MAY 2022 MARKET RECAP

written by Andrew Murphy, Co-Chief Investment Officer

The equity market finished slightly higher in May as the S&P 500 increased by +0.2%. The market has still struggled in 2022, with the year-to-date decline now at -12.8%.The net result in May masks the overall volatility as the S&P 500 moved by at least +/- 1% on 10 of the 21 trading days, or 48% of the time. This compares to 2021, when the S&P moved by +/- 1% on about 22% of trading days.

The S&P 500 has narrowly avoided the technical definition of a bear market, a decline of -20% on a closing basis, as the peak-to-trough decline is so far -18.2% from January 3rd to May 20th.From the year-to-date low, we were pleased to see the market recover by +6% in the last 6 trading days of May. We will keep reminding our clients that market declines are very common, as since 1928 the S&P 500 has averaged an annual peak-to-trough decline of about -15%. Please see our **Client Question titled How often does the stock market decline**?

- **Market Cap**: Mid (+0.7%) outperformed Large (+0.2%) and Small Caps (+0.1%).
- **Style**: Value (Russell 1000 Value: +1.9%) exceeded Growth (Russell 1000 Growth: -2.3%).
- **Sector**: Out of eleven sectors, Energy (+15.8%) was the top performer with Consumer Discretionary (-4.9%) and Real Estate (-5.0%) as the laggards.

The decline in the stock market this year is primarily driven by fears over the Fed tightening monetary policy, increased inflation expectations, the Russia/Ukrainian war, and covid induced shutdowns in China. Only one or two of these issues on their own would be enough to cause some investor consternation, but each of them occurring simultaneously has created a very challenging short-term environment. In the near term, the markets would bounce on any sign of decreased Fed tightening expectations, inflation peaking, a cease fire, or China continuing to ease their severe restrictions.

We are sticking with our investment philosophy of maintaining a long-term viewpoint as the present environment is very challenging and fluid. Given all the uncertainty, we are maintaining defensive positioning while continuing to look for opportunities to tax loss harvest, reposition portfolios, and selectively put money to work for clients that have recently made contributions to their accounts. We did take the opportunity to reposition many portfolios by increasing the equity percentage when the market fell by more than -16%. This is not an attempt to call the bottom, but rather to take advantage of a significant decline by rebalancing for long-term investors. We expect to have more opportunities to rebalance over the next several months as our base case is that volatility will continue.

The markets have several major events over the next month, including, any update on the Russia/Ukrainian War and China lockdowns, May Employment Report (6/3), CPI Inflation (6/10), the June FOMC decision (6/15, the Fed is likely to raise rates by another 50 basis points), and PCE Inflation (6/30).

At Winthrop Wealth, we believe the right mindset paired with a comprehensive financial plan and a thorough investment process can help provide confidence in working towards your long-term financial goals, especially during times of heightened market volatility. We help our clients navigate challenging markets by seeking to ensure their short-term cash flow needs are met while managing the rest of their investments in a globally diversified portfolio. By having two to three years of scheduled cash flows invested in ultra-short fixed income, we decrease the odds that we will need to sell out of risk assets after a market decline to fund distributions. Please see our recent Client Questions that can help put things into context:

- **Market Timing Does Not Work**
- **Sell in May and Go Away?**
- **Market Performance During Fed Tightening Cycles**
- **Market Reaction to Geopolitical Events**
- **Stagflation**

Fixed Income Markets

The Bloomberg Barclays US Aggregate Bond index (Agg), which acts as a proxy for the investment-grade bond market, increased by +0.6% in May, bringing the year-to-date decline to -8.9%. The decline in the bond market this year was driven by an increase in interest rates (bond prices move inversely to yields). The 10-Year Treasury has increased from 1.51% at the start of the year to 2.84% currently.

We hold fixed income to provide ballast, stability, and income to portfolios. Ballast means that ideally the fixed income holdings are increasing when equity markets are declining. For the month of May, bonds did begin to act as a ballast and trade with a negative correlation to stocks as interest rates declined. We suspect that sooner rather than later, long-term interest rates will peak, which will help to provide investors the ballast they are looking for from their fixed income holdings.

The increase in interest rates has also driven the yield to maturity of various bond indices to their highest levels in years. Yield to maturity is defined as the estimated rate of return an investor can expect on a bond if purchased today and held to maturity, assuming the issuer makes all of their interest and principal payments (no defaults). The yield to maturity on the US Aggregate Bond index increased to 3.4% at the end of the month. While 3.4% is not the double-digit yields we saw in the bond market in the early 1980s, it is still far more attractive than what we have seen over the past few years.

Monetary Policy

The Fed has started to tighten monetary policy with the goal of bringing inflation under control. The Fed will act primarily by raising interest rates and decreasing the size of their balance sheet.

Interest Rates: After raising interest rates by 0.50% at the May 4th meeting, the top-end of the federal funds rate now stands at 1.00%.A few weeks ago, Fed Chair Powell stated that, "if the economy performs about as expected, it would be appropriate for there to be additional 50 basis point increases at the next two meetings. "The next FOMC meetings are scheduled for June 15th and July 27th, meaning that in about 8 weeks the top-end of the federal funds rate will likely be at 2.00%. Our sense is that Chair Powell and the committee want to raise rates to 2.00%, start the balance sheet runoff process, and then assess how much further they might need to tighten to bring inflation back to more palatable levels.

Balance Sheet: The Fed is also beginning to reduce the size of their nearly $9 trillion balance sheet. The runoff plan will start in June and ramp up to monthly caps of about $60 billion for Treasuries and $35 billion for agency mortgage-backed securities. The monthly reduction of about $95 billion will be larger than the $50 billion per month pace that was used during the 2017-2019 runoff plan. At the current runoff pace, it will take over 4 years for the Fed's balance sheet to decrease to its pre-pandemic size.

Chair Powell has recently turned a bit unsure as to whether the Fed can achieve a "soft-landing" for the economy. A soft-landing means that the economy can avoid a recession despite the increase in interest rates. Powell admitted that while achieving a soft-landing is challenging, it ultimately might depend on factors outside of the Fed's control, including the Russia/Ukrainian war and China's covid lockdowns. We will keep highlighting that monetary policy is not on a preset course and the Fed will pivot if inflation starts to decelerate, the markets have a significant decline, and/or the economy starts to materially weaken. Fed Chair Powell has demonstrated that he is data dependent and will quickly change policy as the economy and markets evolve.

Inflation

While several of the latest inflation readings eased a bit from recent highs, they are still at nosebleed levels due to supply chain bottlenecks, surging energy prices, massive amounts of stimulus, and pent-up demand.

The Fed's preferred inflation measure (Core PCE inflation) increased by +4.9% Y/Y in April, well above the target of about 2%, but below recent levels of +5.2% in March and +5.3% in February. While inflation may be near peak levels, the key will be how long it takes for disinflation to set in and the growth rate to move back toward 2%. The Fed would very much appreciate a strong period of disinflation which would allow them to slowdown the pace of tightening. We will need to wait at least a few months for this evidence. The Fed's current estimate for Core PCE inflation is +4.3% in 2022, +2.5% in 2023, and +2.1% in 2024.

We are still trying to combat the current rise in inflation by holding little cash in portfolios, avoiding long-term bonds, and overweighting equities of companies that are able to grow their cash flows, earnings, and dividends. Please see our **June Client Question on Inflation**, where we detailed how the data is calculated, why the Fed cares about and targets inflation, and the impact it has on various asset classes (cash, fixed income, and equities). In our **December Client Question – Revisiting Inflation**, we thought it would be helpful to outline three potential scenarios for how inflation could impact the economy and stock market in 2022, provide an update on supply chain bottlenecks, and look at the latest readings of various inflation measures and forecasts.

Economic Data

Our view is that the that the economy is slowing from the post-pandemic boom due to fading stimulus, rising inflation, Fed tightening, and surging commodity prices. The current period is best characterized by high inflation, still solid economic growth, and a lot of uncertainty. The economy is expected to increase by +2.6% in 2022 due to a strong labor market and consumer. However, there is a tremendous amount of uncertainty caused by Fed tightening expectations, the Russia/Ukraine War, and China's covid lockdowns. Both the war and China's covid policies are putting more pressure on global supply chains and upward pressure on already elevated inflation. The Fed has started tightening monetary policy by raising interest rates and decreasing the size of their balance sheet. The longer inflation stays elevated, the more likely it becomes that the Fed will have to overtighten monetary policy and potentially cause a recession to finally bring it down.

Labor Market: The labor market remains strong as the latest Bureau of Labor and Statistics Employment report showed an increase of +428,000 jobs in April and the latest Job Openings and Labor Turnover Survey (JOLTS - April) reported over 11.5 million job openings. The May employment report, which will be released on June 3rd, is expected to show an increase +325,000 jobs with the unemployment rate declining to 3.5%.

Consumption: United States consumers are still spending money although the impact of high inflation is starting to take its toll, especially on the middle- and lower-income population. The latest Census Bureau Retail Sales number came in at +8.2% Y/Y in April. Although several notable retailers have reported that while overall spending is healthy, consumers are beginning to spend less on general merchandise (appliances, electronics, home goods, etc.) and more on food and gas. We expect this unfortunate trend to continue for as long as inflation remains elevated.

Our framework for navigating current conditions:

During periods of market volatility, we follow the same playbook and convey the same messages. At Winthrop Wealth, we believe the right mindset paired with a comprehensive financial plan and a thorough investment process can help provide confidence in working towards your long-term financial goals, especially during times of heightened market volatility.

The Right Mindset – Take a long-term viewpoint and avoid the impulse to market time

"Don't try to buy at the bottom and sell at the top. It can't be done - except by liars."
Bernard Baruch

Market volatility is stressful and controlling your emotions during these periods is critical. Market timing decisions are often emotional rather than rational and data based. Making sudden large adjustments to portfolios is value destructive over time and a major reason for poor investor performance. Our investment philosophy is, never time the market. Please see our Client Question titled Market Timing Does Not Work, where we demonstrate that: the stock market goes up over time despite frequent drawdowns, the average investor underperforms due to market timing mistakes, and the benefit of a diversified portfolio and a long time horizon.

Financial Plan

“The Best way to measure your investing success is not by whether you’re beating the market but by whether you’ve put in place a financial plan and behavioral discipline that are likely to get you where you want to go.”
Benjamin Graham

We believe financial planning drives the investment strategy and provides a roadmap to each client’s unique goals and objectives. The comprehensive financial plan defines cash flow needs, optimizes account structures, considers tax mitigation strategies, and evaluates financial risks as circumstances and/or goals change.

We also stress test the financial plan for many different environments including extreme volatility and market declines. The financial plan does not assume perpetually strong markets and linear returns. Rather it assumes that your portfolio will go through periods of weakness throughout your investment time horizon. We often update financial plans during and after volatility to quantify the impact that the market decline had on the probability that the client will reach their long-term goals and objectives. Since we account for market volatility and declines, the financial plan is less likely to be damaged when these periods inevitably occur.

Investment Process

“Good times teach only bad lessons: that investing is easy, that you know its secrets, and that you needn’t worry about risk. The most valuable lessons are learned in tough times.”
Howard Marks

Our investment management process is designed to provide well-diversified portfolios constructed with a methodology based on prudent risk management, asset allocation, and security selection. We help our clients navigate challenging markets by seeking to ensure their short-term cash flow needs are met while managing the rest of their investments in a globally diversified portfolio.

Market volatility can be used to our advantage by tax-loss harvesting or reallocating to more attractive securities:

- **Tax-loss Harvesting**: Tax-loss harvesting is achieved by selling an investment with a loss and immediately purchasing a different security with similar (but not identical) exposure. The loss on the sold security can be used to offset taxable gains. Since we simultaneously sell a security to capture a loss and purchase a different holding with similar exposure, the client is never out of the market. We can capture losses during declines, and as the market recovers the new position also recovers PLUS the client has a tax-loss to offset future gains. Please see our **Client Question on Tax Loss Harvesting**.

- **Repositioning Portfolios**: Repositioning portfolios means that we can increase the overall equity allocation and/or we can reallocate among various asset classes. During a market selloff, portfolio equity allocations often fall below their target levels. For example, assume a portfolio is invested to its target allocation of 60% equities and then the stock market declines -10%. The new allocation would be about 54% or -6% below the target level. We can use the market decline as an opportunity to buy stocks at lower prices to bring the allocation back to the 60% target level. Furthermore, we can rotate to the equity asset classes that have become more attractive (for equities, we allocate across regions, countries, market caps, factors, styles, sectors, and industries). Keep in mind, some of the best buying opportunities occur during periods of market turmoil.

MARKET RETURNS

US Equity										
Index	May	2022	2021	2020	2019	2018	3-Year	5-Year	10-Year	20-Year
S&P 500	0.18%	-12.76%	28.68%	18.39%	31.47%	-4.39%	16.40%	13.36%	14.34%	9.13%
Russell 3000	-0.14%	-13.90%	25.64%	20.88%	31.01%	-5.25%	15.57%	12.73%	13.95%	9.20%
Dow Jones Industrial Average	0.33%	-8.43%	20.95%	9.72%	25.34%	-3.48%	12.29%	11.87%	12.88%	8.80%
Nasdaq	-1.93%	-22.52%	22.21%	45.05%	36.74%	-2.81%	18.48%	15.38%	16.93%	11.76%
S&P 400	0.72%	-11.01%	24.73%	13.65%	26.17%	-11.10%	13.23%	9.53%	12.17%	9.66%
Russell 2000	0.14%	-16.58%	14.78%	19.93%	25.49%	-11.03%	9.66%	7.68%	10.81%	8.33%
Russell 1000 Growth	-2.32%	-21.88%	27.59%	38.49%	36.39%	-1.51%	18.29%	16.12%	15.98%	10.23%
Russell 1000 Value	1.94%	-4.52%	25.12%	2.78%	26.52%	-8.28%	12.71%	9.47%	12.04%	8.01%
International Equity										
MSCI Index	May	2022	2021	2020	2019	2018	3-Year	5-Year	10-Year	20-Year
EAFE	0.75%	-11.34%	11.26%	7.82%	22.01%	-13.79%	6.42%	4.17%	7.10%	5.56%
Europe	2.12%	-15.62%	13.54%	7.89%	23.20%	-16.90%	5.65%	2.70%	7.67%	4.88%
Japan	1.64%	-13.43%	1.71%	14.48%	19.61%	-12.88%	5.09%	3.67%	6.99%	4.18%
China	1.18%	-16.73%	-21.72%	29.49%	23.46%	-18.88%	-0.11%	1.31%	5.00%	9.91%
Emerging Markets	0.44%	-11.76%	-2.54%	18.31%	18.42%	-14.57%	4.99%	3.80%	4.15%	8.37%
ACWI ex US	0.72%	-10.74%	7.82%	10.65%	21.51%	-14.20%	6.49%	4.42%	6.35%	6.02%
US Fixed Income										
Bloomberg Barclays Index	May	2022	2021	2020	2019	2018	3-Year	5-Year	10-Year	20-Year
Aggregate	0.64%	-8.92%	-1.54%	7.51%	8.72%	0.01%	0.00%	1.17%	1.72%	3.69%
Treasury Bills	0.05%	0.10%	0.04%	0.54%	2.21%	1.83%	0.63%	1.06%	0.59%	1.18%
Corporates	0.93%	-11.92%	-1.04%	9.89%	14.54%	-2.51%	0.76%	1.92%	2.96%	4.73%
Securitized MBS/ABS/CMBS	1.04%	-7.28%	-1.04%	4.18%	6.44%	0.99%	-0.58%	0.69%	1.43%	
High Yield	0.25%	-8.00%	5.28%	7.11%	14.32%	-2.08%	3.33%	3.56%	5.41%	7.24%
Munis	1.49%	-7.47%	1.52%	5.21%	7.54%	1.28%	0.50%	1.78%	2.54%	3.96%
US Equity Sectors										
Index	May	2022	2021	2020	2019	2018	3-Year	5-Year	10-Year	20-Year
Technology	-0.85%	-19.39%	34.52%	43.88%	50.27%	-0.30%	26.23%	21.90%	20.11%	12.78%
Real Estate	-5.02%	-14.19%	46.14%	-2.17%	29.00%	-2.23%	10.17%	10.44%	9.10%	
Industrials	-0.48%	-10.15%	21.10%	11.05%	29.32%	-13.32%	11.55%	8.70%	12.53%	8.52%
Energy	15.77%	58.43%	54.35%	-33.68%	11.81%	-18.10%	20.52%	10.92%	6.69%	8.55%
Consumer Discretionary	-4.85%	-24.69%	24.43%	33.30%	27.94%	0.82%	12.22%	12.01%	14.99%	9.96%
Communication Services	1.79%	-24.35%	21.57%	23.61%	32.69%	-12.53%	9.71%	7.22%	7.50%	6.56%
Consumer Staples	-4.61%	-3.16%	18.63%	10.75%	27.61%	-8.39%	13.70%	8.83%	11.32%	8.80%
Utilities	4.32%	4.65%	17.67%	0.52%	26.35%	4.11%	12.09%	10.30%	11.55%	9.38%
Materials	1.14%	-4.72%	27.28%	20.73%	24.58%	-14.70%	20.21%	12.43%	12.02%	9.08%
Financials	2.73%	-8.78%	34.87%	-1.76%	32.09%	-13.04%	13.26%	11.04%	14.37%	4.80%
Health Care	1.44%	-5.83%	26.13%	13.45%	20.82%	6.47%	17.10%	13.78%	15.88%	9.60%
	Calendar Year Returns						Annualized Returns			

DISCLOSURES:

The economic forecasts set forth in this material may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Content in this material is for general information only and not intended to provide specific advice or recommendations for any individual.

Financial planning is a tool intended to review your current financial situation, investment objectives and goals, and suggest potential planning ideas and concepts that may be of benefit. There is no guarantee that financial planning will help you reach your goals.

Rebalancing a portfolio may cause you to incur tax liabilities and/or transaction costs and does not assure a profit or protect against a loss.

Likewise, it is important to remember that no investment strategy assures success or protects against loss. Past performance is no guarantee of future results. Asset allocation does not ensure a profit or protect against loss. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk. All investing involves risk which you should be prepared to bear.

This information is not intended to be a substitute for individualized tax advice. We suggest that you discuss your specific tax situation with a qualified tax advisor.

All indexes mentioned are unmanaged indexes which cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. Past performance is no guarantee of future results.

The Standard & Poor’s 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.
The Russell 3000 Index is a market-capitalization-weighted equity index maintained by FTSE Russell that provides exposure to the entire U.S. stock market. The index tracks the performance of the 3,000 largest U.S.-traded stocks which represent about 98% of all U.S incorporated equity securities.

The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the Index.

The S&P Midcap 400 Stock Index is an unmanaged index generally representative of the market for the stocks of mid-sized US companies.

The Russell 2000 Index is an unmanaged index generally representative of the 2,000 smallest companies in the Russell 3000 index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.

The Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

The prices of small cap stocks and mid cap stocks are generally more volatile than large cap stocks.

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Index consists of the following developed country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the UK.

The MSCI Europe Index captures large and mid cap representation across 15 Developed Markets (DM) countries in Europe. With 445 constituents, the index covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.

The MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market. With 322 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

The MSCI China Index captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). With 709 constituents, the index covers about 85% of this China equity universe. Currently, the index includes Large Cap A and Mid Cap A shares represented at 20% of their free float adjusted market capitalization.

The MSCI EM (Emerging Markets) Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the emerging market countries of the Americas, Europe, the Middle East, Africa and Asia. The MSCI EM Index consists of the following emerging market country indices: Brazil, Chile, Colombia, Mexico, Peru, Czech Republic, Egypt, Greece, Hungary, Poland, Qatar, Russia, South Africa. Turkey, United Arab Emirates, China, India, Indonesia, Korea, Malaysia, Philippines, Taiwan, and Thailand.

The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 27 Emerging Markets (EM) countries. With 2,354 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.

The Bloomberg Barclays U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds.

The Bloomberg Barclays Capital U.S. Credit Bond Index measures the performance of investment grade corporate debt and agency bonds that are dollar denominated and have a remaining maturity of greater than one year.

The Bloomberg Bloomberg Barclays Capital US Corporate High Yield Bond index is an index representative of the universe of fixed-rate, non-investment grade debt.

The Bloomberg Barclays Insured Municipal Bond Index is a total return performance benchmark for municipal bonds that are backed by insurers with Aaa/AAA ratings and have maturities of at least one year.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.