Manic Monday

June 13, 2022

Larry Adam, CFA, CIMA®, CFP®, Chief Investment Officer

Sadly, what was once the strongest bull market on record—a more than doubling of the S&P 500 from the March 2020 pandemic lows—has officially ended today as the shortest on record (since 1950). Today's decline of ~3.9% has brought the S&P 500 21.8% below its January 3 record high, which exceeds the 20% threshold or generally accepted demarcation line to determine a bear market. It has not only been fast, but it has also been very frustrating as many of the forces of the decline (e.g., war, China COVID zero-tolerance policy, supply chain disruptions, droughts, etc.) are beyond policymakers and investors control. But as fears grow, there are three dynamics to help put them into perspective.

1. We Are Not In A Recession

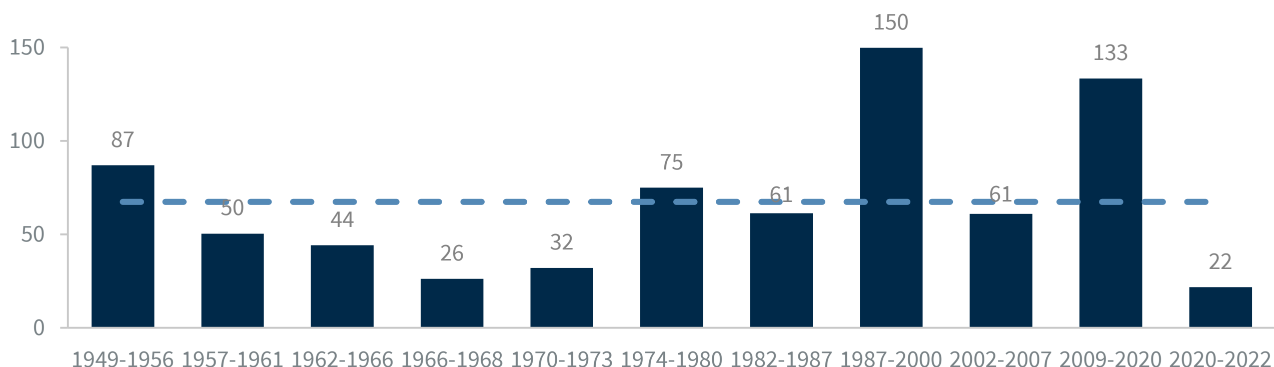
While anecdotal, we are hearing stories from colleagues and clients that are reinforcing our view that while select goods-oriented companies have noted slowing sales and rising inventories, overall spending trends remain positive as the consumer shifts preferences from goods to services. We've heard of the worst traffic in years and miles of backups to vacation destinations despite the high gasoline prices. We've heard of restaurants at full capacity and struggles to obtain reservations that aren't made well in advance. And we've heard of car rental companies cancelling requests on the day of travel due to no cars being available. With the consumer being the biggest driver of economic growth (~70% of GDP) and services representing a larger portion of spend than goods, it is difficult to envision a recession in this environment. We are not saying that this type of spending will last indefinitely, but the willingness and ability to spend by consumers suggests that we are not in a recession now. However, we will need to keep a close eye on these spending patterns as we go into the fall and the ever-important back-to-school and start of the holiday shopping seasons.

2. Nothing Will Be Solved Overnight

Investors are continually searching for answers on the questions of whether the economy will enter a recession, whether inflation is on a descent, and whether or not the Federal Reserve (Fed) can achieve a soft landing. This nervous energy has led to volatile swings in the financial markets as investors recalibrate expectations after each and every data point or headline. To echo our Chief Economist Eugenio J. Alemán, in regard to last Friday's inflation report "nothing has changed in the US economy between Thursday and today, other than goods and services prices are higher than what the market had expected." While we realize it is hard to be patient when you're watching your investments fluctuate in value, this is unfortunately a situation that will require time. As a result, volatility is likely to remain elevated throughout the summer.

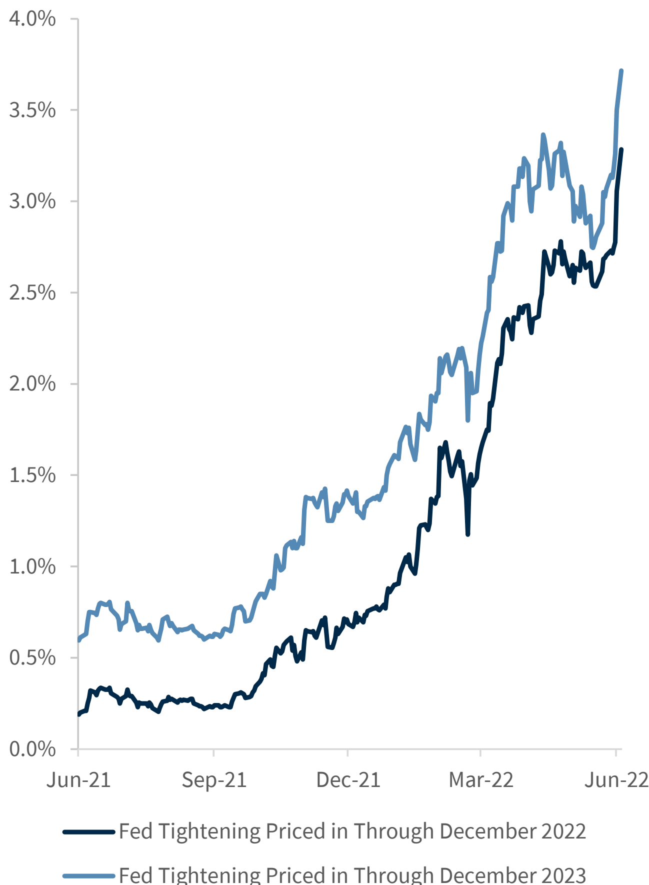
The weakness in the equity market over the last two days was driven by the May inflation report, which was not what we (or anyone else) was hoping for. The fact that inflation did not peak in April further fueled fears of the need for the Fed to

Shortest Bull Market in Post-WWII Era



Source: FactSet, as of 6/13/2022.

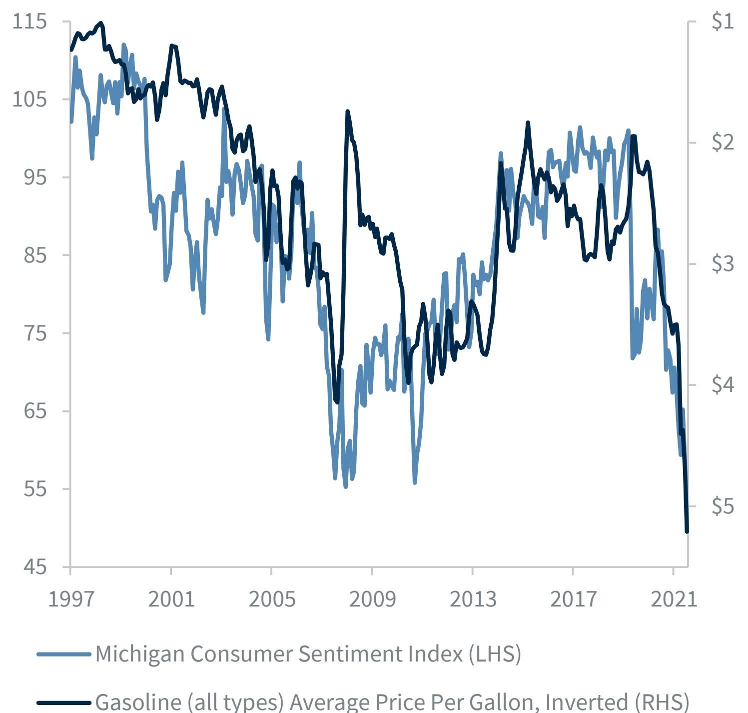
raise interest rates more and ultimately cause the economy to go into a recession. The problem is that while we expect inflation to gradually recede by year end, it will take time. The next reading for Personal Consumption Expenditures (PCE) is not until June 30, and the next Consumer Price Index release is not until July 13. More important, one data point will not suffice as a trend as we will have to see multiple reports showing a firming in the trend. As our Senior Investment Strategist Tracey Manzi explains below, the Fed is unlikely to shift course over one data point. Chairman Powell may express that the Fed is not close to the idea of 75 basis point (0.75%) hikes in this week's conference, but we anticipate that it will proceed with a 50 basis point (0.50%) interest rate hike as planned. The data-dependent Fed needs time to evaluate the economic conditions and any shift to its outlook, just as investors need time, or consecutive declines in inflation, to be convinced that pricing pressures are easing and that a recession can be avoided. Therefore, investors are closely and anxiously monitoring the headlines for precise answers on inflation and the Fed's policy path should prepare for elevated volatility over the upcoming weeks.



Source: FactSet, as of 6/13/2022.

3. In Need Of A Mood Shift

It is plausible we could talk ourselves into a recession due to all of the festering negativism. Consumer sentiment is at the lowest level on record, CEO confidence is at the lowest level since April 2020, small business optimism is at the lowest level since May 2020, and the percentage of bullish investors is at the lowest level since 1990. This widespread pessimism will be the challenge at this week's Federal Open Market Committee meeting that will bring about the updated economic projections and dot plot, and Chairman Powell's press conference. To date, he has been up to this challenge, effectively 'threading the needle' as he expresses the need to have less accommodative monetary policy while simultaneously assuaging fears that the economy is headed for a recession. This very well could be his most important press conference given that the 10-year Treasury yield has soared to 3.4% (the highest level since April 2011) and is clearly impacting the interest rate sensitive parts of the economy, particularly the housing market. Honestly, confidence remains the biggest risk to our more optimistic outlook. The largest driver of sentiment is gasoline prices as the higher gasoline prices go, the lower confidence goes. That is why oil prices remain squarely in our sights—the longer they stay elevated, the higher the probability of a recession.



Source: FactSet, AAA Gas Prices, as of 6/13/2022.

RAYMOND JAMES®

Bottom Line: We Won't Be Stuck In This Rut Indefinitely

During times of elevated volatility and overall uncertainty, it can be hard to visualize reaching the other side to more favorable market conditions. For example, just two years ago, investors, as well as many economists, financial market pundits, and healthcare experts, thought that we'd be stuck in the world of COVID-lockdowns forever. Many thought that stay-at-home winners would continue to prosper at the same pace—which they did not. In short, investors tend to extrapolate the current environment indefinitely and miss the pivot in sentiment, trends and economic conditions. And that is why it is so important to take a step back and look at where these dynamics are likely to go.

Today, for as many negatives as there seem to be, there remain positives that could change the trajectory to a more positive course. For example, some of the forces that sparked the surge in inflation (e.g., depleted inventories, transportation costs, record demand for goods) have started to ease and should lead to a deceleration in pricing pressures, and healthy job creation and wage growth have helped defend against this inflationary environment. We agree with our economist that while recessionary risks are growing, a recession is not our base case over the next twelve months.

However, if we are wrong and a recession occurs, we expect it would be short-lived and mild in nature (an economic decline of less than 2.5%). Currently, consumer and business finances remain in good shape and the economy does not appear to have any imbalances (e.g., housing or technology bubble). Typically, a mild recession has corresponded to an equity market decline of ~24% on average. This suggests that even if we are in the midst of a mild recession, the equity market (S&P 500 down ~22%) has already priced in ~90% of the decline from a historical perspective. With the S&P 500 NTM P/E (currently 15.8x) at the lowest level since January 2019 excluding COVID, the equity market has already priced in much of this negative news. With our base case for positive economic growth in 2022 still intact and a moderation in inflation over the next six to twelve months, Mike Gibbs, Managing Director, Equity Portfolio & Technical Strategy, believes that while equities may continue to be challenged in the near term, the recent selloff is an opportunity for long-term investors.

Eugenio J. Alemán, Ph.D., SVP, Chief Economist

After Friday's worse-than-expected CPI number markets seem to be sending the Federal Reserve (Fed) a clear message: be bold.

Nothing changed in the US economy between Thursday and today, other than goods and services' prices are higher than what markets had expected. And because of that, markets are expecting the Fed to be bolder on rates than what they were expecting before. If this is the case, our expectation for the Fed to stop its interest rate campaign after the September meeting is at risk and this will probably push the monetary institution to continue with rate increases in December. This will push the federal funds rate above what economists call the 'neutral' rate, which means that starting in December, the federal funds rate will be binding. That is, the Fed is expected to take the air out of the economy by pushing interest rates into restrictive territory. Thus, the odds for a recession in six to twelve months' time will increase considerably.

Still, there are six more data points for CPI inflation scheduled before the December 13-14 Federal Open Market Committee (FOMC) meeting and we could see some improvement in inflation readings. However, as of today, markets seem to be pushing hard for the Fed to acknowledge the problem and do something to bring inflation down as soon as possible.

Even a 75 basis point move during this week's meeting has been mentioned in some 'corridors and alleys' of the Fed. If this is the case, the Fed could get to the 'neutral' rate during the July meeting of the FOMC and then push the fed funds rate above neutral during the September meeting.

The Fed moves have already started to affect some of the most interest rate sensitive sectors of the US economy, i.e., the housing market. However, the least interest rate sensitive sector of the economy, consumer demand, is being affected by higher inflation, but it is nevertheless plowing ahead. Will the Fed be willing to send the US economy into recession in order to slow down consumer demand or will it be patient and wait until consumer demand slows on its own? This is the key question!

Thus, this week's FOMC meeting decision and press conference by Chairman Powel will be a very important indicator of how influential Friday's CPI release has been and how, if at all, it has changed the view of Fed officials regarding the path for interest rates and, ultimately, the US economy.

J. Michael Gibbs, Managing Director, Equity Portfolio & Technical Strategy & **Joey Madere, CFA,** Senior Portfolio Analyst, Equity Portfolio & Technical Strategy

The hotter-than-expected May inflation print adds pressure to the Federal Reserve (Fed), which appears increasingly further behind the curve. Bond yields surged in the aftermath, pricing in the likelihood of tighter monetary policy ahead, and the yield curve narrowed. This is weighing on equity market valuations, and pushing the S&P 500 to new lows this morning. And with inflation so high and the Fed justifiably in hawkish mode, a quick dovish pivot (which came to the rescue in the late 2018 trade war and 2020 COVID shutdown weakness) is unlikely in the near term. With this in mind, and the path of least resistance lower technically, we err on the defensive side for now.

In assessing the potential downside, we continue to highlight the 3,400-3,600 area. The S&P 500 is currently trading at a 17.5x trailing P/E, which is much cheaper than the multiples witnessed in the post-COVID era and very reasonable historically. We note that severe drawdowns in the 2015/16 US manufacturing recession, 2018 trade war, and 2020 COVID shutdown found lows in the 14-16x P/E range. At 16x, the S&P 500 would trade at 3,456—interestingly, very near the pre-COVID peak. Additionally, 3,648 represents the average -24% non-recessionary bear market decline historically. Moreover, there is technical justification for the 3,400-3,600 level. The S&P 500 200-week moving average has been a good level of support over the past decade in major market weakness–and is currently 3,498. The 50% Fibonacci retracement level of the post-COVID ascent coincides with this price level at 3,505.

What we would like to see technically in the renewed selloff is a capitulation, where investor 'fear gauges' finally reach 'washed out' levels. These are often contrarian historically, with extreme fear seen near market lows. But inflation remains the number one market driver, and will ultimately determine the degree and/or duration of market weakness. Our base case economic outlook is still positive economic growth in 2022 and 2023, accompanied by a moderation in inflation over the next six to twelve months. So while equity trends are likely to remain challenged in the shorter term, we continue to believe that equities will be higher over the next 12 months and would accordingly be viewing the selloff as an opportunity for long-term investors—increasing our conviction as the inflation outlook and/or technical backdrop improves.

Tracey Manzi, CFA, Senior Investment Strategist, Investment Strategy

The surprisingly strong inflation report last Friday sent the bond market into panic mode, pushing yields across all segments of the curve above the 3% threshold as the market braces for a more aggressive Federal Reserve (Fed). This has led to a sharp flattening in the yield curve, with the all-important 2-year/10-year spread briefly inverting for the second time since early April. The sharp move in front-end rates has reinvigorated recession calls as market expectations for the Fed's terminal rate in this cycle, which is now in excess of 3.7%, continue to move higher.

There is no denying that the recent inflation print was red hot. And yes, it will make this week's FOMC meeting, particularly Chairman Powell's press conference, more interesting as the market is telling the Fed that it is losing patience with the Fed's outlook for inflation. A single inflation print is not likely to alter the Fed's path, at least not for the next meeting, but Powell is going to need to remind the market that there is only so much it can do to control the causes of inflation while providing insights on how the economy is evolving now that financial conditions are tightening.

The magnitude and the change in the inflationary backdrop has continued to create challenges for the markets. However, we think the bond market is smart enough to see there are some observable cracks starting to appear on the horizon. Tighter monetary policy is starting to cool down demand in the housing sector. Consumer confidence is taking a hit as price pressures cut into budgets. Inventory levels have been replenished, perhaps more than is currently needed. And, fiscal stimulus is now clearly in the rear-view mirror. These dynamics should help moderate demand and take the heat out of the current inflation pressures.

We do not agree with the market's current assessment that the Fed needs to raise rates until inflation is back below its 2.0% target. While the Fed is likely to bring rates back to neutral quickly, we do not think they are going to hike the economy into a recession. Although the market is impatient, the peaking process for inflation will be a journey and it will take time to get to its destination. We believe the Fed understands this, despite market expectations of higher yields. However, until we see some signs that the persistent inflationary pressures are abating, the bond market is likely to remain under pressure.

Pavel Molanchov, Managing Director, Energy Analyst, Equity Research

The fact that energy is a major contributor to inflation in the US, as is also the case around the world, is obvious. Last Friday's US CPI data showed an overall price increase of 8.6% year-over-year, of which 34.6% came from energy, including 48.7% from gasoline. The surge in gasoline prices is a worldwide phenomenon, reflecting the much higher oil prices versus 12 months ago. In fact, just the cost of crude oil alone–around $3.00/gallon currently–is as high as US gasoline pricing at the pump was 12 months ago. In this context, the nominal price at the pump, $5.00/gallon, set an all-time high last week. The average US consumer uses around 400 gallons per year, so the more expensive gasoline equates to $600 to $800 of extra spending annually. At the same time, it is worth noting that, on an inflation-adjusted basis, gasoline is still 7% less expensive than it was in 2008. To the question of what will cause oil prices to eventually subside, the short answer is: an end to the war in Ukraine. Russian oil supply is down about 5% since the start of the war, and the European Union's oil embargo has not even taken effect yet. The effect of sanctions and international company divestments will worsen the longer the war drags on.

All expressions of opinion reflect the judgment of the author(s) and the Investment Strategy Group, but not necessarily those of Raymond James & Associates, and are subject to change. This information should not be construed as a recommendation. The foregoing content is subject to change at any time without notice. Content provided herein is for informational purposes only. There is no guarantee that these statements, opinions or forecasts provided herein will prove to be correct. Economic and market conditions are subject to change. Investing involves risks including the possible loss of capital. Material is provided for informational purposes only and does not constitute a recommendation. Diversification and asset allocation do not ensure a profit or protect against a loss.

The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete. Diversification and asset allocation do not ensure a profit or protect against a loss.

INTERNATIONAL INVESTING | International investing involves additional risks such as currency fluctuations, differing financial
accounting standards, and possible political and economic instability. These risks are greater in emerging markets.

SECTORS | Sector investments are companies engaged in business related to a specific economic sector and are presented herein for illustrative purposes only and should not be considered as the sole basis for an investment decision. Sectors are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

OIL | Investing in oil involves special risks, including the potential adverse effects of state and federal regulation and may not be suitable for all investors.

FIXED INCOME | Fixed-income securities (or 'bonds') are exposed to various risks including but not limited to credit (risk of default of principal and interest payments), market and liquidity, interest rate, reinvestment, legislative (changes to the tax code), and call risks. There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices generally rise. A credit rating of a security is not a recommendation to buy, sell or hold the security and may be subject to review, revision, suspension, reduction or withdrawal at any time by the assigning Rating Agency. Ratings and insurance do not remove market risk since they do not guarantee the market value of the bond.

US TREASURYS | US Treasury securities are guaranteed by the US government and, if held to maturity, generally offer a fixed rate of return and guaranteed principal value.

DESIGNATIONS
Certified Financial Planner Board of Standards Inc. owns the certification marks CFP® and CERTIFIED FINANCIAL PLANNER™ in the U.S.
Investments & Wealth InstituteTM (The Institute) is the owner of the certification marks "CIMA" and "Certified Investment Management Analyst." Use of CIMA and/or Certified Investment Management Analyst signifies that the user has successfully completed The Institute's initial and ongoing credentialing requirements for investment management professionals.

CFA® and Chartered Financial Analyst® are registered trademarks owned by CFA Institute.

FIXED INCOME DEFINITION
AGGREGATE BOND | Bloomberg US Agg Bond Total Return Index: The index is a measure of the investment grade, fixed-rate, taxable bond market of roughly 6,000 SEC-registered securities with intermediate maturities averaging approximately 10 years. The index includes bonds from the Treasury, Government-Related, Corporate, MBS, ABS, and CMBS sectors.

HIGH YIELD | Bloomberg US Corporate High Yield Total Return Index: The index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

CREDIT | Bloomberg US Credit Total Return Index: The index measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

DOW JONES INDUSTRIAL AVERAGE (DJIA) | The Dow Jones Industrial Average (DJIA) is an index that tracks 30 large, publicly-owned companies trading on the New York Stock Exchange (NYSE) and the NASDAQ.
NASDAQ COMPOSITE INDEX | The Nasdaq Composite Index is the market capitalization-weighted index of over 3,300 common
equities listed on the Nasdaq stock exchange.
S&P 500 | The S&P Total Return Index: The index is widely regarded as the best single gauge of large-cap U.S. equities. There is over USD 7.8 trillion benchmarked to the index, with index assets comprising approximately USD 2.2 trillion of this total. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.
BLOOMBERG CAPITAL AGGREGATE BOND TOTAL RETURN INDEX ! This index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. The index is designed to minimize concentration in any one commodity or sector. It currently has 22 commodity futures in seven sectors. No one commodity can compose less than 2% or more than 15% of the index, and no sector can represent more than 33% of the index (as of the annual weightings of the components).

NAHB Housing Market Index | The National Association of Home Builders (NAHB) Housing Market Index (HMI) is a gauge of builder opinion on the relative level of current and future single-family home sales.

Chicago Fed's National Financial Conditions Index | The Chicago Fed's National Financial Conditions Index (NFCI) provides a comprehensive weekly update on U.S. financial conditions in money markets, debt and equity markets, and the traditional and "shadow" banking systems.

Credit Default Swap (CDS) Index (CDX) | The credit default swap index (CDX), formerly the Dow Jones CDX, is a benchmark financial instrument made up of credit default swaps (CDS) that have been issued by North American or emerging market companies.

INTERNATIONAL DISCLOSURES FOR CLIENTS IN THE UNITED KINGDOM | For clients of Raymond James Financial International Limited (RJFI): This document and any investment to which this document relates is intended for the sole use of the persons to whom it is addressed, being persons who are Eligible Counter parties or Professional Clients as described in the FCA rules or persons described in Articles 19(5) (Investment professionals) or 49(2) (high net worth companies, unincorporated associations, etc.) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended)or any other person to whom this promotion may lawfully be directed. It is not intended to be distributed or passed on, directly or indirectly, to any other class of persons and may not be relied upon by such persons and is, therefore, not intended for private individuals or those who would be classified as Retail Clients.

FOR CLIENTS OF RAYMOND JAMES INVESTMENT SERVICES, LTD.: This document is for the use of professional investment advisers and managers and is not intended for use by clients.

FOR CLIENTS IN FRANCE | This document and any investment to which this document relates is intended for the sole use of the persons to whom it is addressed, being persons who are Eligible Counterparties or Professional Clients as described in "Code Monetaire et Financier" and Reglement General de l'Autorite des marches Financiers. It is not intended to be distributed or passed on, directly or indirectly, to any other class of persons and may not berelied upon by such persons and is, therefore, not intended for privateindividuals or those who would be classified as Retail Clients.

FOR CLIENTS OF RAYMOND JAMES EURO EQUITIES | Raymond James Euro Equities is authorised and regulated by the Autorite de Controle Prudentiel et de Resolution and the Autorite des Marches Financiers.

FOR INSTITUTIONAL CLIENTS IN THE EUROPEAN ECONOMIC AREA (EE) OUTSIDE OF THE UNITED KINGDOM | This document (and any attachments or exhibits hereto) is intended only for EEA institutional clients or others to whom it may lawfully be submitted.

FOR CANADIAN CLIENTS | This document is not prepared subject to Canadian disclosure requirements, unless a Canadian has contributed to the content of the document. In the case where there is Canadian contribution, the document meets all applicable IIROC disclosure requirements.

Source: FactSet, as of 6/13/2022

INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER 880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863 RAYMONDJAMES.COM
© 2022 Raymond James & Associates, Inc., member New York Stock Exchange/SIPC. © 2022 Raymond James Financial Services, Inc., member FINRA/SIPC. Investment products are: not deposits, not FDIC/NCUA insured, not insured by any government agency, not bank guaranteed, subject to risk and may lose value.

RAYMOND JAMES®

INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER
880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // TOLL-FREE: 800.248.8863 // RAYMONDJAMES.COM

© 2022 Raymond James & Associates, Inc., member New York Stock Exchange/SIPC. © 2022 Raymond James Financial Services, Inc., member FINRA/SIPC.
Investment products are: not deposits, not FDIC/NCUA insured, not insured by any government agency, not bank guaranteed, subject to risk and may lose value.
Raymond James® is a registered trademark of Raymond James Financial, Inc.