Wealth & Investment Management

Quarterly Economic Commentary

July 2022

Market Returns

	12/31/2021	06/30/2022	% Gain/Loss
Dow	36,338	30,775	-15.25%*
S&P 500	4,766	3,785	-20.66%*
NASDAQ	15,645	11,029	-29.62%*

Total Return Including Dividends

By Jim Watts, KS Trust Senior Portfolio Manager

As we close the books on the first half of 2022, we are looking at the worst first-half of a year since 1970 - that's 52 years of history. To say the least, volatility has been extreme over the past six months. We believe that in the third quarter this trend will continue. Generally, we see some improvement and then another round of disappointment with the market generally trending lower. There is a lot of speculation about "the bottom," but no one can say for certain if we have arrived there just yet. However, we believe that we are close enough to the bottom that we can begin to selectively buy. Yes, we are beginning to turn cautiously optimistic about the markets, especially if you have at least an intermediate time frame, say three to five years.

Investing can be, and sometimes is, very emotional. You become attached to a certain company, maybe even sentimental. Buying is much easier than selling because you are optimistic, you feel good about a particular company. Typically, you sell for two reasons: the price has peaked or you made an incorrect decision about the outlook for that company. Both of which seem to indicate that you no longer have confidence in your selection. We try to take the emotions out of buying and selling by investing for the long-term. Buying in this type of market is scary. However, we look at the longer term and try to make smart decisions to grow your portfolio. We can't pick the bottom or the top of the markets, but we can feel fairly confident in investing in companies that are financially strong, pay a good dividend, and provide a service or product that is a necessity.

The Federal Reserve has stepped up their aggressiveness towards inflation. Over the past three meetings they have raised rates 1.50%. It is expected that they will raise them another 0.75% at the July meeting, putting the rate at 2.25%. The expectation is that they will go to at least 3.0% in 2022 and possibly to 3.50% or 4.0% in 2023. We believe that inflation will peak with the July or August report and then slowly moderate. We expect to see a short and shallow recession most likely beginning in late 2022 and continuing into early 2023. We think that the Fed may be a little too aggressive and actually have to reduce rates in late 2023.

Currently, the yield spread on Treasuries is within 0.20%, or 20 basis points. The 2 year is yielding 2.96%, 5 year is 3.03%, 10 year is 3.00%, and the 30 year is 3.16%. As you can see they are all hovering around the 3.0% area, which indicates to us that the bond market thinks the Fed will raise to the 3% area in 2022. We feel we should stay on the shorter end of the curve for two reasons. First, you don't get fairly compensated to go out longer than two years. Second, we think rates will be rising and we want to take advantage of that as it develops. On June 28th, Goldman Sachs came out with a new issue five-year bond - the first 5% rate I have seen since 2008. That gives me some confidence that we can take advantage of rising rates over the next six to twelve months.

There is no doubt that the pain/losses felt in the first half have been real. There has been virtually no place to hide, stocks and bonds have lost money, and even crypto currencies have seen significant declines. As mentioned above, we are not sure where the bottom is, but believe that we are at an inflection point where most of the downside has been accomplished. If the Fed stays aggressive in the short-term, moves towards the 3.0% rate in 2022, and we see signs of inflation moderating in late fall or early winter, we believe that the markets will take solace in that and improve.

Over the past six months our response to the chaos has been to reduce equity exposure, particularly growth equity, and put more emphasis on value and dividends. We have moved into more short-term fixed income to take advantage of rising rates and have held a little more liquidity than normal to take advantage of opportunities. Here is what UBS said about investing on June 29, 2022 in their Daily House View:

"Consider increasing exposure to value stocks. While we expect inflation to moderate through 2022, we expect it to remain above central bank targets. Based on analysis since 1975, value sectors tend to outperform growth stocks when inflation is above 3%, which we expect to be the case for some time. We think value would perform particularly well in our soft-landing scenario, as increased confidence that corporate earnings can stay resilient supports some of value's cyclical sectors, including financials and energy.

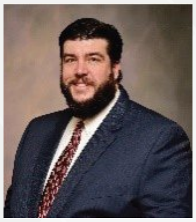
Add to defensives and quality, make use of volatility. To build up defenses against a potential "slump," in which weaker economic data drives lower corporate profit expectations and further downside in stocks, we believe investors should add exposure to quality-income stocks."

Oil prices continue to stay well above $100 a barrel and nationally gas prices average around $4.88 per gallon. We expect this to last well into the fall and possibly beyond that, especially if the Russia/Ukraine war continues. There is no quick fix to produce and refine additional petroleum products. We expect this to continue to put pressure on inflation through the ripple effects of higher energy prices.

We appreciate each client's uniqueness and will always strive to do what is best for each individual client. Please do not hesitate to ask us questions or express your concerns. This is your money and we are your stewards.

We are committed to maintaining a clear focus on building and preserving client's wealth and enhancing their quality of life, both now and in the future. Working in a fiduciary capacity, the KS Trust team provides a single point of contact for a full array of investment services.

Our team's collective knowledge and experience forges our ability to serve our clients more extensively and develop a clear path. It allows us to address the increasingly complex challenges of today's landscape and provide comprehensive financial advice with a clear vision for the future.



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