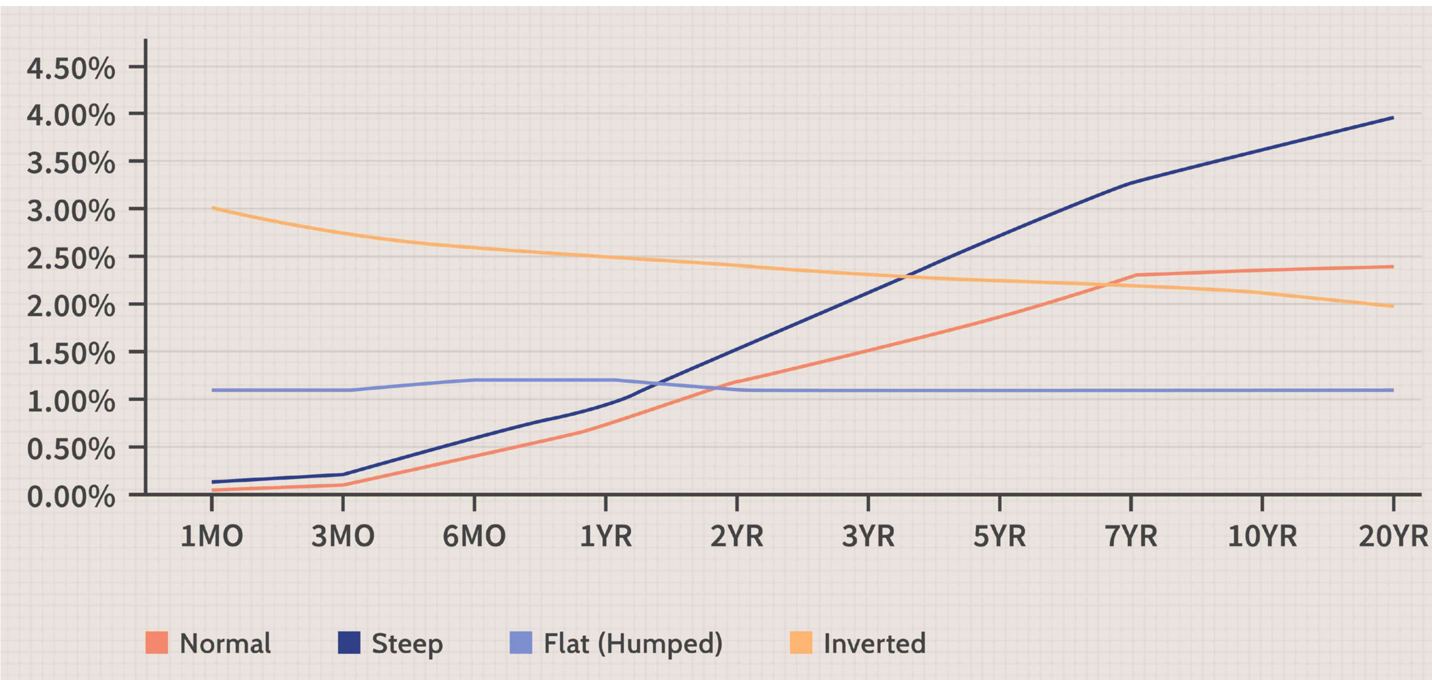
Typically, recessions are preceded by deteriorating economic fundamentals months before the recessions technically start and there are enough aspects of the current economic landscape that lead us to believe we are not in a recession yet, or if we are, it is shallow for the moment. A common harbinger of recessions is the inversion of the yield curve. The yield curve is just a graphical plotting of the yields of different maturing US Treasury bills, notes and bonds. After mapping out the yields, typically you will see a "normal" sloped curve with shorter duration US Treasuries having lower yields and longer duration Treasuries having higher yields as seen in the graph below. In times of perceived upcoming economic stress, an inversion occurs because investors flock to long term US Treasuries as a flight to safety, thereby lowering their yields.

It is true that inverted yield curves have forecasted every recession, however they have also served as a false indicator at times – we find it hard to believe the yield curve inversion in the summer of 2019 forecasted a deadly pandemic that crippled the global economy. There is also some debate as to which part of the yield curve needs to invert to be a true signal of recession. While the spread between the 2-year (3.21%) and 10-year (3.01%) treasuries is currently negative -0.20%, the 3-month (2.51%) and 10-year (3.01%) portion of the yield curve is not inverted*.

The other issue with inverted yield curves is that they provide no guidance on when the recession will occur in the future. Regardless of what the bond market is foreshadowing, a recession now, in six months from now, or in a year from now, there is always a recession coming. Preparing for the eventual recovery often proves to be more beneficial than worrying about when a recession will end.

*Numbers as of July 20, 2022

Yield Curves



Source: Investopedia

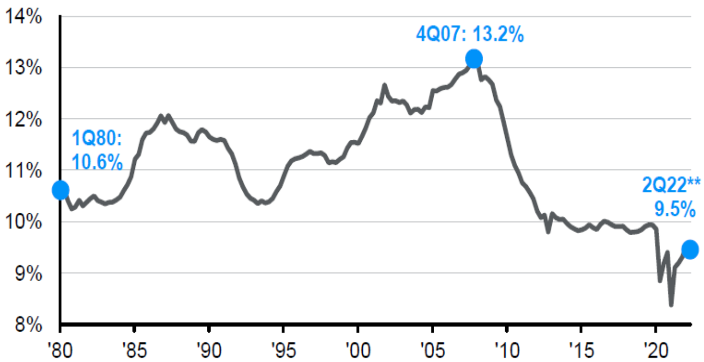
Reasons to be Optimistic

As we discussed, we are not convinced the recession, if it is now, will be a bad one. Recessions are never easy - millions lose their jobs, homes and their savings. One of the benefits of the pandemic was that people were essentially forced to pause spending on many major aspects of their lives. Many still have significantly reduced expenses in areas related to dining, entertainment, commuting to work and travel. Some vacation travel has certainly picked up – don't get us started on what a headache it is to fly these days – but it was mostly non-existent until very recently. Individual balance sheets are stronger than they have been historically during peaks in the economic cycle. Typically, economic activity peaks as consumers feel confident and take on more debt to finance activities and purchases. Possibly due to the economic stimulus provided by our government, or possibly due to a lack of spending options, consumer balance sheets are stronger than at past economic peaks.

A second major reason the recession, whether now or in the future, likely will not be as potent as many are expecting, is the strong labor market. We are beginning to see some companies in specific industries announce upcoming layoffs or temporary hiring pauses. Some of these companies are also those which experienced a meteoric rise in stock price valuations during the pandemic. Despite some headline grabbing numbers, there are still about two job openings for every one worker looking for work.

Household Debt Service Ratio

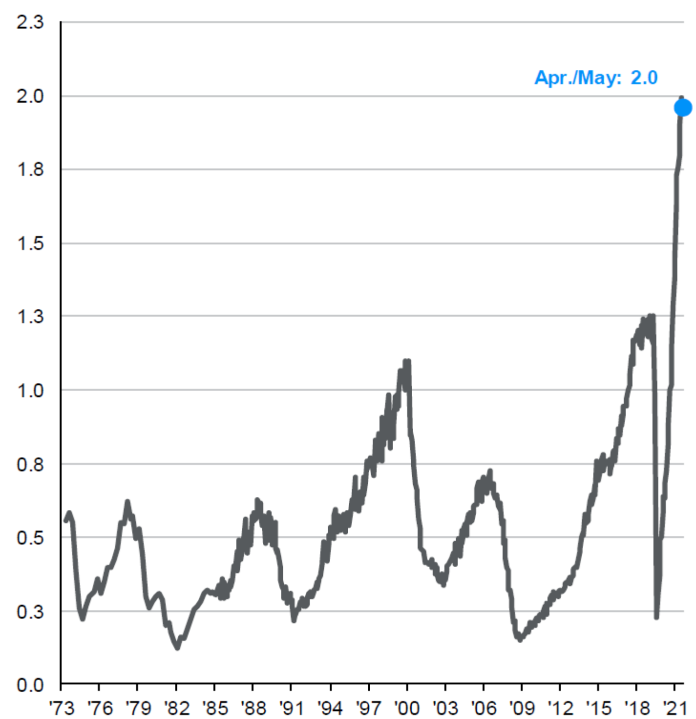
Debt payments as % of disposable personal income, SA



Source: FactSet, FRB, J.P. Morgan Asset Management; BEA. Data include households and nonprofit organizations. SA - seasonally adjusted. **2Q22 figures for debt service ratio are J.P. Morgan Asset Management Estimates. Guide to Markets - U.S. Data are

Ratio of Job Openings to Job Seekers

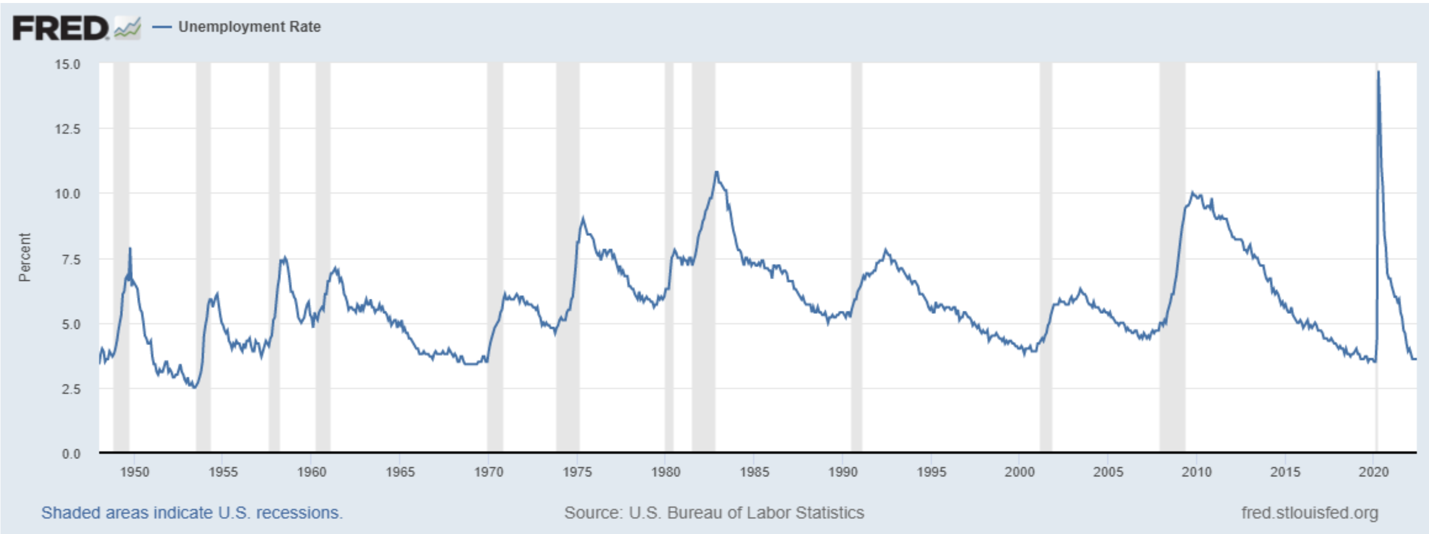
Job openings* lagged 1 month divided by unemployed persons, SA



Source: U.S. Department of Labor, J.P. Morgan Asset Management. *JOLTS job openings from February 1974 to November 2000 are J.P. Morgan Asset Management estimates. Guide to the Markets - U.S. Data are as of June 30, 2022

Lastly, as you can see in the chart below, the unemployment rate bottoms and begins rising several months before recessions technically begin. With the unemployment rate historically low, and not showing signs of rising yet, we are of the belief that we have not really entered a recession, despite what GDP numbers may suggest.

Unemployment Rate



Bear Markets Create Opportunities

Whether investors are in "the US is in a recession now" camp, think "the US is headed for a recession later this year or next", or think "there is a glimmer of hope the Fed can accomplish a soft landing", we want to stress that weak markets create planning opportunities. Consideration should be given to Roth conversions when market levels are depressed. A benefit of converting traditional IRA dollars to Roth dollars while markets are lower is that you can convert more shares of stock, for the same dollar value. For example, if a stock, XYZ, was trading at $100/share and you wanted to make a $5,000 Roth conversion. It would require converting 50 shares of that stock. In a down market, let's pretend that stock is now trading at $25/share. We can convert twice the number of shares, for the same $5,000 value and corresponding tax payment. If we believe the stock is only temporarily depressed, we have effectively transferred twice the number of shares to post-tax accounts and taken an otherwise smaller tax hit. Please reach out to us if interested in learning more about stock transfer opportunities in this current environment.

Managing Risk

In closing, we understand and recognize that it has been a difficult year for investors. Bear markets, a prolonged drop of more than -20% from recent highs, do not come around very often, but when they do, it requires forward-looking planning and a level head. Our attitude is very much centered around managing risk and ensuring that our clients come out of this bear market with stronger portfolios than before they entered it. Good returns and market growth will come, it is just a matter of when and we must ensure that our portfolios are wisely invested when it does.

To us, the way forward is clear - stock valuations have been marked down substantially, the Crypto bubble has burst, "story stocks" or the companies with no or little earnings but a good product have been decimated (i.e., Redfin, Peloton, Spotify, Roku) and meme stocks and SPAC'S have discovered gravity. We would argue this is all rational and all good news for the portfolios we manage. By favoring quality and cash flows over stories and future promises we have avoided many of this bear market's pitfalls.

We are not in the business of predicting short term market movements and are not starting now, but we believe we are entering a change in market leadership that could prove profitable for years. We think this could be a decade where dividend paying stocks provide substantial value to a diversified portfolio. Our unwavering belief is that quality lasts and fads fade - and this is fundamental to our portfolio management process.

As always, if you would like to discuss your portfolio, or would like to connect regarding more detailed thoughts on these or other topics, please do not hesitate to reach out.

withum
WEALTH MANAGEMENT

Need More Information? Please do not hesitate to contact a member of the Withum Wealth Management team with any questions or concerns:

T (732) 450 0147
infowwm@withumwealth.com
withumwealth.com