

Celebrating 34 Years in 2022

Mid-Year Newsletter

“Uncertainty in Financial Markets”

June 14, 2022

President Joe Biden and Federal Reserve Chairman Jay Powell are each like a quarterback who has thrown too many interceptions and the team owner now has lost confidence in their ability thus creating uncertainty for the team. Fed Chairman Jay Powell leads the U.S. Federal Reserve Bank's monetary policy, specifically interest rate and money supply decisions. President Joe Biden as well as the United States Congress are tasked with the U.S. fiscal policy, specifically taxing and spending decisions. As I have chronicled in previous newsletters, the Federal Reserve did not raise interest rates as the U.S. economy heated up and inflation spread last year, and now many feel the Fed is behind in trying to combat inflation that appears to be spiraling ⁽⁹⁰⁾. Plus, the Fed's bond buying quantitative easing activities increased the nation's money supply exponentially during the past 26 months ⁽⁸⁹⁾. Mohamed El-Erian, the chief economic advisor at Allianz recently stated that had the Federal Reserve acted earlier most of the record high inflation could have been avoided ⁽⁹⁰⁾⁽⁹¹⁾.

Unlike President Harry S. Truman, the buck has not stopped with President Biden as he continues to blame inflation on Putin, COVID, the meat industry, oil companies, his predecessor, supply chains, and most recently foreign ocean freight companies, which has led many to question his leadership and specifically his plan to combat inflation as he recently spelled out in a recent Wall Street Journal op-ed ⁽⁷⁵⁾⁽³³⁾. The blaming of companies for price gouging is a distraction from the real causes and more importantly the solutions to inflation according to Jason Furman, an economist who served under Barack Obama ⁽¹⁰³⁾. President Biden's plan for inflation did not mention 'money supply' or 'energy policy' which many believe are the root causes of inflation but instead focused on releasing oil from the U.S. strategic petroleum reserves, negotiation of pharmaceutical drug prices, green energy tax credits and investments, and providing child and elder care coupled with increasing resources for the IRS and higher taxes for individuals and companies ⁽³³⁾⁽⁷⁵⁾⁽⁷⁹⁾⁽⁵⁹⁾⁽⁹¹⁾⁽⁹⁶⁾. Confidence in President Biden's inflation plan may have been undermined by the President himself when he commented to reporters on June 1st "There's a lot going on right now, but the idea we're going to be able to, you know, click a switch, bring down the cost of gasoline, is not likely in the near term, nor is it with regard to food" ⁽⁶⁰⁾.

President Biden passed the American Rescue Plan in early March last year spreading nearly \$2 trillion into an American economy that was already recovering, followed by the \$1.1 trillion American Jobs Plan targeted for the nation's infrastructure, and finally proposing unsuccessfully the \$5 trillion dollar Build Back Better Plan for social spending and increased taxes which was stalled in Congress by Democrats Joe Manchin of West Virginia and Kyrsten Sinema of Arizona as they questioned increasing taxes during a recovery as well as being weary of the additional effects government spending may have on inflation ⁽⁶¹⁾.

Some argue that inflation is a global phenomenon at present, but there could be debate that pouring the \$1.9 trillion stimulus package coupled with increased government spending most likely fueled inflation and thus overheated the U.S. economy ⁽⁶⁷⁾⁽⁵⁷⁾⁽⁶¹⁾. Europe is experiencing inflation, however countries such as Japan, China, and Switzerland also have

supply-chain issues, consequences from the War in Ukraine, and high oil prices but inflation rates are 2 to 2.5% in those countries as their central banks were prudent not to provide excessive stimulus ⁽⁷⁵⁾⁽²⁰⁾⁽⁵⁰⁾⁽⁴⁷⁾. With inflation now above 8% for the first time since the 1980s, the Biden Administration's Treasury Secretary Janet Yellen acknowledged recently that she underestimated the underlying drivers and momentum behind inflation ⁽⁶⁷⁾⁽⁶⁰⁾⁽⁶¹⁾.

As the Nobel Prize winning economist Milton Friedman stated "it is always and everywhere, a monetary phenomenon. It's always and everywhere, a result of too much money, of a more rapid increase in the quantity of money than on output. Moreover, in the modern era, the important next step is to recognize that today, governments control the quantity of money. So that as a result, inflation in the United States is made in Washington and nowhere else" ⁽⁶⁵⁾. Economist Larry Summers, who served both Presidents Obama and Clinton, warned in March 2021 that too much spending and easy monetary policy could ignite inflation with demand outstripping supply ⁽⁶¹⁾⁽⁵⁷⁾. In an April 2020 campaign interview, candidate Joe Biden stated "Milton Friedman isn't running the show anymore" in defense of increased government social spending ⁽⁶¹⁾.

Uncertainty over when 40-year high inflation will peak, widespread labor shortages, and continued supply chain issues may be partly traced to policy decisions from the top and most Americans, believing the economy is on the wrong track, blame both President Biden and Fed Chair Jay Powell; however, these men may just get a little help from a resilient and innovative American economy ⁽⁶⁰⁾⁽¹⁹⁾⁽⁴⁸⁾. The U.S. economy is arguably the best in the world as we export more agriculture products than any other country, are the largest producer of oil and gas, and we have the most innovative technology companies here in the U.S. ⁽⁸⁸⁾. The U.S. is considered the world's center of innovation, has an exceedingly productive workforce, and our capital markets are state-of-the-art and efficient ⁽⁸⁸⁾.

***"Inflation is as violent as a mugger, as frightening as an armed robber,
and as deadly as a hit man." -Ronald Reagan***

Economy

Uncertainty abounds as markets are digesting a litany of global issues from inflationary pressures, supply chain issues, lockdowns in China, and the war in Ukraine ⁽⁵⁾⁽¹⁶⁾. Markets have turned bearish as downward revisions to global growth and high inflation are beginning to affect the economy and a lack of confidence in the Federal Reserve's ability to navigate a soft landing ⁽⁵⁾⁽⁴⁶⁾. As earnings season ended this quarter, retailers Walmart and Target, have highlighted their noted supply chain issues, higher costs, and reduced sales on discretionary items ⁽⁵⁾. However, Home Depot had good earnings and a positive outlook on home improvement discretionary items ⁽⁵⁾⁽⁵²⁾. Although we expect inflation to peak in the next few months it may take several years to get back to what the Fed considers neutral at 2% ⁽⁵⁾.

Markets have been hit hard this year with the uncertainty over inflation, specifically the Federal Reserve and the Biden Administration response to it thus far, and whether it will ultimately lead to a recession. The volatility this year is not entirely due to the current economic conditions, but rather what the market sees as uncertainty looking forward. At the Davos World Economic Forum in Switzerland a few weeks ago, most CEOs expressed strong business at present, but the pessimistic tone of many is that challenges appear to be on the horizon ⁽²³⁾⁽⁴⁰⁾. A Wall Street Journal poll in May of small businesses revealed 57% expect economic conditions to worsen due to the worker shortage, inflation, and supply chain issues ⁽⁴²⁾. Inflation has been present for the better part of a year and building, but the Fed told us it was transitory (temporary), due to the pandemic shutdowns ⁽⁹⁰⁾⁽⁹¹⁾. Part of that is true, as many parts of the country and world were shut down and supply chains are backlogged in many industries. However, the COVID shutdowns coupled with an enormous stimulus injected into the U.S. economy after it was already recovering stimulated demand that could not be met, and when you have too much money chasing after too few goods, prices inflate. It is also worth pointing out that with easy money floating around, many did not return to work right away, and still have not as we have 822 thousand workers that were working before the COVID-19 shutdowns that have not returned to work ⁽⁵⁵⁾. Surprisingly, the Biden

Administration has continually delayed student loan payments, despite a low unemployment rate and more than 11 million job openings ⁽⁵⁷⁾⁽⁷⁰⁾.

The Federal Open Market Committee (FOMC) raised the Fed funds rate by 50 basis points to a range of 0.75-1.0% in May. This was the largest single rate increase since 2000 as all increases since then have been 25 basis points at a time ⁽⁷⁾⁽¹⁷⁾. Chairman Powell stated empathetically that high inflation poses significant hardship especially for lower income Americans ⁽⁷⁾. The Fed also announced they will begin quantitative tightening by selling bonds from its balance sheet at an initial rate of \$47.5 billion per month beginning in June and increasing to \$95 billion per month after three months ⁽⁷⁾⁽¹⁷⁾. The Fed acknowledged weak economic growth in the first quarter mostly due to the inability of businesses to replace inventory due to supply chain issues but highlighted healthy household spending and business capital spending. Chairman Powell said they believe more Americans will enter the workforce but also warned that the China COVID-19 lockdowns and the War in Ukraine may exacerbate supply chain issues ⁽⁷⁾. Chairman Powell stated there is some evidence that core PCE (the Fed's preferred measure of inflation) is at or near peak and that a soft landing, that is, raising rates without recession, is possible although he acknowledged it will be a tough task for the Fed ⁽⁷⁾⁽¹⁷⁾. Powell was stern in his stance that the Fed will not allow a wage-price spiral and if rates need to go higher to stave that off, they will ⁽⁷⁾.

A major cause of uncertainty is whether the Fed can achieve the so called 'soft landing' by raising rates without stalling the economy into recession. Economists believe it most likely rests on three factors; first, how high will the Fed raise rates above the neutral rate, estimated at roughly 2.5%, and how long will the Fed keep the rate above neutral ⁽¹¹⁾. The neutral rate is the estimated rate that will neither stimulate nor restrict the economy ⁽¹¹⁾. It is estimated by economists at Vanguard that the Fed will raise the Fed funds rate to 3.5% by mid-2023 ⁽¹¹⁾. Second, how will the labor market and the inflation rate react to the increased rates, and third, will there be any unanticipated shocks to demand or supply, such as further China Covid-19 shutdowns or a prolonged and expanded war in Ukraine, both with consequences to the supply chains, food supply, and energy demand ⁽¹¹⁾.

Sadly, only 17% of Americans are satisfied with the state of the economy in the country, with 83% dissatisfied, and this is a 6% decline since April as a May Gallup poll reveals with a Wall Street Journal-NORC poll revealing similar results ⁽⁵⁴⁾⁽⁷⁸⁾. The WSJ poll registered the highest level of dissatisfaction with the economy since the poll began in 1972 ⁽⁷⁸⁾. The poll was conducted with U.S. inflation near its highest point in 40 years with gas and food prices skyrocketing, the supply chain issues persisting, and recently the news of shortages of baby formula ⁽⁵⁴⁾⁽⁷⁸⁾. A recent ABC News poll reveals that 83% of respondents say the economy is their #1 concern, followed by 80% indicating inflation, and 74% choosing gas prices ⁽⁷⁴⁾. Consequently, the ABC News poll exposes that only 37% approve of President Biden's handling of the economy, 28% approve of his job on taming inflation, and 27% approve of his performance on reducing gas prices ⁽⁷⁴⁾.

The economy has been influenced the last couple of years by massive government spending, an increase in the money supply, COVID shutdowns of businesses, especially small businesses, that has distorted the economy ⁽¹⁾. As an example, economist Brian Wesbury recently stated that retail sales are up 28.8% versus where they were in February 2020, a big increase over twenty-six months, and by comparison, retail sales were only up 6.7% during the twenty-six months before COVID started ⁽¹⁾. Wesbury's point is that retail sales increased four times faster than normal due to government stimulus and money printing ⁽¹⁾. Brian Wesbury and his economic team at First Trust believe that consumers will continue to buy less discretionary goods in favor of discretionary spending on services such as leisure, entertainment, and travel which they see as finally getting back to normal since the COVID pandemic began ⁽¹⁾. At retailers such as Macy's, Target, and the Gap the pandemic years of strong consumer demand for home goods and clothing coupled with supply-chain issues created scarcity with some items, allowing stores to increase prices and forgo big discounts; however, the reverse is now happening with excess inventories beginning to build and the need to discount at the forefront ⁽⁷⁶⁾⁽⁸²⁾⁽⁷¹⁾.

The Biden Administration restricted U.S. production of energy by increasing regulations, cancelling leases, and shutting down pipelines, and when supply goes down then prices go up just when the demand from people wanting to travel post COVID-19 and manufactures and suppliers are trying to get product and materials to businesses are increasing. Joe Biden now famously stated during his presidential campaign “We are going to get rid of fossil fuels.”⁽⁸⁴⁾ The War in Ukraine has exacerbated the energy policy of the Biden Administration with further constriction on the global energy supply⁽⁵⁶⁾⁽⁵⁷⁾.

Brent Crude Oil prices have risen above \$117 per barrel which has consequently played a part with record inflation especially with gasoline prices, groceries, the transportation of wholesale and retail goods⁽⁵³⁾⁽⁷²⁾⁽¹⁰¹⁾. The U.S. oil output this year is estimated to increase less than half the increase experienced in 2018 and economists at JP Morgan Chase are predicting the average price for a gallon of gas in the U.S. may hit \$6.20 by the end of August⁽⁸⁸⁾. Treasury Secretary Janet Yellen acknowledges high gas prices may persist which she claims are due to the supply disruptions due to the War in Ukraine, but she does not see the U.S. going into recession⁽¹⁰⁵⁾. The U.S. has 13% less oil rigs pumping verses when President Joe Biden took office⁽⁸¹⁾. When President Biden took office the nationwide average for gasoline was \$2.37 and has now more than doubled to an all-time high of more than \$4.91 per gallon for gasoline, and \$5.67 for diesel fuel, and when questioned by reporters in late May, President Biden stated “When it comes to gas prices, we’re going through an incredible transition that is taking place, God willing, when it’s over, we’ll be stronger, and the world will be stronger and less reliant on fossil fuels”⁽⁵⁶⁾⁽⁸¹⁾⁽⁶⁰⁾.

Part of the Biden Administration’s green energy strategy is for Americans to shift from driving gasoline powered cars to electric vehicles⁽⁵⁶⁾. However, electric vehicles are 43% more expensive than gasoline powered cars according to the Kelley Blue Book average per new car purchase transaction, plus lithium, a major component to electric vehicle batteries has increased exponentially by over 400% during the prior year⁽⁵⁶⁾. Keep in mind, to power the battery in an electric vehicle, electricity is needed, and the U.S. electricity grid is currently powered with 39% natural gas, 22% coal, 19% nuclear with only 20% coming from green energy sources such as wind, 10%, and solar, 4%, and hydropower at 6%⁽⁵⁶⁾.

The transition to green energy may have some growing pains as the North American Electric Reliability Corporation (NERC) is warning that 2/3rds of the U.S. may have blackouts this summer⁽⁸⁷⁾. Wind and solar energy are increasing but are only as reliable as the weather and may not always be available during peak demand periods⁽⁸⁷⁾. This presents a problem as natural gas electric plants may not be able to cover renewables during peak demand periods⁽⁸⁷⁾. Fossil fuel electric generation has been replaced in favor of renewable energy in certain areas partly because they are able to turn a profit even if supply exceeds demand due to current government subsidies whereas coal and nuclear generation cannot⁽⁸⁷⁾.

However, President Biden in a Wall Street Journal Op-Ed recently laid out his plan for inflation which included increased taxes for corporations and individuals, more IRS agents and resources, a continuation of his green energy agenda, more social spending, and to install price controls on pharmaceuticals⁽³³⁾. Many believe his plan will do nothing to quell inflation but would most likely do just the opposite⁽⁵⁹⁾. A change in the Biden Administration’s energy policy would be the most effective in stalling inflation as it would be expected to ease supply issues with gasoline, diesel and jet fuel, and energy costs for homes and businesses⁽⁵⁷⁾⁽⁹²⁾. It is my opinion that green energy may be the future for the U.S. but a plan that provides a smoother transition may be warranted.

Jamie Dimon, the CEO of JP Morgan, recently stated that “right now it’s kind of sunny, things are doing fine, everyone thinks the Fed can handle it. That hurricane is right out there down the road coming our way. We don’t know if it’s a minor one or Superstorm Sandy. You better brace yourself” referring to a looming economic climate of Fed tightening, continued inflationary pressures, and the effects from the Russian war with Ukraine on food and energy supply⁽⁶³⁾. A hurricane of some magnitude may be out in the sea but may not hit within the next 12 months according to economist Brian Wesbury at First Trust, as he believes the U.S. economy is still climbing out of COVID as revealed in the May jobs

report with an increase of 390,000 nonfarm payrolls and a 50-year low unemployment rate of 3.6% ⁽⁷⁸⁾⁽⁷⁷⁾. However, Wesbury concedes that 61,000 retail jobs were lost in that report and could expose consumers are buying less goods, but he points out that the report also shows that the leisure and hospitality industry had job gains of 84,000 and is consistent with his thesis of a consumer transition to services such as leisure and travel and away from consumer discretionary goods ⁽⁷⁷⁾⁽⁷¹⁾. Wesbury highlights that the May jobs report marks the leisure and hospitality industry's 17th consecutive month with job gains ⁽⁷⁷⁾.

Disappointingly, the May jobs report shows wage gains of 0.3% for the month but inflation came in at 1% for the month revealing workers' wages are falling behind inflation ⁽⁷⁷⁾⁽⁹⁵⁾. The CPI increased in May revealed consumer prices have increased 8.6% during the prior 12 months, the highest in nearly 41 years ⁽⁹⁵⁾⁽⁸⁹⁾. Although easy money from the Fed has inflated everything, according to Brian Wesbury, consumers are in good shape as evidenced by the financial obligation ratio at 14% at the end of 2021, which is debt payments such as mortgage and car payments plus recurring payments such as property taxes, insurance and utilities divided by after-tax income ⁽⁷⁷⁾. This is the lowest financial obligation ratio since 1980 when such data began to be compiled ⁽⁷⁷⁾. Further, household net worth at the end of 2021 was 8 times after-tax income, the highest ratio on record, and to put that into dollars, Americans had \$1.2 trillion in cash equivalents in early 2020 at the start of the pandemic and by year end 2021 that total was \$4.1 trillion dollars ⁽⁷⁷⁾.

The economy has some momentum at present although it is slowing with rising rates and inflation ⁽⁵⁸⁾⁽³⁹⁾⁽³⁶⁾. We expected the economy to slow after growth of nearly 6% in 2021 to 3-3.5% in 2022 as I originally forecasted in my "2022 Kick-Off Newsletter" in January ⁽¹⁵⁾. We also expected inflation to peak out in late spring or early summer and begin a slow 3 to 4-year decline. However, with the war in Ukraine, as I wrote in my "Special Newsletter- War in Ukraine, Energy, Inflation and Volatility" in March, I tempered my expectations to 3% growth for 2022 with inflation peaking in mid to late summer 2022, with the same 3-4-year slow decline down to the Fed's target for inflation of 2%. We still expect growth in the U.S. for 2022 in the range of 2-3%, and the Federal Reserve Chairman, Jay Powell, stated about the same during his remarks in May when they raised rates by 0.50% ⁽¹⁷⁾. We expect the Fed to increase rates by 0.50-0.75% at both the June and July Federal Reserve meetings, although a larger increase may be appropriate, but what the Fed will do at the September meeting will be dependent on the economic data, specifically inflation, employment, and GDP ⁽⁸⁹⁾.

The housing market may have peaked as more homes for sale and unsold homes have increased year over year for the first time since the pandemic began ⁽⁶⁶⁾⁽⁴⁴⁾. New home sales were down 16.6% in the month of April as the nationwide average on the 30-year mortgage rose above 5% ⁽⁶⁶⁾⁽³⁸⁾. Prices for materials and labor in the construction of new homes have increased, rental rates have escalated, and the cost of increased interest rates on homebuyers has gone up, so we expect the demand for housing to slow somewhat. However, as home prices decline from the healthy valuation increases experienced since COVID began with higher interest rates and a cautious home buyer, we still expect demand to remain relatively robust and prices to stabilize as demand continues to outstrip supply ⁽⁶⁶⁾⁽⁴⁹⁾. The demand in the U.S. at present is for roughly 5 million housing units; apartments, new construction, and existing homes, with only just over 1 million available ⁽⁸⁵⁾. Banks are better capitalized today than they were in the 2008 financial crisis due to reforms enacted and are in a better condition to weather bad times which may be a positive for the housing market ⁽⁶²⁾.

The global food supply is being affected by the Russian invasion of Ukraine pushing prices higher in developed nations but is causing a crisis for developing nations that may not be able to buy or buy as much as needed at the higher prices ⁽⁸⁰⁾⁽⁸³⁾. Russia has blockaded the primary Black Sea ports that grains from Ukraine are exported from and have bombed key infrastructure such as rail yards and warehouses forcing Ukraine to find other routes for export ⁽⁸⁰⁾⁽⁸³⁾. Additional routes have been made available by rail to ports in Poland and Lithuania but differences in railroad track gauge between former Soviet era countries and the rest of Europe have made this difficult with grain requiring off loading and then re-loaded to new trains, plus the overcapacity on the rail lines and the delays due to the war have hampered foreign export of the grain ⁽⁸⁰⁾⁽⁸³⁾. Ukraine is ranked in the top 10 for world exportation of each wheat, corn, sunflower oil, and barley ⁽⁸⁰⁾⁽⁸³⁾.

Economists at First Trust do not expect a recession in 2022 even with the dual headwinds of Fed monetary policy tightening by increasing interest rates coupled with quantitative tightening (bond selling) ⁽¹²⁾. First Trust believes investors may have already priced in a recession with the recent selling of equities and a wider war in Europe that may remain contained, and if so, the market could be oversold, and a reversal could be on the horizon later in the year as investors acquire more confidence and uncertainty dissipates ⁽¹²⁾. Additionally, uncertainty over the mid-term elections may become clearer in the months ahead. The mid-term elections are only 5 months away and with President Biden's approval low, especially among independents, the Democratic congressional majority may be vulnerable thus opening the door to a Republican majority in one or both house of Congress ⁽⁵⁴⁾⁽²⁵⁾. If Republicans can win a majority in either or both the House and Senate, the Biden Administration's plan for higher taxes and more government spending may be completely stalled which may be viewed as favorable for the economy in this inflationary environment, due to the consequent gridlock that ensues in the last two years of the Biden Administration ⁽¹²⁾⁽²⁹⁾.

Further, economists at First Trust believe the U.S. will not recess in 2022 due to continued consumer spending, specifically on increased purchase of services verses consumer goods ⁽¹⁾. Some companies were aided by government shutdowns but now the movement is toward businesses that were shut down by COVID, specifically leisure, travel, hospitality, and recreation ⁽¹⁾. However, Southwest Airlines just cancelled 20 thousand flights for this summer and Delta Airlines canceled 6 thousand flights, both due to staffing shortages ⁽⁸⁶⁾. Although there has been an increase in credit spending this year, unemployment, new home permits, and corporate profits are still solid, and these usually do not foretell a pending recession ⁽¹⁾.

According to the Bloomberg, the consensus among economists puts the odds of a recession starting within the next twelve months at 30% ⁽⁶⁾. Mohamed El-Erian, at Allianz, believes we are in a period of stagflation which is above average inflation coupled with low growth ⁽⁹⁰⁾⁽⁴⁷⁾. El-Erian concedes that recession is a risk during stagflation but cites a strong U.S. labor market that may keep us out of recession ⁽⁹⁰⁾⁽⁴⁷⁾. However, we do not expect a recession during the next year for the following reasons; first, although the Fed has embarked on a monetary policy tightening cycle, rates have increased less than 1% so far and quantitative tightening has just begun so we expect the Fed to pause after the next two interest rate hikes, especially if the Fed raises rates by more than 0.50% during each of the next two meetings. If the economy slows with a cautious consumer and the Fed's monetary actions by the end of summer, inflation may begin to retreat, and the Fed may be reluctant to further push the economy into recession especially if inflation begins to peak ⁽⁶⁾⁽⁹²⁾. Second, tax rates have not increased as originally proposed in President Biden's Build Back Better Plan and likely will not go up in this mid-term election year ⁽⁶⁾. Third, although businesses have been re-stocking inventories at a record pace that should eventually slow, inventories at manufactures, retailers and wholesalers are still relatively low compared to expected demand, even with a slower economy ⁽⁶⁾. Fourth, higher interest rates will slow home sales but demand for apartments and homes to be built after a decade of under-building will remain strong ⁽⁶⁾. Finally, demand for workers remain strong with 11.4 million job openings and 5.9 million unemployed according to the government in the April JOLTS report, and keep in mind there are still 822 thousand workers that have not returned to work since COVID began ⁽⁵³⁾⁽⁵⁵⁾⁽⁶⁾⁽³²⁾.

Although it may not emerge for another few months, a brighter picture may appear for the remainder of the year after fears of slower growth, overtightening by the Fed, spread of the war in Ukraine, and the effects of China's lockdown dissipate ⁽²¹⁾. The Federal Reserve finally seems to be focused on taming inflation but may pivot to a more dovish stance and consider the economic costs of excessive rate hikes as inflation begins to decline ⁽²¹⁾.

The market is already pricing in a lot of bad news both with expected interest rate hikes and anticipated downward revisions to corporate earnings ⁽²⁴⁾⁽⁹³⁾. Higher interest rates for mortgages may continue to slow housing demand and cool consumer discretionary spending ⁽²⁴⁾. There is some initial evidence that supply chains backlogs are beginning to crown in some areas and any surprise could be a positive for the economy, plus China lockdowns for COVID appear to be

over and an end to the war in Ukraine would be a positive development ⁽²⁴⁾. Blackstone's Joe Zidle believes a recession usually contains two preconditions that are not currently present within our economy; corporate profit growth turns negative, and the unemployment rate rises ⁽¹⁵⁾.

The economic trajectory is hard to define at present with no clear sign yet that the 40-year high in inflation has peaked coupled with widespread labor shortages, geopolitical tensions, market volatility, and continued supply chain issues ⁽⁶⁶⁾. However, the picture may become clearer when inflation peaks, but if housing continues to slow, and the job market cools without a peak with inflation, that may add some credence to stagflation and recession fears ⁽⁶⁶⁾. Ultimately, we are in a tug of war between the E's, employment and earnings, and the I's, inflation and interest rates for the trajectory of the U.S. economy. If the E's win out, meaning employment remains strong and corporate earnings continue to increase albeit at presumably a lower rate, the economy would be expected to stay out of recession, but if the I's win, denoting inflation continues to rise and the Fed continues to raise rates above what is expected, the economy will likely be expected to go into recession ⁽²³⁾.

Although higher interest rates and an inflationary environment may slow growth in 2022 as estimates for consumer demand and corporate profits are reduced, economists at Vanguard believe growth will be 3.5%, Blackrock is predicting 2.5%, and many others including the Fed are forecasting something in between ⁽⁸⁾⁽²¹⁾. Market pessimism indicating an imminent recession may be premature based on these projections. However, the consumer sentiment index as measured by the University of Michigan fell to 50.2 in May which is the lowest reading on record with those surveyed indicating inflation their #1 concern ⁽⁹⁵⁾.

Retail stores benefited from pandemic government stimulus checks and stay at home savings which boosted demand for consumer goods, but as the pandemic transitions to endemic status, Americans are transitioning from spending on goods to spending on services such as travel, restaurants, and other activities as well as necessities such as food and gasoline ⁽⁹⁾⁽⁸²⁾. Consumer credit card spending was up 11% on a year over year basis; spending on leisure items such as airfare was up 91% and restaurants up 17% year over year which appears to be getting back to pre-Covid norms ⁽⁹⁾. Food and gasoline prices are creating headwinds for Americans especially at the lower income levels, but Americans continue to spend, and consumer spending comprises approximately 2/3rds of economic growth ⁽⁹⁾. Economists at Blackrock believe the restart from the pandemic lockdowns is still in the early stages, fears over recession are overblown, and further that the ultimate Fed tightening will be less than predicted ⁽¹⁰⁾.

The contrarian view that the U.S. is headed for recession is put forth by Capital Group economist, Darrell Spence. Spence believes the U.S. has entered a wage-price spiral with workers requiring larger salaries for higher consumer prices and employers raising wages in a tight labor market to get the needed workers, with the corresponding productivity growth with the higher wages not enough to offset the cost ⁽²⁶⁾⁽⁵¹⁾. Spence believes the Fed will need to break the spiral which will likely require the unemployment rate to rise and GDP growth to slow below potential ⁽²⁶⁾⁽⁹⁶⁾. This means rates must go higher than the market is predicting and more than likely into recession for the Fed to break inflation ⁽²⁶⁾⁽⁹⁴⁾. However, he does provide alternative scenarios that may emerge, such as inflation begins to fall due to high inflation reaction by consumers and businesses backing away from potential purchases until prices fall unless necessary, or if the Fed can achieve a 'soft landing' or put differently, a moderate slowdown, or lastly if the Fed decides to let inflation run unchecked ⁽²⁶⁾. Spence considers none of the alternative scenarios highly probable and thus is predicting a recession in the U.S. ⁽²⁶⁾.

"Change is the investor's only certain" –Thomas Rowe Price, Jr.

Markets

Markets trade on technical indicators, fundamental analysis, and emotions. Technical analysis is a trading discipline utilized to evaluate securities and market indexes to identify trading opportunities by analyzing statistical trends gathered from trading activity, such as price movement, trading volume, and the relative strength of a security compared to its peers. Technical indicators assist traders in assessing the direction and strength of trends often referred to as momentum. Common examples of technical indicators include the 50-day and 200-day moving averages and the relative strength index. Technical indicators tend to be more effective in the short-to-intermediate term, whereas fundamental analysis tends to be more effective in the intermediate-to-long term with investing.

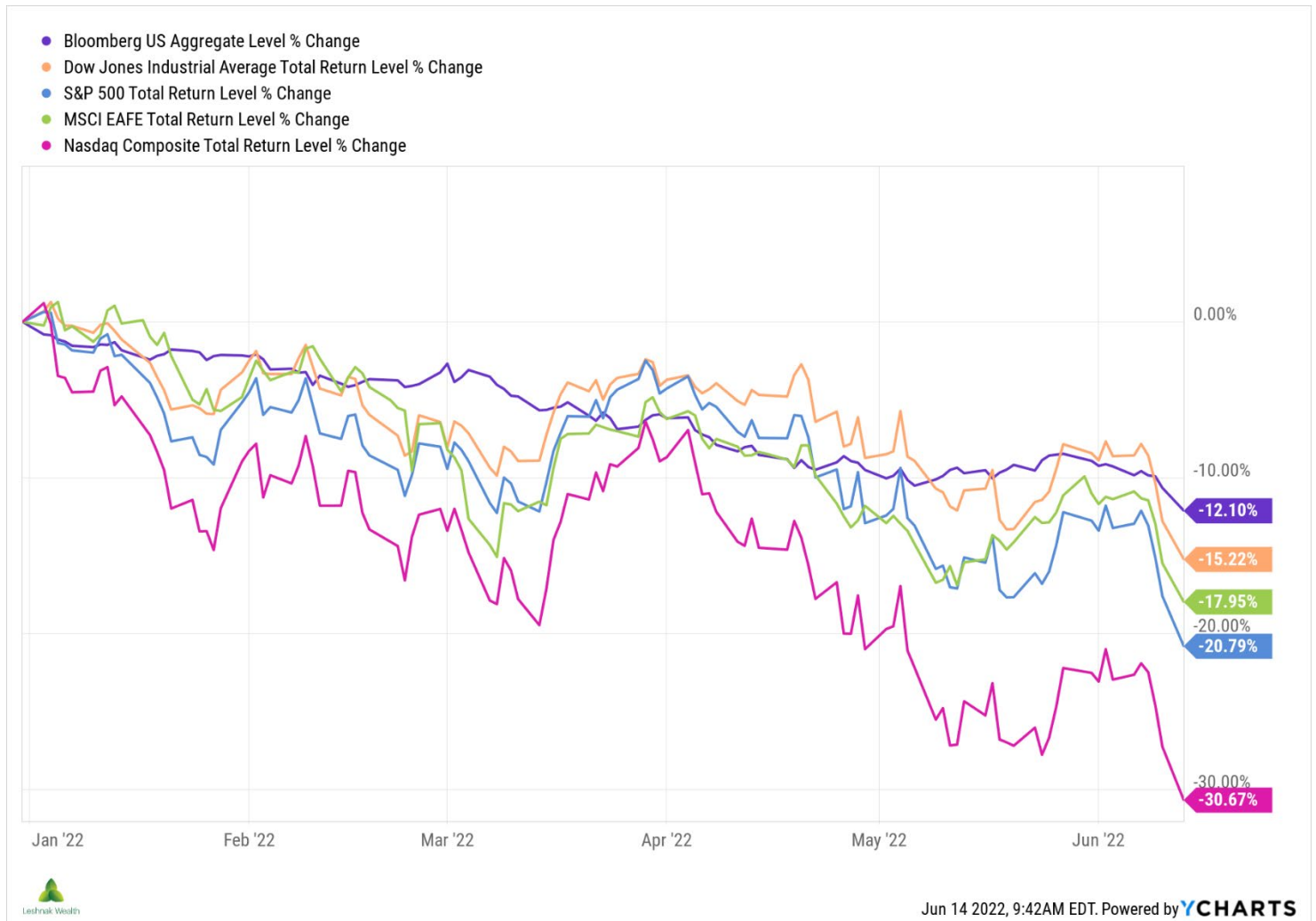
Fundamental analysis is a method of assessing the intrinsic value of a security by analyzing various macroeconomic and microeconomic factors. The intrinsic value can then be compared to its current market price to aid with investment decisions. Macroeconomic factors such as the state of the economy and industry can be assessed with such data points as interest rates, gross domestic product, housing prices, bond yields, consumer price index, unemployment, manufacturing activity and retail sales. Microeconomic factors such as the effectiveness of the company's management can be assessed with common ratios such as the price-to-earnings, price-to-sales, price-to-book, return-on-equity, earnings-per-share, and debt-to-equity.

Behavioral finance studies how emotions impact decisions when investing. Behavioral finance seeks to find out why investors do not always make rational or optimal decisions despite having the information and the tools available. Two of the most powerful investor emotions are fear and greed ⁽¹⁰⁴⁾. Investors sometimes make rash decisions when investing based on the fear of loss, or conversely missing out, or possibly because everyone else is selling, or conversely everyone buying, known as herd mentality, to feel a sense of short-term peace of mind, or conversely a sense of wanting to get in on the easy money, despite the decision potentially going counter to their longer-term goals and their investment plan ⁽¹⁰⁴⁾. It is said that investors derive double the stress when their investment goes down as they do the euphoria when their investment goes up. Behavioral finance helps us understand why we feel the way we do when our portfolio periodically declines, the human emotions involved, biases, and cognitive limitations based on that emotion in processing and responding to new information with our investments, especially when it may seem like the preverbal sky is falling.

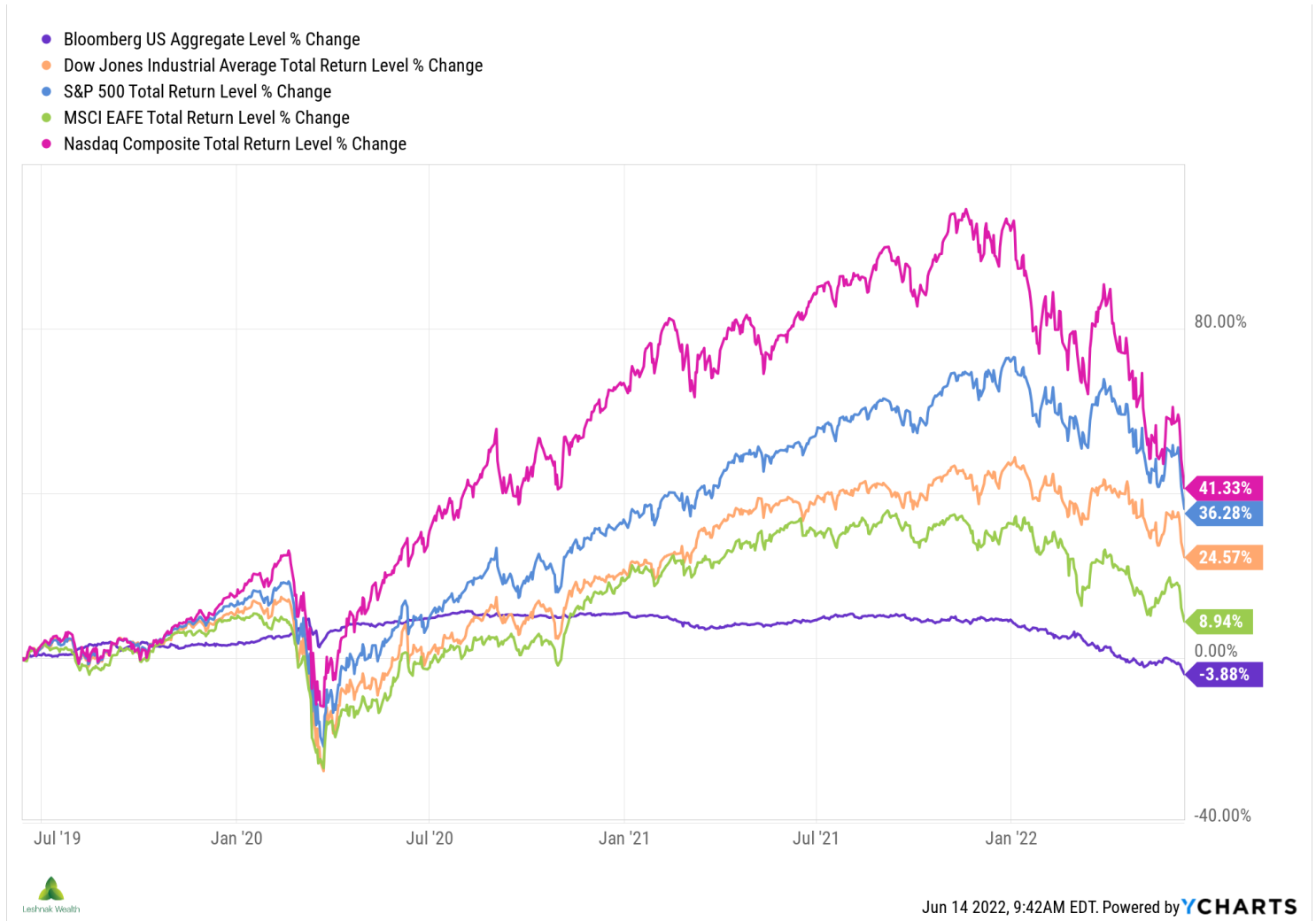
Technical and fundamental analysis as well as emotions are always present in the markets; however, in times of market peaks and valleys, emotions such as greed and fear tend to be more prevalent. We utilize momentum, a form of technical indicator, for a portion of our LW Portfolio Models, and certainly deploy fundamental analysis within the LW Models but emotions are difficult to plan for in the short term and are continually changing. However, the trend would be expected to reveal itself with the momentum technical indicator as well as possible modification to the fundamental outlook of a sector or asset class.

The 24-hour news cycle can be stressful as the press sensationalizes market gyrations that do not calm investor nerves, and worse yet, may prompt a feeling of 'I need to do something' ⁽⁴⁾. When the market goes on a volatility spree, that is when you may be best served by reviewing and trusting your investment plan ⁽¹⁰⁴⁾⁽⁴³⁾. Markets go up, down, and sideways all the time depending on the period you are reviewing, but more than likely those market moves have been accounted for in your properly structured investment plan ⁽²⁷⁾⁽¹⁰⁴⁾. Please know that one of the worst ways to drive yourself crazy is to watch your account values too frequently ⁽²²⁾.

The markets have declined so far this year from their record highs of 2021. The following graph from YCharts depicts the major market indexes as of June 13, 2022. As you can see the best performing index illustrated is the Bloomberg Aggregate Bond Index declining -12.10% year to date, with the worst performing, the Nasdaq Composite Index down -30.67% thus far.



However, to provide prospective the following chart provided by YCharts illustrates the same indexes over the last 36 months ending 6/13/2022 as opposed to the year-to-date time frame illustrated above. In this chart we find the best performing index is the Nasdaq Composite Index up a cumulative 41.33% during those three years, despite the recent downturn. Conversely, the worst performing index is the Bloomberg Aggregate Bond Index losing -3.88% cumulatively in the 36 months ending 6/13/2022 which also includes the recent downturn.



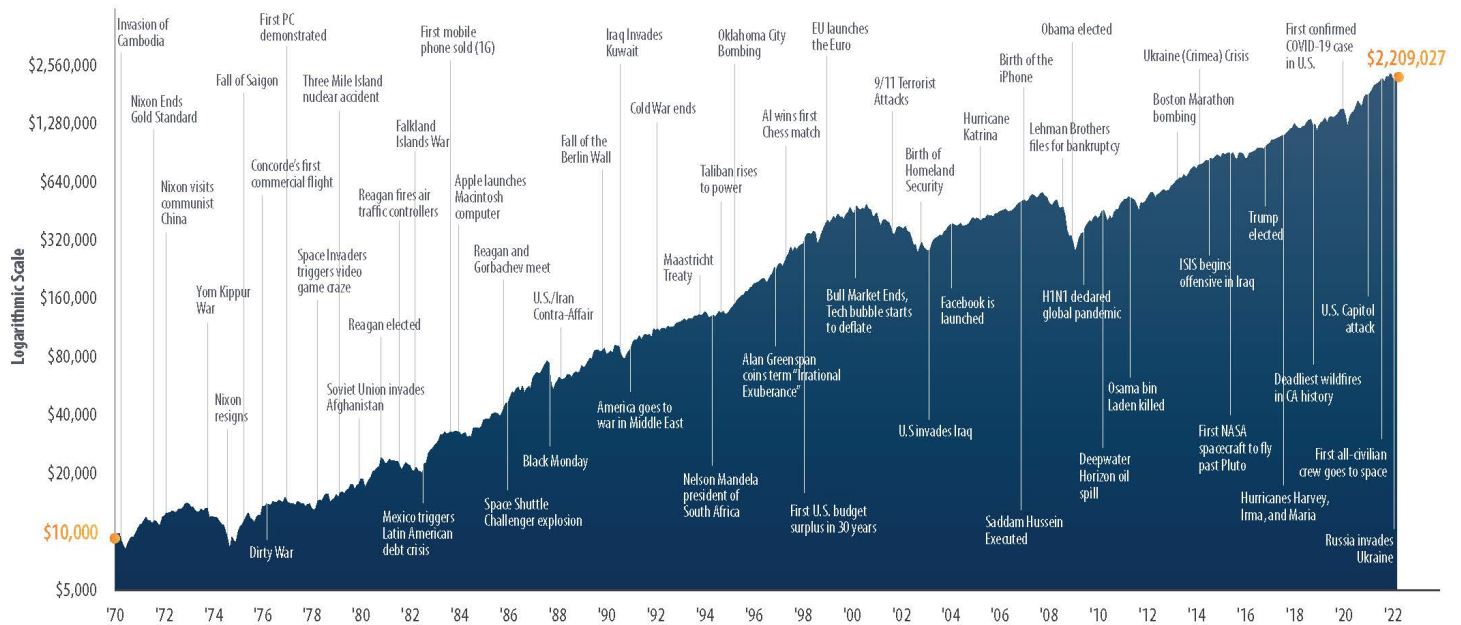
The illustration below was produced by First Trust and depicts the growth of the S&P 500 Index during the prior 52 years ending 3/31/2022. It is important to point out for perspective all the data points contained within this chart represent the crises points and major events occurring during this period.

Crisis and Events

S&P 500 Index: 1970 – 2022

This chart shows the growth of \$10,000 based on S&P 500 Index performance over the last several decades. We believe looking at the market's overall resiliency through major crises and events helps to gain a fresh perspective on the benefits of investing for the long-term.

THE AVERAGE ANNUAL TOTAL RETURN OF THE S&P 500 INDEX FOR THE PERIOD SHOWN BELOW WAS 10.88%.



Source: Bloomberg, First Trust Advisors L.P., 12/31/1969 – 3/31/2022. **Past performance is no guarantee of future results.** This chart is for illustrative purposes only and not indicative of any actual investment. The S&P 500 Index is an unmanaged index of 500 stocks used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index. Index returns do not reflect any fees, expenses, or sales charges. Stocks are not guaranteed and have been more volatile than the other asset classes. These returns were the result of certain market factors and events which may not be repeated in the future.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

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The last illustration is interesting and was produced by First Trust using 40 plus years of the S&P 500 Index data ending 3/31/22. The yellow bars in the chart represents the inter-year low for the S&P 500 Index during each calendar year. The blue bars represent the ultimate calendar year return. The lesson one could discern from this chart is that moving out of

the market especially during extremely volatile periods may produce short-term stress relief but staying the course may provide longer-term benefits.

Staying the Course



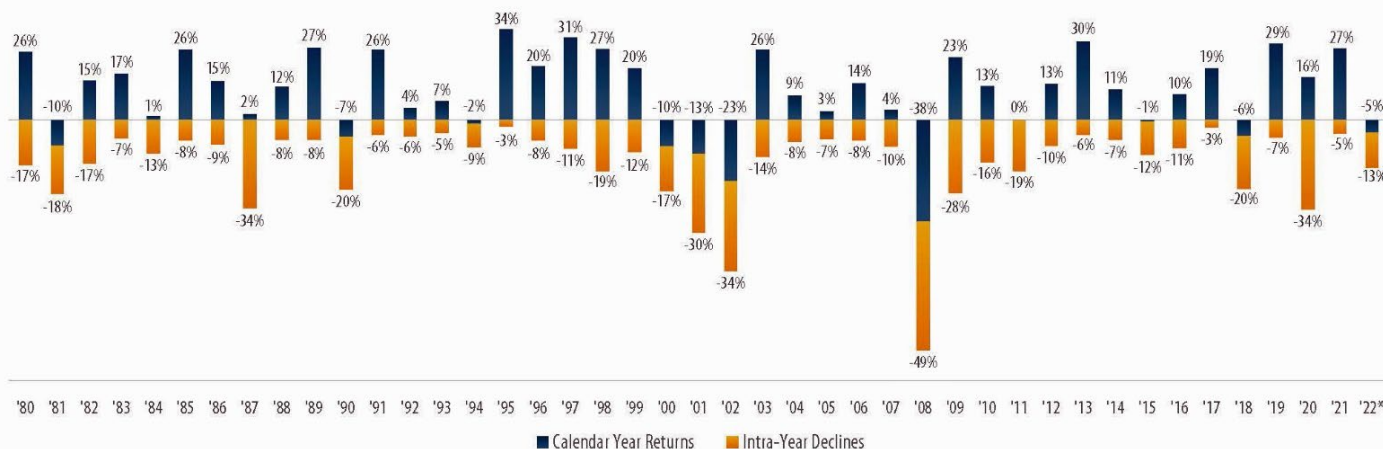
Investors tend to see short-term volatility as the enemy. Volatility may lead many investors to move money out of the market and "sit on the sidelines" until things "calm down." Although this approach may appear to solve one problem, it creates several others:

1. When do you get back in? You must make two correct decisions back-to-back; when to get out and when to get back in.
2. By going to the sidelines you may be missing a potential rebound. This is not historically unprecedented; see chart below.
3. By going to the sidelines you could be not only missing a potential rebound, but all the potential growth on that money going forward.

We believe the wiser course of action is to review your plan with your financial professional and from there, decide if any action is indeed necessary. This placates the natural desire to "do something," but helps keep emotions in check.

INTRA-YEAR DECLINES VS. CALENDAR YEAR RETURNS

Volatility is not a recent phenomenon. Each year, one can expect the market to experience a significant correction, which for the S&P 500 has averaged approximately 14% since 1980. History has shown that those who chose to stay the course were rewarded for their patience more often than not.



Source: Bloomberg, First Trust Advisors L.P. *As of 3/31/2022. Past performance is no guarantee of future results. The benchmark used for the above chart is the S&P 500 Index. The S&P 500 Index is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index. Index returns do not reflect any fees, expenses, or sales charges. Returns are based on price only and do not include dividends. This chart is for illustrative purposes only and not indicative of any actual investment. These returns were the result of certain market factors and events which may not be repeated in the future.

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"We have confidence despite the recent market volatility that your portfolios are positioned to achieve your long-term goals and that your wealth plan remains on track." –Bob Leshnak

LW GamePlan

Our **LW Portfolio Model** strategies are generally meeting or exceeding our expectations when compared to the overall market indices during the recent decline. However, we continually strive for innovative ways to increase return and lower volatility over the market cycle. We employ each strategy for unique and specific reasons⁽⁹⁷⁾. Not every strategy will outperform every time and we will not be perfect in our decisions. Overall, we are proud of the combination of managers (both equities and fixed income) and stocks we have assembled within our LW Portfolios and their respective performance. However, we believe as important to portfolio performance are the wealth plans we have crafted

together, which we continue to revise, update, and carry out. We believe our LW Portfolios are best positioned to go through these volatile times and enable you to fund your retirement income and overall wealth plan—just as we have planned. With that said, we may make some adjustments to our LW Portfolio Models as we go into the summer considering the economic forecast contained herein. Any changes are expected to fine-tune the portfolio verses a wholesale modification or change of overall strategy.

Keep in mind since interest rates were at record lows, our experience indicated that bond maturities should be short to intermediate-term and their quality should be high plus we also added inflation protected bonds over the last two years⁽⁴⁾. Bonds have posted their worst one-year performance since 1842, yet the bond strategies we employ within our LW Portfolio Models have declined less than the indices and are down less than the equity markets year to date⁽⁴⁾. We generally prefer equities verses fixed income because of the inflation fighting ability of stocks plus their ability to compound wealth⁽⁴⁾. Within U.S. equities, we prefer large high quality domestic dividend paying stocks verses smaller growth companies because smaller growth companies offer little or no dividend yield and are generally more volatile over an economic cycle⁽⁴⁾. Although we hold foreign equities in most of our LW Portfolio models, we continue to emphasize domestic equities verses foreign stocks.

Our **LW Portfolio Models** are not immune to declines in global markets nor do we have a crystal ball, but neither do any of the market analysts and forecasters. Our belief is that our LW Portfolio Model construction has positioned us for potential resilience in most environments and situates the portfolio to possibly take advantage of market mispricing. We see no need to change course or modify the overall asset class allocation due to market corrections, or sudden market shocks unless a fundamental change in the underlying outlook for the domestic or global economy has greatly diminished or brightened verses our expectations. As the ancient Buddhist proverb states “If we are facing in the right direction, all we have to do is keep on walking”. Corrections and pullbacks can be expected to last shorter periods on average compared to the bull markets they take reprieve from, as the greed present turns to fear and shakes out those investors who are not fundamentally based in their convictions.

The **LW Portfolio Models** are globally diversified and strategically constructed with core equity positions in small, medium, and large cap equities, each straddled by momentum-based and value-based investment positions. We believe adding momentum-based investment positions using technical analysis offers the opportunity to allow current market trends to play out while also providing the flexibility to potentially reduce exposure when market trends retreat. We also believe adding value-based positions puts us in the position of the “turtle”, in the proverbial tortoise verses the hare scenario, over the long-term with equities. Value-based investment involves buying securities whose shares appear underpriced by a form of fundamental analysis. Additionally, we believe that by combining value and momentum strategies across diverse markets and asset classes may result in significantly higher risk-adjusted rates of returns based on the academic research conducted. Lastly, we prescribe dividend yield from all our equity investment positions so that no matter what markets are doing day to day, we have dividends continuously coming into the portfolio. Our fixed income blueprint for the portfolio consists of allocations to core domestic, foreign core, strategic investment grade, inflation protected, and high yield bonds. Overall, we evaluate investment positions in seven asset classes including domestic equities, foreign developed stocks, foreign emerging market equities, domestic bonds, foreign bonds, cash equivalents, and alternative assets such as real estate, commodities, gold, natural resources and infrastructure for inclusion within our overall asset allocations. How much of each asset class, if any, we hold in these asset classes is based on your unique risk tolerance, financial resources and personal goals and objectives.

As your financial fiduciary, the Leshnak Wealth team cares deeply about your financial well-being and will monitor for rebalancing opportunities that may add value to your portfolio, or to be defensive as conditions might warrant. We know that as your advisor, the trust you bestow upon us is built and maintained on three pillars; doing what we say we will do, assisting with planning for and achieving your financial independence, and providing unbiased advice with your best interest at the forefront. As always, please call with questions or if you wish to discuss your specific portfolio in greater detail.

–Bob Leshnak, June 14, 2022

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