Second Quarter 2022

Figure 1 – S&P 500

Figure 2 – U.S. 10-Year Treasury Yield

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We'd like to welcome recent additions to the BWM team. Josh Barrett joined us as an Associate Wealth Advisor in May, and Sondra Lazzarini started this month as our new Client Relationship Manager. Josh and Sandra will be helping to care for our clients and to build a stronger, more robust firm. We know that you'll enjoy working with them.

Market Recap

Stocks continued their 2022 slide, with returns worsening through the second quarter. The S&P 500 large cap index fell 16.1%, and is now -20% for the year, the worst first half since 1970, and entered an official "bear" market. The selling was widespread. Small and mid-cap stocks also suffered, dropping 17.2% and 15.4% respectively. Foreign markets also fell sharply. The MSCI Emerging Markets index lost 11.5% and developed countries outside the U.S. fell 14.5%. U.S. value stocks (-11.3%), boosted by energy, continued to outperform growth (-20.8%), in a further reversal of the last 3 years. Fixed income also continued to lose ground, with the Bloomberg U.S. Aggregate Bond Index falling 4.7% in the quarter, finishing the first half of the year -10.4%.

Economic news remained challenging in the second quarter, as inflation worldwide stayed at historically high levels. The war between Russia and Ukraine, while not dominating headlines, has continued. This has kept pressure on key commodity prices including oil, natural gas, and grain. War, as noted before, is inflationary. The Fed raised interest rates as expected. The high inflation, and threat of additional interest rate hikes by the Federal Reserve, has pressured growth stocks, which dominate the top of the S&P 500. With stocks in a bear market, recession fears have risen, further weighing on investor sentiment. Towards the end of the quarter, recession concerns took hold and traders took profits in market leaders including energy.

First quarter earnings remained strong, rising 9.7% on 13.5% revenue growth. These results were much better than the 3.6% earnings growth expected at the beginning of last earnings season. However, looking ahead, investors see only 2.1% growth in the second quarter. Estimates overall fell through the quarter, from a peak of +5.2% in April. Excluding the hot energy sector, earnings are expected to decline 5.2%. Corporate earnings in most sectors are under pressure from inflation and, in some cases, slowing demand. Companies that can pass along cost increases, especially energy producers, are enjoying higher profit margins. As of this writing, analysts expect earnings growth to rebound in the 2nd half of the year. However, many market watchers expect estimates

Index returns taken from Morningstar.com

to fall further as companies begin to report. After the sharp losses of the first half, stocks may benefit if earnings and guidance are better than feared.

Economic Perspective

The economy, as measured by gross domestic product, shrank at an annual rate of 1.6% in the first quarter, after posting robust growth of 6.9% in the fourth quarter of 2021. A drop in exports was the biggest drag, a trend that may have continued in the second quarter. This was reflected in manufacturing surveys, which suggested slowing growth and declining new orders. The services sector also registered slowing activity. COVID remained a concern for many but appeared to have a diminishing impact on economic activity. Travel increased sharply, straining airline and airport capacity, as consumers took long-delayed vacations.

The economy continued to add jobs through the quarter, although at a slightly slower rate, and the unemployment rate remained at 3.6%. However, total employment still hasn't reached the record high of February 2020. The labor force participation rate fell marginally from 62.4% to 62.2%. Participation is still below the 63.4% logged just before the pandemic. Open job postings remained near record highs, as employers struggle to fill positions. The tight labor market has resulted in higher wages, adding to inflation pressures. Increased pay has helped some consumers maintain purchasing power. Overall, consumer balance sheets remain sound, with debt burdens at their lowest levels of the last forty years (**Figure 3 – Household Debt Service Payments as a Percent of Disposable Personal Income**).

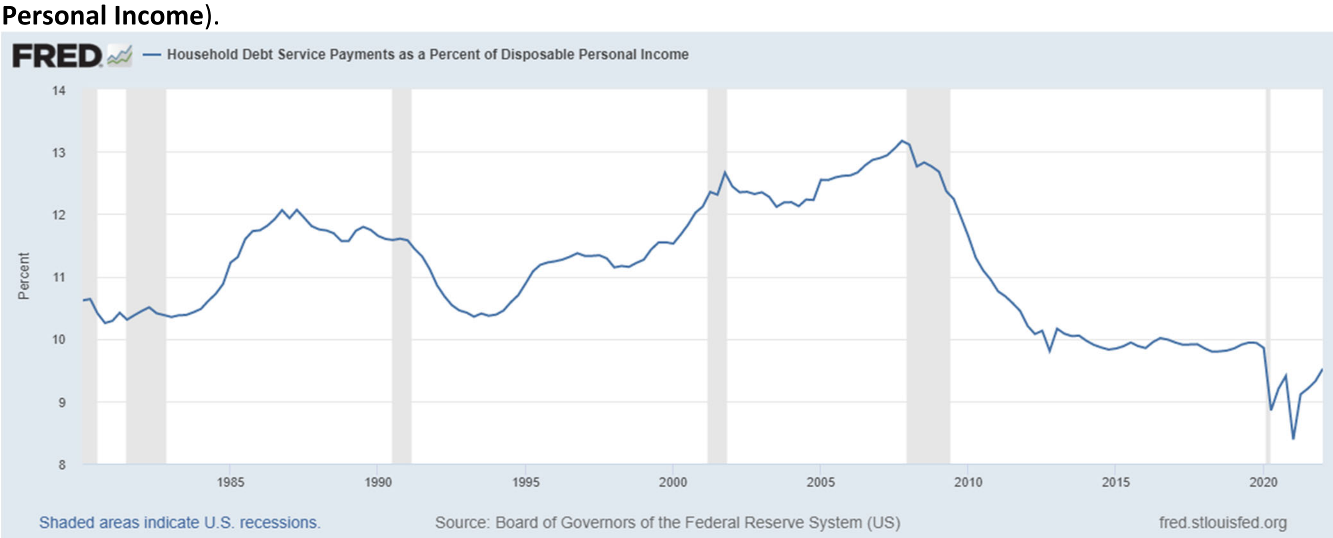

Figure 3 – Household Debt Service Payments as a Percent of Disposable Personal Income

With inflation for both producers and consumers hovering at 40-year highs, the Federal Reserve continued to raise interest rates, including the first ¾% increase since 1994. The Fed's intention is to slow the economy and bring down inflation. Rising interest rates squeeze asset prices by raising borrowing costs, including mortgage rates. Also, investors may be more inclined to keep money in bonds or interest paying accounts, rather than invest in stocks. Higher mortgage costs are starting to have an impact on home sales. In June, mortgage rates rose to 5.8%, the highest since 2008, and 15% of home sales fell through, the largest share of cancellations since April 2020.

Figure 3 – Technology Select Sector Fund

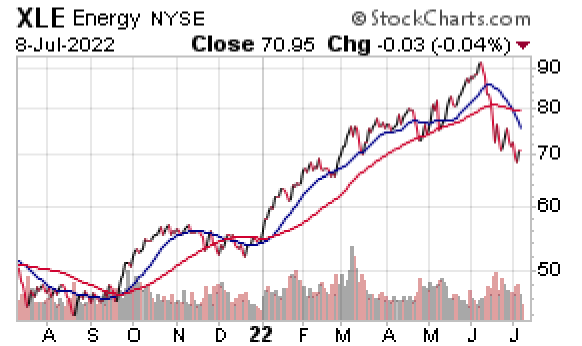

Figure 4 – Energy Select Sector Fund

Looking Ahead

After the rough first half of this year, valuations of many stocks have come down. The S&P 500 price to earnings ratio, a common measure of valuation, has fallen to levels last seen in 2018. The most expensive stocks, including the technology sector (**Figure 3**), have seen their valuations contract the most. However, if interest rates continue to rise, and the economy continues to slow, valuations may fall further. The technology sector currently accounts for 30.3% of the S&P 500's value and 25.8% of its earnings. In contrast, the energy sector (**Figure 4**) contributed 9.7% of the S&P 500's earnings while comprising only 5.1% of its value. Energy stocks, with their rich cash flows and above market yields, may continue to outperform in the coming months.

The Wall Street Journal recently reported that stocks averaged 23.9% in the year after entering an official bear market. The U.S. economy has a solid track record of recovery and expansion after stumbles. For most investors, staying the course is likely to prove rewarding over time. At the same time, we recognize that your situation may feel different, and we look forward to reviewing with you soon.

Best regards,

Kenneth M. Bernard, CFA