TOWNELEY CAPITAL MANAGEMENT

FINANCIAL MARKETS OVERVIEW SUMMER 2022

2ND QUARTER 2022 MARKET SUMMARY

The only sectors and asset classes that avoided the market carnage during the first quarter of 2022 were energy stocks, commodities (other than precious metals), and Treasury bills. During the second quarter, nothing was immune except cash. As the Fed trims their balance sheet and continues to raise rates to combat inflation, recessionary fears are growing. However, with unemployment close to a record low and consumers continuing to spend, a recession, if it happens at all, may be months away. Given the Fed's policy moves and slowing economic growth, the financial markets are likely to remain volatile in the near term. The third quarter has started off very strong with equity and fixed income both recording positive returns and the S&P 500 Index ended July with its best month since 2020.

U.S. EQUITIES

The NASDAQ Index officially entered bear market territory in April, and the S&P 500 Index followed suit in June. While shares of the ten largest companies in the highly concentrated S&P 500 index at year-end had a range of returns of -0.9% (Visa) to 125.3% (Nvidia) during 2021, year-to-date (through 7/15/2022) losses for the top 10 ranged from -6.9% (Berkshire Hathaway) to -46.4% (Nvidia). Since the beginning of the year, a rotation from growth to value stocks has taken place, as large-cap value outperformed large-cap growth by 8.3% during the 1st quarter and 15.1% during the 2nd quarter.

	QTD (%)	YTD (%)
S&P 500	-16.1	-20.0
Russell 1000	-16.7	-20.9
Russell 1000 Value	-12.2	-12.9
Russell 1000 Growth	-20.9	-28.1
Russell 2000	-17.2	-23.4
Russell 2000 Value	-15.3	-17.3
Russell 2000 Growth	-19.3	-29.5

INTERNATIONAL EQUITIES

International equity markets provided no respite for investors during the first and second quarters. Developed market equities lost 14.5% during the second quarter and are down 19.6% through June 30. Europe and Japan lead the decline. In response to the Russia-Ukraine war and its inflationary effect on European economies, the European Central Bank announced its first interest rate increase in over 11 years in July, with another hike planned in September. Japan, the highest debt-to-GDP country in the world, continues to pursue its yield curve control plan to keep inflation below 2.0%. China was the only emerging market to generate a positive return in the 2nd quarter. Energy- and commodity-rich emerging market countries are under pressure due to the rising dollar, concerns over a global recession, and the general easing of commodity prices that support their markets.

	QTD (%)	YTD (%)
MSCI ACWI ex-US	-13.7	-18.4
MSCI EAFE	-14.5	-19.6
MSCI Europe	-14.5	-20.8
MSCI Japan	-14.6	-20.3
MSCI EM	-11.4	-17.6
MSCI China	3.4	-11.3
MSCI EM ex-China	-17.9	-20.8

FIXED INCOME

Bonds continued to sell off sharply during the second quarter. Yields remain markedly higher in response to elevated inflation data and the hawkish Fed's interest rate hikes. Government bonds rallied near the end of the quarter, reflecting rising recession concerns. The 10-year Treasury yield was unusually volatile during June, peaking at 3.5% on June 14 and finishing the quarter at 3.0%. Corporate bonds underperformed government bonds during the second quarter as spreads widened markedly. Finally, mortgage rates have hit their highest levels since 2008. The 30-year fixed rate hit 5.8% on June 23, dropping to 5.3% by the quarter's end. Only a year ago, some homeowners locked in rates below 3.0%. Volatility will remain high, and there will likely be liquidity constraints for corporate and mortgage-backed securities when the Fed eventually curtails its massive balance sheet.

	QTD (%)	YTD (%)
Bloomberg US Govt Interm	-1.7	-5.8
Bloomberg US Govt Long	-11.9	-21.2
Bloomberg US Treas TIPS	-6.1	-8.9
Bloomberg US Corp Bond	-7.3	-14.4
Bloomberg US Corp HY	-9.8	-14.2
Bloomberg Municipal	-2.9	-9.0

CURRENCIES

The U.S. dollar continues to be resilient in the face of global uncertainty. Not only has it risen by 6.3% in the 2nd quarter, but it has led the pack by 9.5% year to date, setting a 19-year high. Even though the European Central Bank has announced pending rate hikes, the Euro is moving towards parity with the dollar. For the first time in two decades, the 1-dollar bill and the 1-euro coin are almost the same value. Japan continues to be the only developed country to maintain an easy monetary policy, and as a result, the Yen has stumbled to a 24-year low to the dollar. The combination of interest rate differentials, focused monetary policy, and risk aversion dynamics contributed to the dollar's strong performance.

	QTD (%)	YTD (%)
US Dollar	6.3	9.5
Euro	-6.0	-8.3
Yen	-9.7	-15.1
Chinese Yuan	-5.0	-5.1
Pound Sterling	-7.9	-10.2
MSCI EM Currency	-4.4	-3.9
Bitcoin	-55.8	-57.4

REAL ASSETS

Gold returns have been lower than expected this year, partly due to the growing strength of the U.S. dollar. Gold tends to do well when the U.S. dollar is declining. Industrial metals were the worst performing real asset last quarter, with the prices of aluminum, nickel, and zinc declining significantly. The Bloomberg Commodities index posted a negative return in the 2nd quarter after a spectacular 24.5% first-quarter return. The primary component lifting commodities was the energy subsector, which is the weightiest component in the index (34.8%). Amid strong demand and continued supply constraints, energy was the best performing component during both the first and second quarters. U.S. REITS were down significantly during the second quarter, driven partly by rising interest rates.

	QTD (%)	YTD (%)
S&P GSCI Gold	-7.6	-1.5
Bloomberg Commodity	-5.7	18.4
Bbg Sub Energy	7.0	58.3
Bbg Sub Industrial Metals	-26.4	-9.6
MSCI US REIT	-16.9	-20.3

INVESTMENT ACTIVITIES

Recessions and downturns happen, and recovery and upswings always follow. Despite claims to the contrary, no one can accurately predict the future direction of the stock market, the trajectory of inflation, or the occurrence of recession. There are, however, actions that we can take on your behalf to help navigate the murky waters ahead.

Tax Loss Harvesting

For the first time in years, the bond market decline enabled us to harvest capital losses in the fixed income segment of taxable private client portfolios. Tax loss harvesting is an investment strategy that turns realized losses into tax offsets for future gains while still remaining invested in the given asset class. We view tax losses as a benefit, as they can be applied in both the current tax year as well as carried forward indefinitely into future tax years.

Rebalancing

At Towneley, we use rebalancing as a critical tool to help navigate difficult market environments and reduce portfolio risk. During the second quarter, we took the following actions related to the fixed income (bond) portion of the portfolio:

- To mitigate rising interest rate risk, we targeted a duration of approximately 4 years, shorter than the general market's measure of 6.5 years. Duration risk represents the possibility that changes in interest rates may reduce or increase the market value of a fixed-income investment. A longer duration exposes the portfolio to decreases in value when interest rates are rising significantly.

- To decrease the risk of default, which may be more likely in challenging economic times, we increased the average credit quality of our taxable bond fund strategy to AA. This score signifies that most bond issuers held in the portfolio are financially sound and have adequate revenues and cash reserves to pay their debts.

- Towneley decreased allocations to corporate bonds, mortgages, and securitized investments, as any illiquidity risk attributable to the FED winding down its balance sheet could result in rising yield spreads, thus rendering weaker performance for these investments.

We will be making further tactical adjustments to the domestic equity and international equity segments of client portfolios. These adjustments will include a further tilt toward value and additional active managers. We are maintaining the ratio of 70% domestic equities to 30% international equities. The rising U.S. dollar and global geopolitical risk landscape continue to favor greater allocations to domestic equities over both international developed and emerging markets.

Given gold's low correlation to other asset classes, and its distinction as a safe haven when the stock market is declining and the federal deficit is rising, we continue to see value in maintaining a modest position in our precious metals strategy, and do not expect to make any near-term changes.

Connecting with Towneley

We encourage you to schedule an appointment with your Towneley team to review any changes in your families' or organizations' financial situation. This is also a good time to review your spending and cash flow needs, as well as to address any questions or concerns that you may have.