Q2 Market Summary

It is no secret that both stocks and bonds have taken their lumps so far this year. There are several reasons to account for the weakness: rising inflation, the Fed raising interest rates, higher oil and gas prices, Russia, high risk assets falling out of favor, valuations compressing, potential profit margin pressure, recession talk, etc. If there is one thing that markets tend to not like, it’s uncertainty, and I think we can all agree that there is a fair share of that currently.

With uncertainty, however, comes opportunity, and we see a few silver linings in the clouds that the headlines are focusing on. First, stock valuations have become more reasonable than 6-12 months ago, and dividend yields have risen in conjunction. Second, bonds in some sectors of the market are now priced below par, providing what is primarily an income-producing investment with some appreciation potential as well. And third, the mentality of excessive risk taking and the fear of missing out on higher returns by speculative investors appears to be waning as investor sentiment has begun to slide.

Second quarter earnings reports will be aplenty over the next 3-4 weeks. Given recent Fed actions and elevated inflation data, we are watching to see what corporate profits will do, and what managements see for their companies in the future. As we have stated before, headlines may drive stock prices in the very short term, which fuels the trading community, but earnings drive stock prices longer term, which is the focus of most investors. Our belief remains that if inflation is contained and corporate profits are not meaningfully weakened, then stock prices could stabilize from current levels. However, should any of the areas of uncertainty listed above pressure corporate earnings lower, then we could see more downside to stock prices.

In the near term, perhaps the overriding benefit to the recent short-term weakness that we’ve experience is the unwanted reminder that all investors should periodically re-evaluate their investment goals and define an appropriate level of risk to take. The simple part is stating those objectives. The difficult part is riding through rough patches and wondering if you’re doing the right thing. The good news is that if or when there is a recession, economic or earnings, it has always been followed by a recovery, which tends to reward investors.

Sincerely,

Gary Orf, CFA

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