Economic & Investment Outlook – 2nd Half 2022

The first six months of 2022 saw the S&P 500 Index decline -23%, from its all-time high at 4,796.56 on January 3 to a closing low of 3,674.84 on June 17. The index rebounded slightly by the end of the quarter, closing at 3,785.38 on June 30.

More noteworthy even than the extent of the decline was its gathering momentum: in mid-June, the market ran off a streak of five out of seven trading days and 90% of the S&P 500 component stocks closed lower. This is one-sided negativity on a historic scale.

Let's stop right there. Because regardless of any and all other points we wish to make in this report to you, the most urgent should already be clear.

Simply stated, the best way to completely destroy any chance for lifetime investment success has historically been to sell one's equity portfolios into a bear market.

However, to sell when investor sentiment is sufficiently negative to drive 90% of S&P stocks lower on five out of seven trading days—to sell, that is, when everyone else is selling—must strike us as the height of long-term folly.

That said, let's attempt to explain what's going on here. (We may have made some or all of these points earlier. If we have, please bear with us: they are worth repeating.)

To do so, let's go back to the bottom of the Great Recession on March 9, 2009. From that panic-driven trough, the S&P 500 (with dividends reinvested) compounded at +17.6% annually for the next twelve years, through the end of 2021. At its peak this past January 3, the Index was up seven times from its low. This was one of the greatest runs in the whole history of American equities. Moreover, the Index's compound return over the last three of those years—2019 through 2021, encompassing the worst of the coronavirus plague—shot up to +24% annually.

But when inflation soared late last year, it became evident that equities' exceptional increase over those three years had been fueled to some important extent by an excess of fiscal and monetary stimulus, mounted to offset the economic devastation of the pandemic. In summary, the Federal Reserve created far too much money, and then left it out there far too long.

And since inflation, as Milton Friedman taught us, is always and everywhere a monetary phenomenon, we investors now find ourselves having to give back some of the extraordinary 2009–

2021 market gains, as the Fed moves belatedly to sop up that excess liquidity by raising interest rates and shrinking its balance sheet.

Yes, the war in Eastern Europe and supply chain woes of various kinds have exacerbated inflation, but in our judgment they're irritants: monetary policy (seasoned as well with a bit too much fiscal stimulus) got us into this situation, and monetary policy must now get us out. If an economic slowdown over a few calendar quarters is what it takes to stamp out inflation, it would be by far the lesser of the two evils.

Two Possible Outcomes for the Economy and Markets

Discussions of out-of-control inflation and a possible recession have been heard on news channels for the last few months. If kept under control, inflation is healthy for the economy as long as it does not increase more than two percentage points each year. Recessions are considered an unavoidable part of the business cycle and occur when a nation's economy experiences negative gross domestic product (GDP), rising levels of unemployment, and falling retail sales.

The stock market is considered a forward economic indicator, having a remarkably strong record of moving downwards in anticipation of economic slowdowns and upwards before an economic recovery actually begins. The exact timing and magnitude are unpredictable, however, which prevent investors from being able to successfully time the markets.

Over the coming months, the Federal Reserve will utilize certain economic tools to fight inflation. The ideal scenario would be that through a delicate management of the economy, with mild interest increases, the economy avoids a recession, but still manages to bring inflation to more desirable levels. This result is known as a "soft landing". In this case, the markets may be "oversold", having declined further than investors would expect for this economic scenario. A recovery could be on the way in a very short period.

If, however, a recession occurs, then the current market levels seem appropriate. The stock market, having already dropped 20-plus percent this year, could continue to maintain close to its current level, and not suffer substantial additional declines. It could take several weeks, or possibly months, before the recovery begins, however. In either scenario, it is reasonable to expect that between now and year-end, the markets would be advancing once again.

Total Wealth Planning's diversification and tactical asset allocation reduced the amount of loss in portfolio values as compared to the performances of the equity market indexes

On a relative basis, Total Wealth Planning's managed portfolios outperformed the equity indexes in the first half of 2022 and, importantly, are positioned for future growth. Historically, when rebounds occur, they do so in powerful sporadic spurts without notice and without regard to the presence of a recessionary economic environment. For example, the most significant decline in the last fifty years was from 1973-1974 when the index of small companies declined -30.90% and -19.95%, respectively. The climate at that time was similar to today in terms of high inflation, but the country was also experiencing a severe recession. These results were followed by extraordinary gains from 1975-1983, when the same index increased +52.82%, +57.38%, +25.38%, +23.46%, +43.46%, 39.88%, +13.88%, +28.01% and +39.67%. It is impossible to forecast the timing and the strength of the future rebound, but inevitably it will occur. Attempts to predict when most often prove foolish and costly.

Prudent Portfolio Management Integrated with Comprehensive Financial Planning Provides the Best Long-Term Results

As described in previous communications from Total Wealth Planning, we advocate a proven Nobel Prize-Winning Approach for managing our client's investment portfolios. By maintaining consistent exposure to a diversified array of 15-20 individual asset classes, clients' investment portfolios will have every opportunity for growth. By making tactical shifts, over and above periodic rebalancing and profit-taking opportunities, we seek to add value, especially during periods of elevated volatility. At Total Wealth Planning, our team of financial planning and investment management professionals work closely together to ensure that opportunities for adding value to your financial situation are not overlooked. In our opinion, wealth building and preservation must include not only investment management, but also financial planning activities, such as cash management, debt management, tax planning, risk management, college funding, retirement planning, and estate preservation.

Please contact us at any time with question or comments.

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