Quarterly Market Update – 2Q, 2022

Executive Summary

30,000'

- **Fed Continues Rate Hiking Cycle –** Persistently high inflation weighed on consumers and businesses, prompting the Federal Reserve to raise rates more aggressively than anticipated, opting for the high-end range increase of 75 basis point or 0.75%, in June's meeting.
- **U.S. Bear Market, Increased Recession Risk –** Central bank momentary policy has generally shifted towards tightening and less accommodative for risk-based assets. Late-cycle business growth, persistent inflation, and low consumer confidence have trended U.S. recession risk higher.
- **Commodity Prices Rise, Cooling Demand –** Q2 saw many commodity prices hit multi-year highs. However, with global growth forecasted to fade on weaker consumer demand current prices are expected to moderate.
- **Global Business Cycle Shifts -** The U.S. is in late-cycle expansion phase with a moderate recession risk, while Europe faces near-term risk and China showing signs of emerging from its growth recession.
- **China's Industrial Recovery Gains Steam –** Fiscal and monetary policy have eased in China recently, including measures to support manufacturing and consumer spending.
- **Yield Curve Inversions Since 1950 –** Have occurred before the last 8 recessions but has also occurred twice since 1950 without a recession (1966, 1998), for the inversion of the 10-year and 3-month treasuries.
- **Consumer Sentiment, Tight Labor Market –** Even though unemployment of 3.6% continues to experience multi-decade lows, nominal increases in wage growth has been offset by high inflation, weighing on consumer confidence.
- **Corporate Profit Margins Under Pressure –** Typical of late-cycle, top-line growth has slowed but is still positive. However, input and payroll costs have begun compressing profit margins which could lead to more near-term earnings revisions.
- **Inflation Stubbornly Persistent, Supply Pressures Easing –** Energy and commodities remain potent drivers of inflation, however COVID related supply pressures have begun to ease.

ABOUT THE FIRM

Virtus Capital is an independent investment advisory firm serving high net-worth individuals, families, and business owners.

CONTACT US

Virtus Capital, LLC

Office
4250 North Fairfax Dr.
Suite 600
Arlington, VA 22203

www.virtuscap.com

(571) 527-4955

jgreenwich@virtuscap.com

Performance

Equity Benchmarks	Returns as of 6/30/22 3 Month	YTD
S&P 500 PR	-16.45%	-20.58%
Dow Jones Industrial Average	-11.25%	-15.31%
Nasdaq Composite	-22.44%	-29.51%
Russell 2000	-17.20%	-23.43%
MSCI AC World Index ex USA Net	-13.73%	-18.42%
FTSE Emerging Index	-10.29%	-14.99%

Bond/Commodity Benchmarks	Returns as of 6/30/22 3 Month	YTD
Bloomberg US 1-5 Year Treasury	-0.85%	-4.20%
Bloomberg US 5-10 Yr Treasury	-3.41%	-9.19%
Bloomberg US Long Treasury	-11.93%	-21.25%
Bloomberg US 5-10 Yr Corporate	-6.36%	-12.94%
Bloomberg Municipal Bond	-2.94%	-8.98%
Bloomberg Commodity Index TR	-5.66%	18.44%

*Data Source: Morningstar and Vanguard Funds

Discussion

Domestic and global financial markets in the first-half of 2022 experienced price volatility and contraction. Fed Chairman, Jerome Powell, continued to deliver on his promise of tackling high consumer inflation with a +1.5% increase in the Fed Funds Rate, YTD. Beginning June 1, the Fed also began its quantitative tightening program, "QT", which effectively reduces its reserves by allowing maturing assets on their balance sheet to rollover, which moderates the supply of money circulating in the economy. The target is to trim the Fed's balance sheet by \$3.3T, from its current position of \$9.9T. This systematic reduction of liquidity along with a year-end target of 3.75-4% on the Fed Funds rate, is all aimed at combating persistently high prices and input costs. Relief can't come quick enough for consumers, as June's

Executive Summary

headline CPI print recorded a searing +9.1%, year-over-year. Globally, manufacturing activity is exhibiting late-cycle patterns, which is indicative of slowing growth rates and rising inventories. Financial markets are keeping an eye on profit margin compression and forward earnings guidance, with market indices such as the benchmark S&P 500 struggling to find direction after its steepest first-half decline in over five decades. Energy and to a lesser extent commodities have out-performed YTD but have seen renewed headwinds at the end of Q2 in the form of a historically strong U.S. dollar, and a forecasted manufacturing cooldown. We surmise that markets have digested a healthy portion of the recent inflation news but have yet to capture the full scope of a largely publicized recession risk, as the S&P 500 Index now implies an 85% chance of recession given historical data of similar bear markets. Valuations are now more in line with long-term historical averages – as of June 1, the S&P 500 sits at a forward Price-to-Earnings of 15.8x, the median historical average is 13.5x. For more context, if you take the average P/E ratio from 1981-2021 of 21.9x, the argument could be made that multiples "look" more fairly valued simply on price. However, in this context we are only addressing the "P" in the equation and a decline in corporate earnings - the "E" - could spell further multiple compression, implying markets still may have additional downside risk in the short-term. Virtus Capital's immediate-term, tactical position from the start of Q1, 2022 continues to incorporate high-quality security selection and favorably priced industry leaders. Our diversified, multi-factor strategies include risk-adjusted exposures to commodities, energy, and materials that have shown resilience during higher inflationary periods and low correlation to other market segments. While we highlight a tactical framework in the short-term to align with current market dynamics, we prudently maintain a vigilant and measured approach to our overall portfolio designs that focus on long-term investable outcomes and value-oriented opportunities for our stable of investors.

Q2, 2022 Quote:

"There will always be bull markets followed by bear markets followed by bull markets."

- World Renown Investor – **Sir John Templeton**

Quarterly Market Update – 2Q, 2022

Executive Summary

Sources

(1) Benchmark return data - https://personal.vanguard.com/us/funds/tools/benchmarkreturns

(2) Benchmark return data – www.morningstar.com

(3) FOMC - https://www.federalreserve.gov/monetarypolicy/fomc.htm

(4) U.S. Bureau of Labor Statistics - https://www.bls.gov/

(5) Bloomberg - https://www.bloomberg.com/news/articles/2022-06-01/how-fed-qt-intersects-with-2-trillion-in-cash-quicktake

(6) Forbes - https://www.forbes.com/advisor/investing/stock-market-outlook-and-forecast/

(7) SP 500 Data - https://finasko.com/sp-500-pe-ratio/#:~:text=According%20to%20historical%20data%2C%20the,5.31%20found%20in%20December%201917.

(8) Templeton Quote - https://www.azquotes.com/quotes/topics/bull-markets.html