



CAPSTONE
WEALTH ADVISORS

Outlook on the Markets

MID-YEAR SUMMER 2022 ISSUE



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Capstone Wealth Advisors is pleased to release our Mid-Year Outlook on the Markets written entirely by our advisory team. Our outlook is based on our views and philosophies as we see them impacting financial markets, and your money. Current trends, economic indicators and in-depth analysis is at the core of what we do. We monitor and analyze economic trends to help our clients have a clear understanding of the direction the economy is headed and how that impacts your portfolio strategies.

We have six offices throughout the Pacific Northwest, utilizing a team approach to provide continuity for your asset planning needs. Our investment committee meets weekly to discuss current economic events, market trends, asset allocations and more. By using a disciplined and methodical approach to investing, we remove the noise and emotion from your investment portfolio and allow you to focus on the things you love and enjoy most.



“Inflation - That’s the price we pay
for those government benefits
everybody thought were free.”
– Ronald Reagan

As we enter the second half of 2022, economic conditions both domestic and globally continue to weaken. The US Federal Reserve (Fed) is currently taking measures to slow down our economy and bring rampant inflation under control. This is being done by two measures, increasing interest rates in order to decrease consumption, and by reducing the amount of money circulating in our economy. The impacts of these moves have only begun to be felt and continued efforts to slow down our economy should be expected through the remainder of this year.

With an ongoing war between Russia and Ukraine affecting global food and energy supplies, Europe on the brink of recession, skyrocketing gas prices, a choked-up supply chain, interest rates rising, a weakening housing market, and an administration that seems more concerned with social issues than economic ones, it all leads many investors to grow increasingly worried about the outlook for our economy and the market.

On June 14th, President Biden is on record saying “I’ve never been more optimistic about America than I am today. I really mean that.”¹ Given Americans currently identify 40-year high inflation levels as a top concern, it underscores the growing lack of confidence in this administration’s ability, or willingness, to adequately address our economic issues.

Oil is at the forefront of the inflation issue with surging fuel prices impacting nearly every segment of the global economy. Our belief is that without a meaningful reduction in the price of oil it is difficult to pencil out how real inflation, which includes food and energy price increases, will come down anytime soon. US oil refining capacity is near 100% and demand remains strong, making it nearly impossible in the immediate term to meaningfully reduce the cost of fuels.

Another challenge facing the world is the potential for food shortages coming this fall. Due to the sanctions imposed on Russia, the world’s largest supplier of fertilizer, the price of fertilizer has soared upwards of 400% in some instances. Coupled with diesel prices over \$5.50/gallon, farmers are also experiencing unseasonable weather issues with crops being impacted due to flooding and other unusual seasonal weather patterns. We believe there is a high likelihood that basic food items like corn, wheat, soybeans, etc., could be in short supply causing even higher prices this fall. Remember, we are still eating off last year’s crop which was planted when there was no war and diesel was at \$3.15/gallon.² This year’s crop is yet to be harvested or transported to market.

While farming costs have risen substantially, so have the selling prices for their products. Add to this supply disruptions caused by the war, and it leads to North American farmers likely making a windfall profit this fall. For this reason, we have already added positions in farming, fertilizer, and agriculture to client portfolios with the appropriate risk tolerances.

Facts to Consider

- **The S&P/Case-Shiller Home Price Index**, widely recognized as the gauge for home price movements, reported that national home prices continue to increase at a fast rate since June 2020. The index currently sits at 311.84 as of April 2022 – representing a 39.5% increase since June 2020.³
- **The Consumer Confidence Index**[®] decreased in June, following a decline in May. The Index fell to 98.7 – down 4.5 points from 103.2 in May – and now stands at its lowest level since February 2021. The **Present Situation Index**—based on consumers' assessment of current business and labor market conditions—declined to 147.1 from 147.4 last month. The **Expectations Index**—based on consumers' short-term outlook for income, business, and labor market conditions—declined sharply to 66.4 from 73.7 and is at its lowest level since March 2013. All indicating a decline from previous levels and implying a deterioration of economic conditions in the months to come.⁴
- **The Purchasing Managers Index (PMI)**[®] for the manufacturing sector reported economic activity grew in May, with the overall economy achieving a 24th consecutive month of growth. The May Manufacturing PMI[®] registered 56.1%, an increase of 0.7% from the reading of 55.4% in April. While a reading of greater than 50% indicates economic growth, this is one of the lowest Manufacturing PMI[®] reading since September 2020, when it registered 55.4%, and the overall trend has shown a decreasing figure over the past several months. The U.S. manufacturing sector remains in a demand-driven, supply chain-constrained environment.⁵
- **The National Federation of Independent Business** reported labor shortages continues to be a challenge for small businesses with 51% (seasonally adjusted) of owners reporting job openings they could not fill in the current period, up four points from April and matching the 48-year record high set in September. 23% of owners reported labor quality was their top business problem, second to inflation. 12% of owners cited labor costs as their top business problem.⁶
- **The Bureau of Economic Analysis** reported Personal Income increased \$89.3 billion (0.4%) in April. Disposable Personal Income (DPI) increased \$48.3 billion (0.3%) and Personal Consumption Expenditures (PCE) increased \$152.3 billion (0.9%). When adjusted for inflation, "Real DPI" increased less than 0.1% in April and "Real PCE" increased 0.7%; goods increased 1.0% and services increased 0.5%. The PCE price index increased 0.2%. Excluding food and energy, the PCE price index increased 0.3%. The increase in Personal Income in April primarily reflected an increase in compensation and personal income receipts on assets that were partly offset by a decrease in proprietors' income.⁷
- **The Official Unemployment Rate** in the US, known as "U-3", remained at a seasonally adjusted 3.6% in May according to the Bureau of Labor and Statistics. The U-6 unemployment rate, a more comprehensive measure of unemployment, was at 7.1% in May which has been an improvement from the May 2021 rate of 10.1%.⁸
- **Gross Domestic Product (GDP)**, after being adjusted for inflation, decreased at an annual rate of -1.5% in the first quarter of 2022 according to the U.S. Bureau of Economic Analysis. In the fourth quarter of 2021, real GDP increased 6.9%. The decrease in real GDP reflected decreases in private inventory investment, exports, federal government spending, and state and local government spending, while imports, which are a subtraction in the calculation of GDP, increased. Personal consumption expenditures (PCE), nonresidential fixed investment, and residential fixed investment increased.⁹
- **CBOE Volatility Index (VIX)** has continued to experience moderate volatility over the last six months. Its highest level over that period was 36.45 on March 7th, 2022. The index sits at 32.95 as of mid-June. Many Wall St professionals have cited the absence of the VIX pushing above 40 as an indication that the current market downswings have not peaked yet. Generally, a significant increase in volatility index over 40 has coincided with the late phases of a Bear Market.¹⁰



The economic situation in Europe has also been plagued by the ongoing war and has caused prices of natural gas to skyrocket even more than what we are experiencing in the US. To further exasperate the issue, increased interest rates in the US have increased demand for US Dollars, making foreign currencies relatively less valuable versus the Greenback – causing foreign investments to have higher volatility due to increased currency exchange risk. China is still pushing its “Zero COVID” lockdowns and as a result, investing in International and Emerging Markets stocks is unattractive at this time.

Bond markets have also experienced increased volatility this year as the Fed began increasing interest rates back in March. This was to little surprise given bond prices and interest rates move opposite of each other. The bright spot for this asset class is that the bond market moves in advance of the Fed’s interest rate decisions and bonds have already repriced to a large degree, indicating we have likely seen the bulk of their declines already.

What does all this mean to you and your portfolio?

Investors should expect to see ongoing volatility in financial markets through the end of this year. For client portfolios, we have already taken measures to reduce, and in some instances eliminate, positions in sectors of the market that have a higher exposure to downturns – Having the right kind of diversification in this market is essential to your overall success. Sectors like Energy and Agriculture stocks have outperformed, and we have been increasing the level of cash in client portfolios as well to help reduce your overall portfolio volatility during this period of time.

While the current market and economic climate is choppy to say the least, investors should remind themselves that every recession, bear market or economic downturn in history has always ended and subsequently followed by a long-term sustained bull market, lasting far longer than the downturn. We believe this situation is no different.



To our valued clients, your investment portfolios already reflect our investment philosophy. As market conditions change, we will continue to proactively implement portfolio adjustments as part of our investment process. For those of you who are not currently a client, we invite you to schedule a complimentary consultation with our team. We can discuss the current economic outlook in greater detail and specifically how it might affect your existing portfolio. If you would like to schedule, please call our office directly at (877) 739-6007 or email us at info@capstonewealthadvisors.com.

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