2nd Quarter 2022

Quarterly

A quarterly update from The Pacific Financial Group | TPFG.com

THE PACIFIC FINANCIAL GROUP

Outlook

Similar to Q1, markets remained volatile in both directions during Q2, although broader equity and fixed income categories notched a second straight losing quarter. The S&P 500 posted its worst start through six months since 1970. Here's a look at how some notable domestic equity indexes performed over multiple timeframes through Q2. (S&P)

S&P Dow Jones Indices					
S&P TOTAL RETURNS, CUMULATIVE					
	S&P 500	S&P MidCap 400	S&P SmallCap 600	S&P Composite 1500	DJIA
Jun,'22	-8.25%	-9.62%	-8.54%	-8.34%	-6.56%
YTD 2022	-19.96%	-19.54%	-18.94%	-19.91%	-14.44%
3 Months	-16.10%	-15.42%	-14.11%	-16.02%	-10.78%
6 Months	-19.96%	-19.54%	-18.94%	-19.91%	-14.44%
12 Months	-10.62%	-14.64%	-16.81%	-11.02%	-9.05%
3 Years	35.29%	22.05%	23.55%	34.15%	23.33%
5 Years	70.86%	40.41%	41.60%	67.91%	60.94%
10 Years	238.16%	181.40%	190.74%	233.11%	202.48%
15 Years	241.86%	219.21%	218.40%	240.91%	233.99%
20 Years	468.55%	519.28%	522.75%	478.06%	442.53%
25 Years	580.53%	1019.70%	826.20%	614.95%	610.14%
S&P TOTAL RETURNS, ANNUALIZED					
12 Months	-10.62%	-14.64%	-16.81%	-11.02%	-9.05%
3 Years	10.60%	6.87%	7.30%	10.29%	7.24%
5 Years	11.31%	7.02%	7.20%	10.92%	9.98%
10 Years	12.96%	10.90%	11.26%	12.79%	11.70%
15 Years	8.54%	8.05%	8.03%	8.52%	8.37%
20 Years	9.08%	9.55%	9.58%	9.17%	8.82%
25 Years	7.97%	10.14%	9.31%	8.19%	8.16%

Source: Howard Silverblatt (S&P) - https://twitter.com/hsilverb/status/1542628935539761154

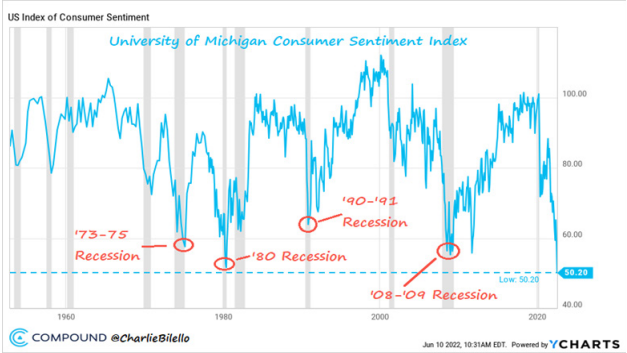
Inflation concerns, recession fears, and less accommodative monetary policy from the Federal Reserve were some of the factors contributing to weakness in financial markets during the quarter. Some general themes that played out in Q2 include Value leading Growth and fixed income products continuing to lag as inflation pressures were elevated. We expect volatility to remain elevated in both directions during the third quarter as markets continue to digest elevated inflation, more restrictive central bank policy, and Q2 earnings.

Inflation:

Inflation pressures continued to build during Q2. The Bureau of Labor Statistics (BLS) reported the May Consumer Price Index (CPI) advancing by +8.6% Y/Y, the highest reading since December 1981. [1 2] - We believe inflation may be nearing a peak and will be watching this statistic closely.

Consumer Confidence:

With inflation pressures elevated, the consumer is feeling its adverse effects. One popular measure of consumer confidence (The University of Michigan Consumer Sentiment Index) registered an all-time low in June 2022 (the chart below summarizes the initial reading for June of 50.2 which was later revised lower to 50).[3]



Source: Charlie Bilello (Compound Advisors) - https://twitter.com/charliebilello/status/1535269974113234944

For context, this reading is much more sensitive to inflation than some other consumer confidence measures (such as the Conference Board) given its emphasis on consumer buying conditions in big ticket items like houses and cars which have surged in cost over the last year or so. Should inflation begin to come back down, we would expect confidence to begin trending in a positive direction.

The Federal Reserve & Interest Rates:

In response to rising inflation pressures, The Federal Reserve continued to rein in the extremely accommodative monetary policy that had been in place since early 2020 in response to the Covid-19 outbreak and financial market turmoil at that time. As such, the Federal Reserve hiked its benchmark interest rate by 50 basis points at the May meeting [4] as well as 75 basis points at the June meeting (highest increase since 1994). [5] We'll get greater clarity on the Fed's next move at the July meeting.

Jobs:

The labor market remains on sound footing. The most recent non-farm payroll report from May showed a monthly gain of +390k jobs with the headline unemployment rate remaining low at 3.6% for the third consecutive month. Wage growth was moderate at +5.2% Y/Y. Despite a recent uptick in initial jobless claims, demand for workers remains strong. [6 7]

Gross Domestic Product (GDP):

Q1 GDP unexpectedly contracted by -1.6%. [8] Among the highlights, weakening trade data, lower private investment, and lower Government spending were partially offset by higher consumer spending. At the time of this writing, the Atlanta Fed's GDPNow model (which is a proprietary GDP tracking model that the Federal Reserve maintains) was projecting a similar decline in Q2 GDP [9] , although it is subject to change based on economic data and model inputs.

Valuation:

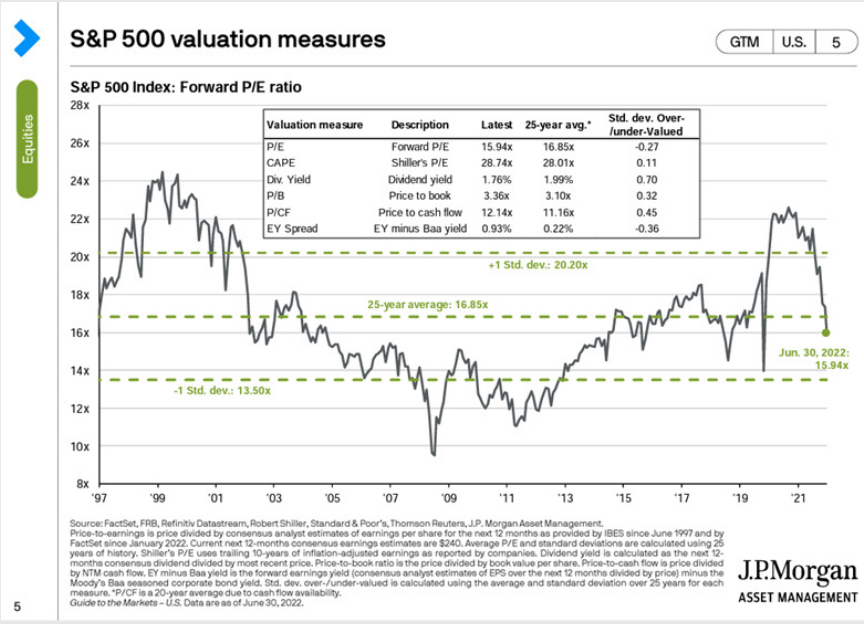
As JPMorgan notes in the following chart, valuation metrics have retraced to more reasonable levels given the decline in equities since the peak last year. As you can see on the following chart, several popular valuation metrics like Price/Earnings (PE) and others are all in-line or close to the longer-term 25-year average. Valuation had been a bigger risk in late 2021 but is looking more neutral now. We would caution that valuation is often a poor short-term timing indicator as it tends to be more indicative of investor sentiment and longer-term return prospects.

Earnings:

According to FactSet, earnings rose at a healthy +4% rate during the first quarter with similar growth expected for the upcoming quarter. Earnings estimates for the remainder of the year remain healthy; however, a majority of S&P 500 companies cited inflation as a key risk on their earnings call which may cause downward revisions to earnings in the months ahead. [10] As second quarter earnings season kicks off in mid-July, we'll get greater clarity on the state of corporate earnings.

Q3 Preview/Conclusion:

Looking ahead, we will be monitoring several items in the upcoming quarter including the direction of monetary policy from the Federal Reserve, second quarter earnings results, and economic data to see if recent softness in areas like housing, consumer confidence, and manufacturing has follow through to the downside or is temporary. In our opinion, inflation, Federal Reserve policy, and earnings are the biggest market risks heading into the third quarter. Potential catalysts include a deceleration in inflation, easing tensions between Russia & Ukraine, relief in supply chain disruptions, upside surprise in Q2 earnings, and a pivot in central bank policy to more accommodative measures. Thank you for taking the time to read our newsletter and entrusting The Pacific Financial Group with your financial needs. We look forward to updating you again next quarter.



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	15.94x	16.85x	-0.27
CAPE	Shiller's P/E	28.74x	28.01x	0.11
Div. Yield	Dividend yield	1.76%	1.99%	0.70
P/B	Price to book	3.36x	3.10x	0.32
P/CF	Price to cash flow	12.14x	11.16x	0.45
EY Spread	EY minus Baa yield	0.93%	0.22%	-0.36

Source: JP Morgan Guide to the Markets (Q3 – Page 5) - https://am.jpmorgan.com/content/dam/jpm-am-aem/global/en/insights/market-insights/guide-to-the-markets/mi-guide-to-the-markets-us.pdf

Source References:

1 - Bureau of Labor Statistics May Inflation Release. https://www.bls.gov/news.release/cpi.htm

2 - CNBC May Inflation Recap. https://www.cnbc.com/2022/06/10/consumer-price-index-may-2022.html

3 – Bloomberg Consumer Sentiment Overview for June. https://www.bloomberg.com/news/articles/2022-06-10/us-consumer-sentiment-slumps-to-record-low-on-inflation-woes

4 – Federal Reserve May Statement. https://www.federalreserve.gov/newsevents/pressreleases/monetary20220504a.htm

5 – Federal Reserve June Statement. https://www.federalreserve.gov/newsevents/pressreleases/monetary20220615a.htm

6 – May Nonfarm Payroll Report (Bureau of Labor Statistics). https://www.bls.gov/news.release/pdf/empsit.pdf

7 – CNBC May Nonfarm Payroll Overview. https://www.cnbc.com/2022/06/03/jobs-report-may-2022-.html

8 – Final Q1 GDP Revision (Bureau of Economic Analysis). https://www.bea.gov/news/2022/gross-domestic-product-third-estimate-gdp-industry-and-corporate-profits-revised-first

9 – Atlanta Fed GDPNow Estimate. https://www.atlantafed.org/cqer/research/gdpnow

10 – FactSet Earnings Insight from 6/10/2022. https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_061022.pdf

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