ON THE MARGIN

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May 2022 Recap

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There is a general tiptoeing around the word “recession” perhaps due to the fear of it becoming a self-fulfilling prophecy. For the first four months of the year, even with the consumer price index exceeding a forty-year record, there was a general preference to believe in the saving grace of the American shoppers rather than to consider the impact of those prices on the tendency to consume. During the month of May, however, investors threw caution to the wind to discuss a potential recession out in the open. Evidence mounted during earnings calls as corporate leaders discussed headwinds that may lie ahead. Large tech companies announced a pause in hiring, Snap Inc. spoke of reluctant corporate spending for advertising, and retailers painted a picture of cautious consumption patterns. No one actually knows if we will encounter an economic contraction. But the risks of a recession certainly seemed to rise during the month of May.

GLOBAL EQUITY

The technical correction in the S&P 500 Index in April turned into a momentary bear market last month as equity markets continued to sell off in the first three weeks of May. Unlike the first four months of 2022, the attention shifted from inflation fears to concerns about the impact of high prices on growth. As the word “recession” emerged in the public discourse, economically sensitive sectors sold off along with the repricing of tech stocks. Small cap stocks were entrenched deep into a bear market. However, there was a dramatic turnaround during the last week, triggered by the potential “flexibility” in monetary policy indicated in the Fed’s meeting minutes. This relief rally left most major indices flat for the month.

On the earnings front, the blended earnings growth rate for the S&P 500 companies for Q1 is 9.2%[1]. This number is higher than expected at the beginning of the quarter (4.6%), but investors responded to other details and forward guidance. Large retailers such as Walmart and Target told a tale of cautious American consumers who are spending less on discretionary goods as fuel and food prices soar. The frugality of Americans also meant that they chose to spend more at Dollar Tree, who reported a positive earnings surprise for the quarter. Finally, the inventory levels increased year-over-year – much of the general merchandise that the stores over-ordered last fall due to supply chain issues sat on the shelves.

These retailers gave us a front row view of how high prices are impacting American consumption, which makes up nearly 70% of U.S.’s GDP.

International developed markets dipped into the negative territory in local currency terms, with the MSCI EAFE index posting a positive return only due to the falling US dollar. After a struggle to find unity in its approach to Russian energy, the European Union reached a deal on a partial ban of Russian oil, and energy prices continued to climb. The ban fuels the current inflationary momentum around

TABLE 1: **Global Equity**

	MAY	QTD	YTD	1 YR
Dow Jones Industrial Average	0.33	-4.51	-8.43	-2.65
S&P 500 Index	0.18	-8.55	-12.76	-0.30
Russell 2000	0.14	-9.79	-16.58	-16.96
Russell 1000 Growth	-2.32	-14.12	-21.88	-6.25
Russell 1000 Value	1.94	-3.81	-4.52	0.93
MSCI ACWI USD	0.12	-7.90	-12.83	-6.78
MSCI EAFE USD	0.75	-5.77	-11.34	-10.38
MSCI EM USD	0.44	-5.15	-11.76	-19.83
MSCI ACWI ex US USD	0.72	-5.61	-10.74	-12.41

Source: Bloomberg, as of 5/31/2022. Past performance does not guarantee future returns.

1 FactSet Earnings Insight, 5/27/2022. 97% of companies in the S&P 500 Index have reported actual earnings.

the world: German inflation hit an all-time high to 8.7% YoY[2] and Japan also saw a surge in their producer prices during May. These developments hint at sustained high prices for the global economy in the months to come. In emerging markets, China is struggling to grow due to its zero-COVID policy and saw its industrial production and consumption plummet. And while commodity-producing EM countries are currently benefiting from high materials prices, they also rely on the Chinese consumption for these goods. The importance of the Chinese economy and the nervousness around its weakness was reflected in the general muted returns of the MSCI EM Index despite its attractive valuations.

FIXED INCOME

A shift in thinking from inflation concerns to growth worries meant falling Treasury yields. As equity markets sold off, Treasuries finally played the traditional role as a safe haven asset. The 10-year Treasury yield fell to a low of 2.7% as investors piled in, after having breached 3.2% intraday as the post-pandemic high. Investors with diversified portfolios saw the benefit of holding fixed income as falling yields favored longer duration assets. The Bloomberg US Aggregate Bond Index gained 0.64%, and the Bloomberg Investment Grade Corporate Index saw some relief during May despite some expansion in credit spreads. Still, 2022 remains a difficult year so far for fixed income with significant losses year to date.

TABLE 2: **Fixed Income**	MAY	QTD	YTD	1 YR
Bloomberg US Aggregate	0.64	-3.17	-8.92	-8.22
Bloomberg 1-3 Yr Gov/Credit	0.61	0.07	-2.42	-3.03
Bloomberg Treasury 5-7 Yr	0.74	-1.95	-7.47	-8.04
Bloomberg Investment Grade Corp	0.93	-4.59	-11.92	-10.28
Bloomberg High Yield Corp	0.25	-3.32	-8.00	-5.27
JPMorgan EMBI Global Diversified	0.03	-5.57	-15.03	-15.38

Source: Bloomberg, as of 5/31/2022. Past performance does not guarantee future returns.

Despite the potential for "flexibility" in the Fed's tightening plans, the Fed Funds futures market is still pricing in at least 7 rate hikes by the end of 2022. The Fed's hawkish plans need to be taken in context with other central banks. While some banks may have raised rates, the European Central Bank, the Bank of Japan, and the People's Bank of China (PBOC) in particular have not yet embarked on a monetary tightening journey. In fact, the PBOC has been reducing rates and expanding liquidity to combat the current economic malaise in China. In the coming months it will be interesting to see where capital will flow due to this divergence in policy and the implications for the foreign fixed income markets, rates, and currency.

CODA

Just as no one can predict a recession with precision, no one knows where the market bottom is. The otherwise turbulent month of May ended with some relief, but we do not know if the trough is behind us. And there are still significant challenges that lie ahead. Tightening liquidity in the global financial markets, persistently high prices of necessary goods and services, and corporate earnings peak in the rearview mirror suggest that markets may continue to be cautious in the near future. To see a complete reversal of market sentiment, it may take a decisively less-hawkish Fed or an outright reversal of the tightening trajectory. In the meantime, we hope to see the economy steer through these difficult waters without the word "recession" becoming a self-fulfilling prophecy.

2 German Federal Statistical Office, 5/30/2022.

Anna Rathbun serves as the Chief Investment Officer for CBIZ Investment Advisory Services. Her tenure with the firm has spanned economic and market research, portfolio construction, and creating insights in investment themes to share with the investment community. Anna began her career in investments at Wellington Management, and subsequently, Harvard. She has served as a Managing Director for a registered investment advisory firm where she specialized in alternative investments. She is a graduate of Harvard University with a B.A. in Economics. Her early passion for the arts led her to classical music, for which she obtained a Master of Music and Doctor of Musical Arts from the Cleveland Institute of Music. Anna's career in music spanned a wide spectrum of performances to a faculty position at her alma mater. With a unique background that embraces both finance and the arts, Anna is dedicated to the issue of financial sustainability for organizations serving a mission.