NORTH STAR
Resource Group

MARKET UPDATE
QUARTER 2, 2022

The Stock and Bond Markets Hate Uncertainty

The second quarter of the year has created a lot of uncertainty for the markets. Inflation continues to be the main topic of interest, including how the Federal Reserve may be able to combat it to hopefully create that soft economic landing. A surprise increase from the May reading for inflation caused a stock market sell-off to end the second quarter. This larger than expected reading has caused further concern for longer term growth prospects, both from economic and earnings perspective. This could become an issue as the GDP growth rate for the first quarter of 2022 shrank by 1.5%, setting up the potential for two quarters of negative GDP growth, which is the definition of a recession.

A recession is not necessarily a terrible thing and considered part of a normal business cycle. If second quarter GDP also posts a negative quarter, economists are still noting strong employment numbers, consumer spending, housing data, and corporate profits. Much of this economic data volatility is resulting from the fluctuations from COVID, multiple big, quick rebounds on sharp market downturns. These strong numbers for the meantime are supporting the case for just a market downturn. As can be expected, this creates further uncertainty around how big and how long the downturn would or could last.

As we know, the markets hate this uncertainty.

Change in the markets

It was a rough second quarter for the markets: The US Large Cap Index—the S&P 500—was down for the quarter -16.10%, small caps in the Russell 2000 index were down -17.20%, and the international MSCI EAFE index was down -14.51%[1].

The fixed income markets and the Barclay's Aggregate Bond Index continued their downward slide, down -4.69% as these inflation numbers continue to come in higher than expected and the Federal Reserve Rates are increasing at a faster rate.

Year to date the markets are off -20%, -23.4%, -19.3% and -10.35%[2], respectfully, for the S&P500, Russell 2000, MSCI EAFA, and Barclay's Aggregate indexes.

Inflation as measured by the Headline CPI is up 8.58%, well above the 4.7% reading in 4Q '21[2] and the Fed Target of 2%.

There has been no reprieve in avoiding the downturn with interest rates rising as quickly as they have.

As we had mentioned last quarter, this higher inflation continues to affect growth stocks the most. Small- and mid-cap growth stocks continued the strong slide. Year-to-date the small caps are down -29.5%, mid caps down -31%, and large cap growth down -28.1%[2].

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This sell off has now also affected the value side, which was flat to slightly down in the first quarter. The small cap value stocks sold off to be down -17.3% year to date and large cap value was down -12.9%[2].

Only one sector has had positive returns for the year: Energy, up 31.8%[1], as the war in Ukraine and sanctions on Russia continue to disrupt oil and natural gas supplies worldwide. The sectors that have lagged the most are Consumer Discretionary, down -32.8%; Communication Services, down -30.2%; and Technology, down -26.9%[1]. Consumer spending, while remaining strong, continues to be suspect to longevity in the face of higher prices. Technology and Communication services are growth sectors where the growth concerns and high PE ratios are being called in question.

Earnings growth of corporations will become all the industry rage and discussion points as this uncertainty creeps into the longer-term strength of company growth and their balance sheets. Forward Price to Earnings, or P/E ratio, of the S&P500 has continued to cheapen, falling below the 25-year average of 16.85 times to 15.94 times[2]. The P/E ratios for large-cap growth and blend continue to be expensive, and other asset classes like small cap are getting cheap, particularly small-cap growth, to their long-term average.

A P/E ratio is calculated by simple dividing the stock price by earnings per share. P/E ratios are important—they indicate what the market is willing to pay for growth. The prospect of growth slowing down, or getting cut, will affect earnings. For this reason, the market is selling off those companies with most risks. Value continues to be cheap compared to growth.

International

On the international front, we are seeing a very similar trend with inflation and Federal Reserve banks beginning to raise interest rates. Unlike the US, Europe has the overhang of the Ukrainian War and more direct concern to oil prices and natural gas, so their current inflation has been more pronounced. This will continue to provide uncertainty to their markets as they head into fall and winter months, as an economy has relied on Russian oil, and particularly natural gas, for heating. If there was clarity around the war ending, you can imagine a jump in their markets. International PE valuations continue to remain very cheap to the US, while their dividend yield is 1.8% higher than the US rate. Within the Emerging markets, the China COVID Shutdown continues to be the main concern as market digests the uncertainty of the impacts to their economy.

Portfolio management

From a portfolio management perspective, we have seen investment portfolios trend back toward that risk / return reward. Unlike first quarter, when the most conservative portfolio—20/80 equity to fixed income—was down the most, we are seeing the continued equity sell off affect the equity-oriented portfolios most. For the one-year performance for the indexes, the Aggressive Growth, 100/0 is down -16.03%; Growth, 80/20 down -14.74%; Conservative Growth, 60/40 down -12.82%; Income & Growth, 40/60 down -11.74%; and Income, 20/80 down -10.41%[1].

Fixed income

On the fixed income side, all the fixed income markets have continued their sell-off with the inflation numbers and the expectation that the Fed will be more aggressively increasing rates. For the second quarter in a row, the quarter ended with short-term rates rising faster than long-term rates, ending with an inverted yield curve. The impact of previous Federal Reserve actions and market expectations of future actions has had a significant effect on the US Treasury yield curve. Across the yield curve the 2-year jumped from .73% at the end of last year to 2.92% now, the 3-year jumped from .97% to 2.99%, the 5-year from 1.26% to 3.01%, the 10-year from 1.52% to 2.98%, and the 30-year from 1.90% to 3.14%[2].

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These big jumps in Treasury yields are a significant reason the fixed income markets and bond are down in price. The Treasury market is directly correlated to interest rates and most other investment-grade fixed-income markets trade on a spread basis to these treasuries. As a reminder, there is a negative correlation between fixed-income prices and interest rates. As interest rates go up, from either market expectation or Fed Rate hikes, the price of bonds will go down. Short-duration bonds have lost value, but should recover the fastest, as their shorter maturities will renew more quickly with higher yields and coupon rates. The 6-month Treasury bill's yield jumped from 0.19% at end of last year to 2.51% currently. You will notice immediately a significant increase in money market yields, with the rest of fixed income to follow over time.

For those astute investors, you may be aware that an inverted yield curve can be a signal for a possible economic slowdown or a recession.

An inverted yield curve is where short-term rates are higher than long-term rates. Yields on US Treasury bonds signal future expectations of economic growth. To better understand what is happening with an inverted yield curve, know the markets are expecting growth in the near term to be better than that of the future, or simply put: an economic slowdown. In addition, 10 of the last 11 recessions have been proceeded by an inverted yield curve on a 12-to-18-month delay. The definition of an inverted yield curve is the 2-year yielding more than the 10-year. Although rare, this has now happened multiple times over the last two quarters. It will attract media attention.

What this means for investor behavior

What to do now? **Don't look at your portfolio.**

All this number minutia can be overwhelming and stressful, and it doesn't really matter when you take that long-term investment view. The uncertainty can cause people to act irrationally and make decisions detrimental to their long-term financial health.

Recently, an article caught my eye from industry financial planner and speaker, David Hullstrom of Financial Architect's. He writes about the "Happy Factor," it reads like this:

> *"One very popular strategy is to simply don't look at your portfolio. Most people, when they look at their portfolios, are happy when the value has increased and are unhappy when it has decreased. The magnitude of the change seems less important than the direction in determining how they feel. Therefore, to maximize happiness, most people should probably look at their portfolios less often. Here's why:*
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> *From the beginning of 1988 (no daily total return data prior to 1988) through 6/28/22, the U.S. stock market (using the S&P 500 total return index still) has had an average annual return of about 10.5%. In other words, ignoring transaction costs and taxes, $10,000 invested at the end of 1987 in U.S. stocks with dividends reinvested would have grown to about $315,000 today. If you looked at your portfolio daily during this period you would have been unhappy about half the time, while if you looked annually, you would have been happy about 4 out of 5 times. Here are numbers:*

Frequency of Looking	Happy	Sad
Daily	54%	46%
Weekly	58%	42%
Monthly	66%	34%
Annually	79%	21%

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Taking the long-term view at North Star Investment Resource Center, we continue to believe diversified portfolios and disciplined investment strategies continue to provide the best opportunities for those investors seeking growth.

We welcome investment discussions, should you have any questions or concerns or if there is a change in your investment time horizon or financial circumstances. Please feel free to contact us at your convenience.

Written by North Star Investment Resource Center

AVERAGE ANNUAL RETURNS FOR PERIODS ENDING 6/30/2022						
INDEX	**2ND Q**	**YTD**	**1 YR**	**3 YRS**	**5 YRS**	**10 YRS**
S&P 500	-16.10%	-19.96%	-10.62%	10.60%	11.31%	12.96%
Russell 2000	-17.20%	-23.43%	-25.20%	4.21%	5.17%	9.35%
MSCI EAFE (U.S. dollars)	-14.51%	-19.57%	-17.77%	1.07%	2.20%	5.40%
Barclays US Aggregate Bond	-4.69%	-10.35%	-10.29%	-0.93%	0.88%	1.54%
BENCHMARK COMPOSITES	**2ND Q**	**YTD**	**1 YR**	**3 YRS**	**5 YRS**	**10 YRS**
Aggressive Growth	-15.68%	-20.34%	-16.03%	6.88%	7.63%	10.29%
Growth	-13.48%	-18.26%	-14.74%	5.62%	6.48%	8.65%
Conservative Growth	-11.21%	-16.05%	-12.82%	4.40%	5.43%	7.06%
Income and Growth	-9.00%	-14.04%	-11.74%	2.71%	3.97%	5.22%
Income	-6.86%	-12.10%	-10.41%	1.31%	2.82%	3.65%
USD VS LCL	**2ND Q**	**YTD**	**1 YR**	**3 YRS**	**5 YRS**	**10 YRS**
MSCI EAFE NR USD	-14.51%	-19.57%	-17.77%	1.07%	2.20%	5.40%
MSCI EAFE NR LCL	-7.83%	-11.27%	-6.59%	4.37%	4.27%	8.33%

S&P 500 - The S&P 500 Index is an unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the U.S. Please note an investor cannot invest directly in an index.

Russell 2000 - Russell 2000 Index is an equity index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. Please note an investor cannot invest directly in an index.

MSCI EAFE - The MSCI EAFE Index is the Morgan Stanley Capital International Index and is designed to measure the total return of the developed stock markets of Europe, Australia and the Far East. Investment risks associated with international investing, in addition to other risks, include currency fluctuations, political and economic instability and differences in accounting standards when investing in foreign markets. Please note an investor cannot invest directly in an index.

Barclays US Agg Bond - The Barclays U.S. Aggregate Bond Index is a broad-based bond index comprised of government, corporate, mortgage and asset-backed issues, rated investment grade or higher, and having at least one year to maturity. Please note an investor cannot invest directly in an index.

MSCI ACWIxUS - The MSCI ACWI ex US Index is a market capitalization weighted index was designed to provide a broad measure of equity-market performance throughout the world. It is comprised of stocks from 22 of 23 developed countries (excluding the US) and 25 emerging markets. Please note an investor cannot invest directly in an index.

Source: [1]Morningstar Direct, [2]JPMorgan – Guides to the Market

The Benchmark Composite returns are a weighted average of index data comprised in the following manner. Aggressive Growth is 45% S&P 500, 25% Russell 2000 and 30% MSCI EAFE. Growth is 35% S&P 500, 20% Russell 2000, 25% MSCI EAFE and 20% Barclays US Aggregate Bond. Conservative Growth is 30% S&P 500, 10% Russell 2000, 20% MSCI EAFE and 40% Barclays US Aggregate Bond. Income and Growth is 20% S&P 500, 5% Russell 2000, 15% MSCI EAFE and 60% Barclays US Aggregate Bond. Income is 15% S&P 500, 5% MSCI EAFE and 80% Barclays US Aggregate Bond.

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any funds or stocks in particular, nor should it be construed as a recommendation to purchase or sell a security. Investments will fluctuate and when redeemed may be worth more or less than when originally invested.

Investments that focus in one sector may involve a greater degree of risk and volatility than an investment with greater diversification.

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