

Stegent Equity Advisors, Inc. Investment Letter

Market Review

July 2022

Markets were down across the board for the second quarter in a row with Q2 2022 continuing to see negative returns. U.S. stocks dropped 16.7%. International stocks were also down 14.7%. Emerging markets lost 11.4%. Global real estate was down a significant 17.2%. And finally, U.S. bonds were down 4.7%, falling for the second quarter in a row.

Are we in a bear market? Given that most major indexes were down nearly 20% during the first half of 2022, a lot of experts are saying that we have entered bear market territory. Another indicator is the aggregate bond market being down 11% year-to-date. The bond market, represented by AGG, has only produced negative annual returns in four years since 1977 (1994, 1999, 2013, and 2021). Additionally, there have been 25 years with negative stock returns since 1929 and bonds were positive in 22 of those years. This is an important factor when you consider that bonds have been great tools for providing downside protection against equities when the market is falling.

For further clarification between bear and bull markets, here is a take from one of our trusted sources Dan Ferris of Stanberry Research: "A bull market is a sustained uptrend in stock prices that often lasts several years. Most mature bull markets are characterized by some amount of speculative activity in a particular sector, which can overflow into other areas of the market. A bear market is a sustained downtrend of 20%-plus that usually lasts no more than about two years. The dot-com bust from 2000 to 2002 and the housing bust/financial crisis from 2007 to 2009 were the most recent bear markets. As of this writing, the S&P 500 Index has not closed 20% below its January 3 high. So, by traditional metrics, we're technically still in a bull market. However, those traditional metrics ignore the bigger picture. If you study the way stocks have traded since the beginning of the year, it's clear we've been in a bear market for months already. We've seen constant declines punctuated by sharp upward surges, with many more stocks declining than rising."

The FED raised rates twice in the second quarter, bringing the total to four rate hikes in 2022, with the goal of slowing inflation. However, the FED's approach to make larger rate hikes on the front-end may not result in the solution they are hoping for. According to Zacks Investment Management, Inc., "inflation today is primarily a supply issue, and the Fed has no control over supply. The Fed can't fully fix the shortage of goods in the market by ending QE, trimming its balance sheet, and/or raising the fed funds rate."

Given the recent hastening by the Fed in the pace of rate hikes, we do not think equities are going to reach a new high (an S&P 500 north of 4800) until one of two things happens.

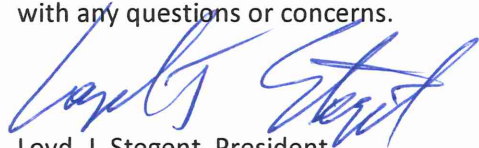
The first, and much more likely, possibility is that the Federal Reserve eventually gets monetary policy tight enough to bring inflation down toward its 2.0% target, which, in turn, also induces a recession. In that scenario, a new bull market would start sometime during the recession, once investors start to grow more confident about the recession ending soon.

The second, and less likely, possibility is that the Fed pulls off a soft-landing, in which case a bull market would start once investors become more confident the Fed has succeeded. We'd love to see this second scenario play out, but don't expect it.

Either way, we don't expect the S&P 500 to hit a new all-time high, above the old high of 4,797, anytime soon. Instead, until one of our two scenarios plays out – a recession or the realization the Fed has pulled off a soft-landing – US equities are likely to be in a trading range with potential bear market rallies that come and go. At current prices, equities could easily rally from here, but if a recession is eventually coming that rally will not last.

In closing, it's now clear that the Fed is raising short-term interest rates much faster than anyone thought at the start of the year and will likely continue to raise rates through 2022. Supply-chain issues are not likely to be resolved in the next few quarters and will lend themselves to even higher consumer prices. And while we do not know what the future holds, we are using the information available to us now to make the best decisions for our clients going forward. The continued uncertainty can only mean one thing: we will tread with caution by remaining defensive with our positioning.

As always, we are grateful for the opportunity to continue to serve as your trusted advisor. Please reach out to us with any questions or concerns.



Lloyd J. Stegent, President
Stegent Equity Advisors, Inc.

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