FLEURUS INVESTMENT ADVISORY

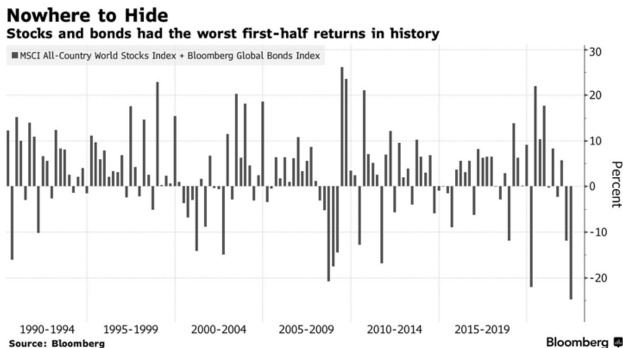
July 4, 2022

Overview

June has been the worst month of 2022 for investors, so far. The S&P's 500 tumbled **8.25%,** while the Nasdaq Composite fell **8.65%** and the Russell 2000 (Small Cap Index) sunk **9.98%**. Internationally, the situation was not better with the EPAC BM Index of developed economies down **10.02%.** Meanwhile, emerging markets did a bit better again in June with the MSCI (EM) down only **6.64%**.

The bond market suffered too, but to a lesser degree. US Corporate bonds went down **2.80%** overall and the long-US bond declined **1.48%**. The high yield sector fared worse losing **6.74%** on fears of a looming recession. Municipal bonds lost bout **1.80%**.

The chart below encapsulates the rather sorry state of things for investors as of June 30 and gives a historical perspective:



Each bar corresponds to a six-month period and adds the performances of bonds and equities over the respective half-year. Rarely have we seen a performance from both sectors that would lead to a cumulative 30% loss. This is where we stand as of June 30 (the chart shows a slightly better number in the mid-twenties as it reflects performances as of two days before the end of the quarter).

In June, our median portfolio lost **5.22%.** Over the same period, a portfolio consisting of 50% ACWI (All Country World Index) and 50% AGG (US Bond Aggregate) lost **4.82%**. On a YTD basis, our median portfolio has lost **17.67%** vs. **15.05%** for our index. As a reminder, the equity allocation in our clients' portfolios varies currently from 45% to 70%, depending on risk profile.

Market developments

The performance of equities in the month of June can be split in two: 1) Before the Federal Open Market Committee (FOMC) meeting of June 14-16 and, 2) After that date. Before the FOMC meeting the S&P's 500 sunk more than 11%. After that, it bounced a bit back recouping close to 3% to finish the month down 8.25% overall.
The chart below illustrates that dichotomy:

Before the FOMC meeting, fears of rising inflation caused the market to sink. The Consumer Price Index for the month of May showed a year-on year increase of 8.6%. While some comfort could be taken from different metrics (the Core CPI was "only" 6%), investors fled. This high level of inflation spooked the Fed too. While most investors expected a .50% adjustment to the Fed fund rate, this unexpectedly high CPI print caused the Fed to go for a .75% increase instead. In anticipation of this move, markets sunk even more.

The mood started to change somewhat by June 16 when, within hours or being surprised by the higher rate adjustment coming from the Fed, some market participants started giving credence to the notion that the Fed would not be able to push rates up as much and for as long as they intended. In essence, more and more investors started thinking that the economic recession that the Fed would trigger through its robust fight against inflation would eventually cause them to moderate their restrictive policy, more than anticipated.

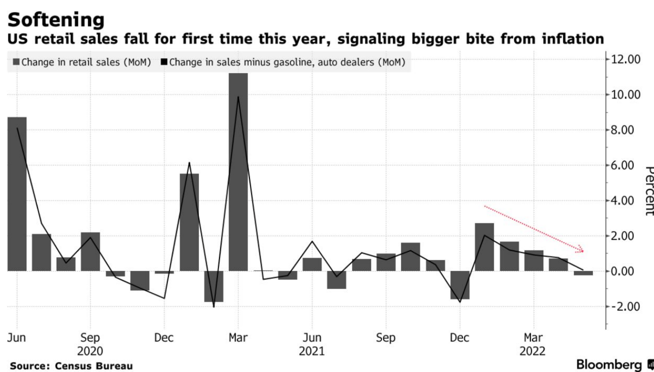
That line of thought gained ground over the remainder of the month and eventually caused bonds to rally. During that second half of the month most sectors of the fixed income world rallied, sometimes spectacularly. The yield on the US 10-year note dropped from 3.50%, on June 14 to 2.98%, on June 30. Such a rapid move is breathtaking and indicative of the uncertainty that plagues investors with respect to the direction of the US economy and the effects of the Fed's restrictive monetary policy.

Tilts and Allocations

The deteriorating investment climate in June caused me to further pare our equity holdings. On a net position, I reduced our US equities (SPY) by about 10% across all portfolios. I used the proceeds to invest in short-term corporate bonds (VCSH) on the assumption that, if a recession were to materialize, it should be fairly shallow.

While interest rates are likely to move up again, credit spreads for investment grade bonds have sufficiently widened over the past six months to justify allocating to the sector. The Vanguard Short-Term Corporate Bond ETF (VCSH), with an average duration of 2.8, seemed like an ideal vehicle to do so (duration is a measure of sensitivity to interest rate movements).

The chart below illustrates one of the economic components that investors are focused on these days:



The US consumer is slowing her spending, probably as a result of inflation. At the same time, the Fed is lifting interest rates in order to fight inflation, putting pressure on consumers and businesses to reduce their spending. No wonder investors are worried about an impending recession.

No-one really knows if the US is about to experience a recession (although the odds are that it will) and if it does, how lengthy and serious it will be. Calibrating equity exposures in this environment is particularly challenging. My intention today, based on current data, is to stay put for now, save for small position adjustments.

Conclusion

An important series of market-moving inflation data will be released this week. During the following one, the first third quarter corporate earnings season will start. The earnings announcements will be scrutinized for signs of an economic slowdown. Finally, by the end of July, the Fed's next interest rate decision will add another factor to the mix and could contribute to another market ruction.

As much as I would want the month of July to be less tempestuous than June, a lot will depend on these pieces of data and how the market interprets them. Let's hope that things quiet down a bit. We all need it!

Thank you for your continued trust.

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