Highlights and Insights

May 9, 2022

Benefit Financial Services Group 1643 E. Bethany Home Road,, Phoenix, AZ 85016 I Phone: 602-997-8882 I www.bfsg-az.com

Inside This Issue

Market Recap

Market Musings

Market Recap

As we enter the second week of May, the Federal Reserve (the “Fed”) has raised interest rates twice and the S&P 500 is down 13% year-to-date and near its lowest level since May 2021.[1] The 10-year Treasury yield rose from 1.51% to 3.01%--a rise of almost 100% since the beginning of the year. As bond yields continue to move higher, bond prices are under pressure. The Bloomberg U.S. Aggregate Bond Index is lower by 10.5% since the beginning of the year.[2]

The trajectory for both Fed policy and inflation remain key drivers for both the equity and bond markets. With inflation rising at the fastest pace in 40 years, the market has priced in almost 275 bps worth of tightening in 2022, which would be the largest amount of tightening over a 12-month period since 1994. In addition, another 50+ basis points of tightening have been priced in to each Fed meeting into mid-2023.[3] However, normalizing supply chains, emerging weakness in housing sales, and an expected slowdown in goods prices, suggest that we are at or near peak inflation. If so, we may also be near peak hawkish sentiment about Fed policy. As inflation begins to roll over, which we expect to start with the April or May CPI report, the expectations for Fed rate hikes likewise should begin to moderate. This should be supportive of risk assets and allow bond yields to decline moving forward.

The current 13% decline in the S&P 500 Index is in-line with the average 14% intra-year pullback experienced since 1980.[4] What has made the recent downturn feel worse is that bonds have not provided their typical cushioning effect during current market corrections. While the losses in the fixed income portion of portfolios are unusual, the silver lining is that the recent sell-off in the bond market has put some yield back into fixed income for investors. Although we expect volatility to remain elevated, we caution investors from panic selling as fundamentals and the broad oversold position of stocks and bonds continue to support a move higher in both markets over the next 12 months.

Mark L. Blom, CFP® - Senior Wealth Manager

Market Musings

The Powell Paradox

On the surface, Fed Chairman Jerome Powell's Wednesday announcement that the Fed would raise the Federal Funds rate by 50 basis points (1/2%) came as no big surprise to the financial markets. It was the first half-point rate hike since 2000. When the Federal Reserve's meeting minutes were announced, the markets took the decision in stride.

It was Chairman Powell's remarks during his press conference after the release of the Fed's meeting minutes that caused the markets to go on a wild ride.[5] He stated that it was likely that two more rate increases of 50 basis points would occur in June and July. In answer to a press question whether they had considered a 75-basis point rise at their June meeting, which the market had expected, he replied they did not. Nor was it on the table for July and August. That unexpected "dovishness" ignited a sharp stock and bond price rally, over the prospects that the Fed would go slow in tightening monetary policy. The Dow Jones Industrial Average ended Wednesday ahead over 900 points and 10-year bond yields fell from a high of 2.97% to 2.91%.[6]

But things changed radically on Thursday. It is unclear why Mr. Powell wanted to tamp down forecasts of a 75-basis point increase. It may have been that the Fed didn't want to signal that they were in a panic over their inability to tame inflation other than to raise interest rates in larger increments. But here is the rub. By explicitly taking a larger move off the table, the Fed risked producing the opposite effect of what it said it wanted to accomplish, namely, reducing demand *by tightening financial market conditions.* Instead, that big rally in stocks and bonds underpinned the notion that they have the market's back (i.e., wanting to moderate market losses), causing financial conditions to be easier than anticipated, since stocks are a key component of the financial-conditions framework. The rally could loosen the constraints on the economy, the opposite of what Powell intended, and would promote more risk taking.

So, overnight, market participants got the notion that the Fed was inducing easier market conditions that would cool rising interest rates *at the expense of battling inflation,* it's number one priority. On Thursday, stock prices opened sharply lower and continued falling throughout the day. In the end, the Dow lost all and more than it gained the day before.

We have observed in the past how good news can be bad news for asset prices. Frequently, good economic data have been received poorly in markets, due to its presumed negative impact on central banks. That dynamic is being taken to an extreme length right now, when it's possible to frame rising stock prices ("good news") as themselves sending a *bearish signal* ("bad news") given their influence on financial conditions.

Thomas J. Steffanci, PhD - Senior Portfolio Manager

Sources:

1. The S&P 500 is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market. Total return as of May 6, 2022.
2. The U. S. Aggregate Bond Index is a broad-based index used as a proxy for the U.S. bond market. Total return as of May 6, 2022.
3. Source: Bloomberg, CME Group. Fed Funds futures contracts are used to estimate the market's view of the probability of a rate change by the Federal Reserve.

4. Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management. Intra-year drops refers to the largest market drops from a peak to a trough during the year.
5. Source: Federal Reserve (https://www.federalreserve.gov/monetarypolicy/fomcpresconf20220504.htm)
6. The Dow Jones Industrial Average, or simply the Dow, is a price-weighted measurement stock market index of 30 prominent U.S. companies.

To unsubscribe from this newsletter, please send an email to Unsubscribe@BFSG.com.

Disclosure: Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Benefit Financial Services Group ("BFSG"), or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from BFSG. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. BFSG is neither a law firm, nor a certified public accounting firm, and no portion of the newsletter content should be construed as legal or accounting advice. A copy of BFSG's current written disclosure Brochure discussing our advisory services and fees is available upon request. **Please Note:** If you are a BFSG client, please remember to contact BFSG, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services, or if you would like to impose, add, or to modify any reasonable restrictions to our investment advisory services. BFSG shall continue to rely on the accuracy of the information that you have provided. **Please Also Note**: Please advise us if you have not been receiving account statements (at least quarterly) from the account custodian.