JSF FINANCIAL

ROLLER COASTER MARKETS: MAY 2022

MAY 2022

As you may have noticed, equity markets have been experiencing intense volatility, and the percentage of stocks hitting fresh 52-week lows has spiked over the last few months.[5] On May 20th, the S&P 500 even entered bear market territory, which is defined as a selloff by more than 20% from a recent high, before U-turning to end the month essentially flat.[6]

The volatility can be a lot to handle as an investor, and it raises a question we've heard a lot recently: What comes next? In this newsletter, we'll take a look at the current state of the markets and policy and what we might expect to see over the summer.

QUICK TAKE

After selling off to the lowest levels since March 2021, the S&P 500 stock market index managed to close out May essentially unchanged.[1, 2] Following reports of slowing inflation, equity markets made a sharp U-turn to end May flat while Treasury yields dipped (prices higher).[3] The Fed plans to get to neutral rates (that neither stimulate nor restrict) before evaluating further moves.[4]

Inflation is Tapering Off

Economic data later in the month of May indicated that inflation seems to be slowing down, which means the Federal Reserve ("the Fed") may not need to be as aggressive in its rate hikes.[7] As a result, yields took a breather and dipped to end the month (bond prices rallied).[8]

Index Returns
(May 2022 and Year To Date)

Bloomberg Barclays Aggregate Bond Index US investment grade bonds	0.64% for May*	-8.92% for the year*
S&P 500 Index Large US Equities	0.01% for May*	-13.30% for the year*
MSCI World Index Large/mid developed world equities (ex-US, CAN)	0.15% for May*	-12.76% for the year*
MSCI Europe Index Large/mid developed european equities	0.97% for May*	-11.60% for the year*
MSCI Emerging Markets Index Global emerging market equities	0.47% for May*	-11.68% for the year*

* As of May 31, 2022

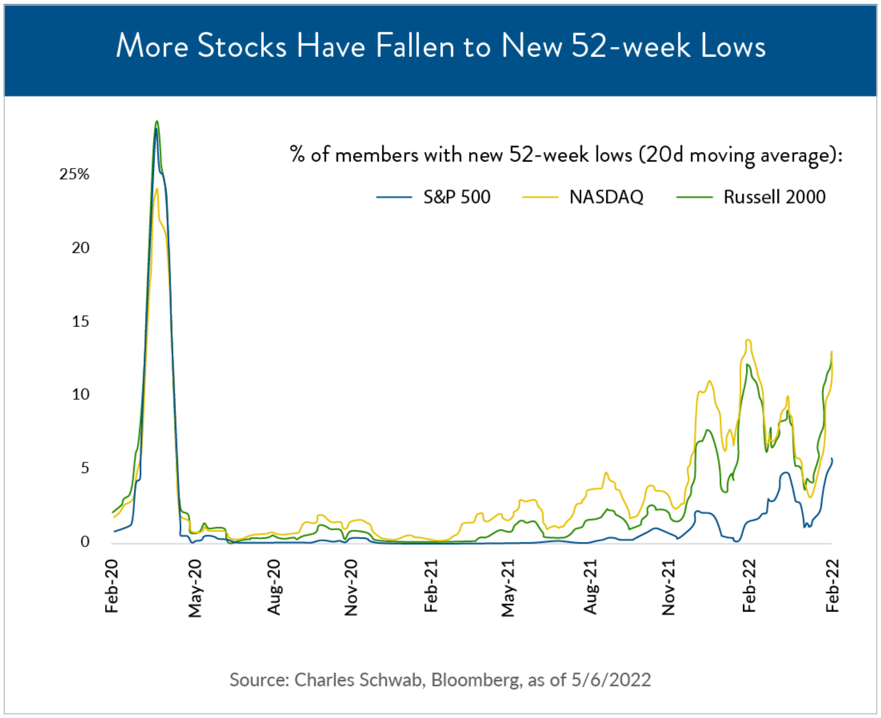
Consumers seem to share this view. The New York Fed's Survey of Consumer Expectations (SCE) shows that medium-term inflation expectations have reached a plateau, and longer-term expectations have remained stable.[9] In short, consumers expect this bout of inflation to fade over the next few years and still remain low in the long run.[10]

Secondly, US wage growth seems to be topping out, which could reduce the risk of a wage-price spiral that the Fed is trying to prevent.[11] In short, the wage-price spiral involves companies raising prices because of higher labor costs, which in turn leads workers to demand higher wages.[12]

According to Goldman Sachs economist Spencer Hill, wage growth should slow to 4.5% by year-end, headed towards the 3.5% to 4% pace that might be compatible with the Fed's 2% annual inflation target.[13]

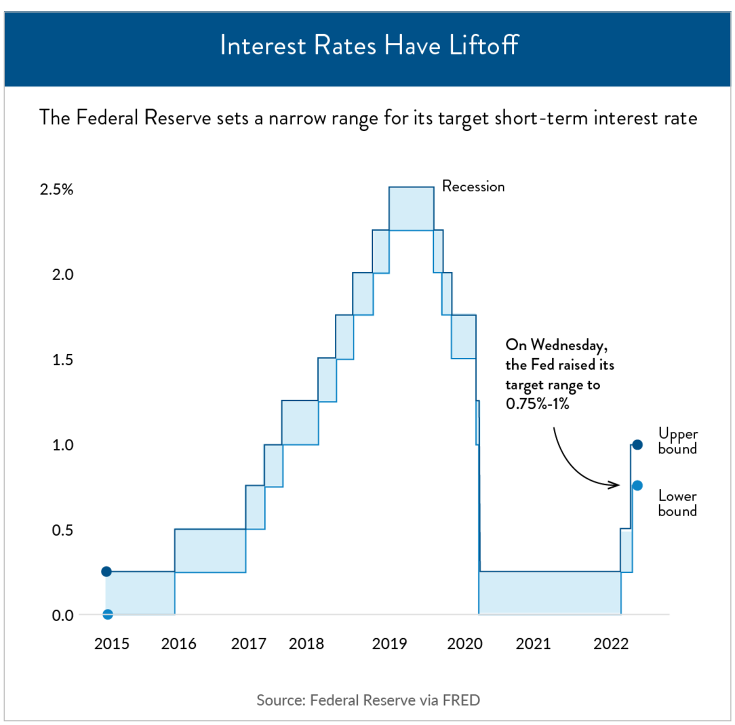
Rate Hikes Ahead

The Fed will continue to keep tabs on economic data to adjust policy. First, while inflation data is important, inflation expectations also can provide insight into what the Fed needs to do. Fed officials work to keep inflation expectations anchored and stable, so that price inflation doesn't continuously run higher.[14]



In May, the Fed delivered the largest rate hike since 2000 with a 50 basis point (0.5%) move.[15] During the meeting, officials agreed that they need to raise interest rates by 50 basis points at each of the June and July meetings.[16]

The Fed also announced plans (in line with previous guidance) to run down its balance sheet, reducing its holdings that support the bond market.[17] These moves remain in line with the fight against inflation and the bid to withdraw monetary stimulus.



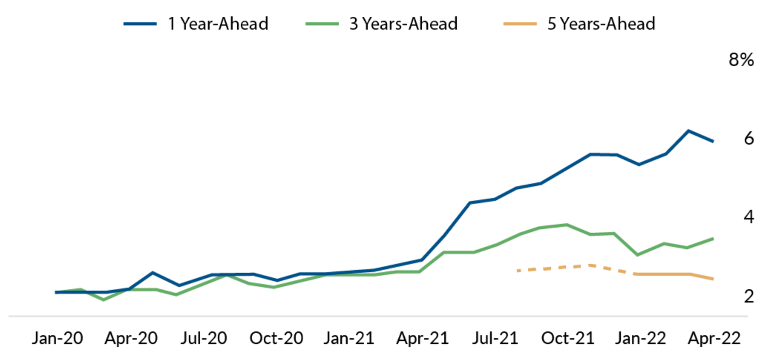
However, in a positive surprise to markets, Fed Chair Jerome Powell stated during the press conference that a 75 basis point rate hike was not being “actively considered.”[18] Blackrock maintains the view that the path of short-term rates will be less than what the market is pricing in now.[19] In other words, the Fed may be able to pivot to being more dovish and hike rates less aggressively.

The May meeting minutes show that the Fed is considering getting to neutral (neither stimulating or restrictive for the economy) before taking further action.[20] Former Treasury Secretary Lawrence Summers says that the Fed has “at last” adopted an appropriate policy posture by emphasizing flexibility.”[21]

We’ve already seen some impact from the shift to higher rates. For example, mortgage rates have jumped to their highest point in a decade, making it even more expensive to buy a house.[22] While that may put a damper on things for home buyers, the Fed is putting the brakes on the economy on purpose to help reel in inflation.[23] It is important to remember that while the stock market is a leading indicator, the housing market is a lagging indicator. Thus, even though mortgage rates have risen quickly and the financial markets have fallen year to date, the real estate market often doesn’t adjust for at least 6-12 months after these events.

Inflation Expectations

While short-term inflation expectations are rising, consumers expect price gains to remain stable in the long run



Source: Federal Reserve Bank of New York

Heading Into the Summer

Overall, the economy has slowed in the face of rising inflation, monetary tightening, and persistent global supply chain issues.[24] As growth slows, PIMCO’s Allison Boxer says they expect the Fed will start to make smaller interest rate moves in the fall and/or pause after a rapid summer tightening cycle.[25]

Given a volatile economic and market backdrop, we believe that prudent planning remains essential. If the market volatility has changed any of your plans, be sure to reach out and schedule a review so that we can make sure your financial objectives match your investments. We’re here to navigate challenges and opportunities with you!

As summer arrives, we would like to take this opportunity to congratulate all of our new graduates–your hard work has paid off! For those planning summer travel, good luck booking trips amid the busy season, and safe travels.

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Asset Allocation and Diversification do not guarantee a profit or protect against a loss.

The Bloomberg Barclays U.S. Aggregate Bond Index measures the investment-grade U.S. dollar-denominated, fixed-rate taxable bond market and includes Treasury securities, government-related and corporate securities, mortgage-backed securities, asset-backed securities and commercial mortgage-backed securities.

The S&P 500 Index is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market.

SPX, or the Standard & Poor's 500 Index, is a stock index that is comprised of the 500 largest U.S. publicly traded companies by market capitalization, or the stock price multiplied by the number of shares it has outstanding.

The MSCI World Index is a broad global equity index that represents large and mid-cap equity performance across 23 developed markets countries and covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI Europe Index captures large and mid-cap representation across 15 developed markets countries in Europe and covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.

The MSCI Emerging Markets Index captures large and mid-cap representation across 26 emerging markets countries and covers approximately 85% of the free float-adjusted market capitalization in each country.

SOURCES

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