Q3 2022 NEWSLETTER

IMPACT

FINANCIAL STRATEGIES

July 1, 2022

Belief. Reality. Perspective.

Belief. I believe that moments matter more than money. I believe life is about more than the *things we have*. I also believe that the global economy is not in danger of immediate collapse (even though I believe in business cycles and that eventually we will have another recession). Simultaneously, I believe that *eventually* markets will reach all-time new highs. I believe that the world will continue to live with Covid. Finally, I believe that as long as people around the world want to live a better quality of life, the companies providing services and products that enhance lives will create value and grow in accordance with populations and economies.

Reality. I am also a realist. I am a human being along with you, and I feel the same emotions about the world as you do. I understand that there is a lot going on that is creating angst, fear, anxiety, and pessimism. Consumer sentiment in our nation is at an all-time low. Inflation is at 40 year highs, the markets had the worst six months in over five decades. There is continuing tragedy on our nation's soil and around the world. The reality is that the markets have (finally, and at least partially) priced in these facts after ignoring them for much of the last two years. On a personal level, it feels like everyone is dealing with some level of grief. This last quarter has been so difficult for so many of you. You have lost loved ones, you have lost spouses, you have lost parents, aunts, even jobs and pets. The reality is that we are still not emotionally recovered from this pandemic, and things keep coming at us. We are being constantly barraged by sensationalistic 24/7 news, social media rants, upcoming mid-term elections, and colorful and addictive alerts. It is hard to step back and unemotionally re-assess reality.

Perspective. 246. 48. 2000+ Last week, our country celebrated its 246th year of Independence. Last month, I turned 48, I was lucky enough to spend a few days for my birthday at my favorite place in nature; the great California Redwoods. We spent hours walking among trees, that in many cases, are over 2000 years old. Perspective. Considering the duration of our country's independence against some of our country's oldest living things illustrates the absurdity of anyone prognosticating or focusing on daily, weekly, or monthly moves in the US Economy or the stock market. Of course, it matters; and it is important. However, when we can take a step back and have a larger perspective it suddenly does not seem as important as the moments. The last goodbye, or one last anniversary or birthday to celebrate because there may not be another; or times spent with children or grandchildren for that very special small time of their lives while they are still able to be innocent, loving, "kids."

Believe that history will repeat itself, or least rhyme, going forward. Address the financial *reality* we are experiencing and adjust as needed (that's what we are here for). *Have perspective*; don't lose sight of what matters and try not to have an emotional response to what we cannot control. Sounds easy… I know it's not. But we are here walking alongside you. I hope you enjoy this newsletter, please reach out if you have any questions or comments.

Justin

Quarterly Insights – July 2022

High Inflation and Rising Interest Rates Result in the Worst S&P 500 Performance in Decades

The S&P 500 continued to decline in the second quarter, hitting the lowest level since December 2020 as still-high inflation, sharp increases in interest rates, rising recession risks, and ongoing geopolitical unrest pressured stocks and other assets.

After a rebound in March, the S&P 500 dropped sharply in April to start the second quarter. While some of the reasons for the declines were similar to the first quarter (rising rates, high inflation, geopolitical concerns) the primary catalyst for the April sell-off was something new: a massive COVID-related lockdown in China. Unlike most of the rest of the world, China continues to enforce a "Zero-COVID" policy, whereby small outbreaks are met with extremely intense city- and province-wide lockdowns. At the peak of the recent COVID outbreak and subsequent lockdowns throughout China, it was estimated that 46 separate cities and provinces, impacting 300 million people and representing nearly 80% of China's economic output were shut in and shut down, essentially halting the world's second-largest economy. This sharp drop-in economic activity not only increased the chances of a global recession but also compounded global supply chain problems (Shanghai, the world's busiest port, operated far below capacity during the lockdowns). The severe decline in economic activity in China combined with lingering concerns about rising interest rates and high inflation hit stocks hard in April, and the S&P 500 fell 8.7%.

The selling continued in early May, as the Federal Reserve raised interest rates by 50 basis points at the May 4th meeting, the single-biggest rate hike in 22 years. Additionally, at the press conference, Fed Chair Jerome Powell clearly signaled that the Fed would continue to hike rates aggressively to tame inflation and that weighed on stocks, pressuring the S&P 500 to fall to new 2022 lows in mid-May. But towards the end of the month, markets staged a modest rebound thanks to potential improvement in multiple market headwinds. First, as COVID cases declined, the Chinese economy started to reopen, and by the end of May, the port of Shanghai was operating at 80% capacity, a material improvement from earlier in the month. Additionally, Atlanta Fed President Raphael Bostic stated that the Fed might "pause" rate hikes in the late summer or early fall, and that gave investors some hope that the end of the Fed rate hike cycle may be closer than previously thought. Finally, some inflation metrics implied price pressures may be peaking. Those potential positives, combined with deep, short-term oversold conditions in equity markets, prompted a solid rally in late May and the S&P 500 finished the month with a fractional gain.

But the relief didn't last long. On June 10th, the May CPI report showed inflation had not yet peaked as CPI rose 8.6% year-over-year, the highest reading since 1982. That prompted a violent reversal of the late-May gains, and the selling and market volatility was compounded when the Federal Reserve increased interest rates by 75 basis points on June 15th, the biggest rate hike since 1994. Additionally, Fed Chair Powell again warned that similar rate hikes are possible in the coming months. The high CPI reading combined with the greater-than-expected rate hike hit stocks hard, and the S&P 500 dropped sharply in mid-June to its lowest level since December 2020. During the last two weeks of the quarter, markets stabilized as commodity prices declined while U.S. economic readings showed a clear moderation in activity and that rekindled hope that a peak in inflation and an end to the rate hike cycle might come sooner than feared. Those factors, combined with the fact that markets had become nearterm oversold again, resulted in a modest bounce late in the month, but the S&P 500 still finished with a solidly negative return for June.

In sum, the factors that pressured stocks in the first quarter, including high inflation, the prospect of sharply higher interest rates, geopolitical unrest, and rising recession fears, also weighed on stocks in the second quarter and until investors get relief from these headwinds, markets will remain volatile.

Second Quarter Performance Review

All four major stock indices posted negative returns for the second straight quarter, and like in the first quarter, the tech-heavy Nasdaq underperformed primarily thanks to rising interest rates while the Dow Jones Industrial Average relatively outperformed. Also, like the first quarter, rising rates and growing fears of an economic slowdown fueled the continued rotation from high valuation, growth-sensitive tech stocks to sectors of the market that are more resilient to rising rates and slowing economic growth.

By market capitalization, large-cap stocks again outperformed small-cap stocks in the second quarter, although the performance gap was small. Large-cap outperformance continued to be driven by the rise in interest rates as well as growing recession fears. Small-cap stocks are typically more reliant on debt financing to sustain their businesses, and therefore, more sensitive to rising interest rates than large-cap stocks. Additionally, investors again moved to the relative safety of large caps amidst rising risks of a future slowing of economic growth or recession.

From an investment style standpoint, both value and growth registered losses for the second quarter, a departure from the first quarter where value posted a positive return. However, value did again handily outperform growth on a relative basis in the second quarter. Rising interest rates, still-high inflation, and increasing recession concerns caused investors to continue to flee growth-oriented tech stocks and rotate to more fairly valued sectors of the market, although again, both styles finished the quarter with negative returns.

On a sector level, all 11 S&P 500 sectors finished the second quarter with negative returns. Relative outperformers included traditionally defensive sectors such as utilities, consumer staples, and healthcare, which are historically less sensitive to a potential economic slowdown, and the quarterly losses for these sectors were modest. Energy was also a relative outperformer thanks to high oil and gas prices for much of the second quarter, although a late-June drop in energy commodities caused the energy sector to finish the quarter with a small loss.

Sector laggards in the second quarter were similar to those in the first quarter, with communication services, tech, and consumer discretionary sectors seeing material declines due to the aforementioned, broad rotation away from the more highly valued corners of the market. Specifically, internet stocks again weighed on the communications sector, while traditional retail stocks were a drag on the consumer discretionary sector following unexpectedly bad earnings from several major national retail chains. Financials also lagged in the second quarter thanks to rising fears of a future recession combined with a flattening yield curve, which can compress bank profit margins.

US Equity Indexes	Q2 Return	YTD
S&P 500	-17.41%	-19.96%
DJ Industrial Average	-12.17%	-14.44%
NASDAQ 100	-23.50%	-29.22%
S&P MidCap 400	-16.62%	-19.54%
Russell 2000	-18.02%	-23.43%

Source: YCharts

Internationally, foreign markets declined in the second quarter as the Russia-Ukraine war continued with no signs of a ceasefire in sight. However, foreign markets relatively outperformed U.S. markets as foreign central banks are expected to be less aggressive with future rate increases compared to the Fed. Emerging markets outperformed foreign developed markets thanks to high commodity prices (for most of the quarter) and despite rising global recession fears.

International Equity Indexes	Q2 Return	YTD
MSCI EAFE TR USD (Foreign Developed)	-15.15%	-19.25%
MSCI EM TR USD (Emerging Markets)	-11.92%	-17.47%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	-14.34%	-18.15%

Source: YCharts

Commodities registered slightly negative returns in the second quarter thanks mostly to steep declines in late June. Fears of a global recession hit most commodities at the end of the quarter and erased what was, up to that point, a solidly positive performance for the broader commodity complex. Oil finished the quarter with a small loss. Prior to late June, oil prices were sharply higher for the quarter, but rising fears of reduced future demand and increased supply weighed on the oil market into the end of the quarter. Gold, meanwhile, logged solidly negative returns despite the increase in market volatility and multi-decade highs in inflation, as the strong dollar and rising real interest rates weighed on the yellow metal.

Commodity Indexes	Q2 Return	YTD
S&P GSCI (Broad-Based Commodities)	-1.62%	35.80%
WTI Crude Oil	-1.78%	41.43%
Gold Price	-5.88%	-1.28%

Source: YCharts/Koyfin.com

Switching to fixed-income markets, most bond indices again registered solidly negative returns as still-high inflation and the prospect of faster-than-expected rate increases from the Fed weighed on fixed-income investments.

Looking deeper into the bond markets, shorter-term Treasury Bills again outperformed longer-duration Treasury Notes and Bonds as high inflation and the threat of more than previously expected Fed rate hikes weighed on fixed income products with longer durations. Short-term Treasury Bills finished the quarter with a slightly positive return.

Corporate bonds underperformed in the second quarter as rising recession fears paired with already-high inflation weighed considerably on corporate debt. For much of the quarter, high-quality investment-grade bonds and lower-quality high yield corporate bonds had similar negative returns, implying investor concerns about a future recession were general in nature. However, an increase in disappointing economic data hit high-yield corporate bonds at the end of the quarter and they underperformed their higher-quality counterparts.

US Bond Indexes	Q2 Return	YTD
BBgBarc US Agg Bond	-4.63%	-10.35%
BBgBarc US T-Bill 1-3 Mon	0.12%	0.16%
ICE US T-Bond 7-10 Year	-4.00%	-10.53%
BBgBarc US MBS (Mortgage-backed)	-3.98%	-8.78%
BBgBarc Municipal	-2.77%	-8.98%
BBgBarc US Corporate Invest Grade	-7.16%	-14.39%
BBgBarc US Corporate High Yield	-9.78%	-14.19%

Source: YCharts

Third Quarter Market Outlook

The S&P 500 just realized its worst first-half performance since 1970 as initial market headwinds of high inflation and sharply rising interest rates combined with growing recession risks and extreme geopolitical uncertainty pushed stocks and bonds sharply lower through the first six months of the year.

Those declines are understandable considering inflation reached a 40-year high, the Federal Reserve raised interest rates at the fastest pace in decades, the world's second-largest economy effectively shut down and the Russia-Ukraine war raged on.

But while the volatility and market declines of the first six months of 2022 have been unsettling and painful, the S&P 500 now sits at much more historically attractive valuation levels. And at current prices, a lot of negativities have been priced into the market, opening the possibility of positive surprises as we move forward in 2022.

Regarding inflation and Fed rate hikes, markets have aggressively priced in stubbornly high inflation and numerous additional rate hikes from the Federal Reserve between now and early 2023. But if we see a definitive peak in inflationary pressures in the coming months, then it's likely the Federal Reserve will hike rates less than currently feared, and that could be a materially positive catalyst for markets.

On economic growth, the Chinese economic shutdown has increased global recession concerns, but recently officials in Shanghai declared "victory" against the latest COVID outbreak and if Chinese economic activity can return to normal, that will be a positive development for global economic growth. Meanwhile, recession fears are rising in the U.S., but stocks are no longer richly valued, and as such, aren't as susceptible to an economic slowdown as they were at the start of the year.

Finally, regarding geopolitics, the human tragedy in Ukraine continues with no end in sight, but the conflict has not expanded beyond Ukraine's borders, and many analysts believe that some sort of conflict resolution can be reached in the coming months. Any sort of a truce between Russia and Ukraine will likely reduce commodity prices and global recession fears should decline as a result.

Bottom line, the markets have experienced numerous macro-and micro-economic headwinds through the first six months of the year, and they have legitimately pressured asset prices. But the sentiment is very negative at the moment, and a lot of potential "bad news" has been at least partially priced into stocks and bonds at these levels, again creating the opportunity for potential positive surprises.

To that point, the S&P 500 has declined more than 15% through the first six months of the year five previous times since 1932. And in all those instances, the S&P 500 registered a solidly positive return for the final six months of those years.

Obviously, past performance is not necessarily indicative of future results, and we will continue to be vigilant to additional risks to portfolios, but market history provides a clear example that positive surprises can and have occurred even in difficult markets such as this. More importantly, through each of those declines, markets eventually recouped the losses and moved to considerable new highs.

At Impact Financial Strategies, we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. Successful investing is a marathon, not a sprint, and even temporary bouts of volatility like we experienced over the past three months are unlikely to alter a diversified approach set up to meet your long-term investment goals.

Therefore, it's critical for you to stay invested, remain patient, and stick to the plan, as we've worked with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline.

Rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,

All your team at Impact Financial Strategies

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FINANCIAL STRATEGIES

A Game of Multiples (Updated 7/7/2022)			
Market Influence	**Current Situation**	**Things Get Better If…**	**Things Get Worse If…**
Inflation	Inflation remains at multi-decade highs as CPI continues to move higher month after month.	The July CPI report shows a decline in yoy headline CPI (towards 8%).	The July CPI increases again, above 8.6%.
Fed Tightening	The Fed hikes 75 bps in reaction to the hot June CPI and rate hikes going forward are expected to be between 50-75 bps.	The Fed hikes 50 bps in July and starts to signal it's nearing a place where it can pause rate hikes.	The Fed hikes 75 bps in July and signals more are coming until inflation is under control.
China Lockdowns	COVID-19 cases have declined in China and the economy has largely opened up, but "Zero COVID" remains the policy so the consistent threat of lockdowns remain.	COVID-19 cases stay low, and ideally, Chinese officials distance themselves from "Zero COVID."	COVID-19 cases rise, and new lockdowns are implemented in industrial cities (Beijing, Shanghai).
Russia/Ukraine War	Russia continues to make territory gains in eastern Ukraine and there remains no progress towards a ceasefire.	Russia declares "victory" and stops its advance and discusses terms of a ceasefire.	The conflict extends beyond Ukraine, increasing the risk of a larger conflict (possibly with NATO).
Economic Growth	Economic growth is losing momentum, although that's what's necessary to eventually get to "peak hawkishness."	Economic growth continues to moderate, allowing the Fed to "pause" rate hikes in the fall or winter.	Economic growth collapses, resulting in intense stagflation.
Expected 2023 S&P 500 EPS	**$225**	**$235**	**$210**
Multiple	16X-17X	17X-18X	15X-16X
S&P 500 Range	3,600-3,825	3,995-4,230	3,150-3,360
S&P 500 Target (Midpoint)	3,713	4,113	3,255
Change from today	**-4.7%**	**5.5%**	**-17%**

DISCLOSURES

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The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market.

The Dow Jones Industrial Average (DJIA), commonly known as "The Dow" is an index representing 30 stocks of companies maintained and reviewed by the editors of the Wall Street Journal.

The NASDAQ Composite Index is an unmanaged index of securities traded on the NASDAQ system.

The S&P MidCap 400® provides investors with a benchmark for mid-sized companies. The index, which is distinct from the large-cap S&P 500, measures the performance of mid-sized companies, reflecting the distinctive risk and return characteristics of this market segment..
Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index.

The S&P GSCI is a composite index of commodities that measures the performance of the commodity market. S&P GSCI Gold is an index tracking changes in the spot price for gold bullion. S&P GSCI Crude Oil is an index tracking changes in the spot price for crude oil. GLD is a gold index fund based on gold and holds gold and/or cash as its only assets, but shareholders are not guaranteed to receive physical gold in exchange for their shares.

The MSCI EAFE (Europe, Australasia, and Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States & Canada. The EAFE consists of the country indices of 22 developed nations.

The MSCI Emerging Markets is designed to measure equity market performance in 25 emerging market indices. The index's three largest industries are materials, energy, and banks.

The MSCI ACWI (All Country World Index) is a free floating-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets.

The Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixedrate taxable bond market.

The Barclays US T-Bill index measures the performance of public obligations of the U.S. Treasury that have a remaining maturity of greater than or equal to 1 month and less than 3 months.

The ICE U.S. Treasury 7-10 Year Bond Index is market value weighted and is designed to include U.S. dollar denominated, fixed rate securities with minimum term to maturity greater than or equal to seven years and less than ten years.
Barclays Capital U.S. MBS Index measures the performance of investment grade fixed-rate mortgage-backed pass-through securities of GNMA, FNMA, and FHLMC.

The Barclays Capital Municipal Bond is an unmanaged index of all investment grade municipal securities with at least 1 year to maturity.
The Bloomberg Barclays US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USDdenominated securities publicly issued by US and non-US industrial, utility and financial issuers.

The Bloomberg Barclays U.S. Corporate High Yield Bond Index is composed of fixed-rate, publicly issued, non-investment grade debt, is unmanaged, with dividends reinvested, and is not available for purchase. The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility and Finance, which include both U.S. and non-U.S. corporations.

Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Diversification and asset allocation do not ensure profit or protect against loss. Holding investments for the long term does not insure a profitable outcome. Investing involves risk and you may incur a profit or loss regardless of the strategy selected. Links are being provided for information purposes only. Raymond James is not affiliated with and does not endorse, authorize or sponsor any of the listed websites or their respective sponsors. Raymond James is not responsible for the content of any website or the collection or use of information regarding any website's users and/or members.