Quarterly Market Perspective

Q2 2022

GuideStone Capital Management

MACROECONOMIC

- **Concerns over inflation bumped the ongoing Russia/Ukraine conflict from its top spot in the headlines during the second quarter of 2022.** In May, the Consumer Price Index ("CPI") reached a 40-year high at 8.6% year-over-year. Whether or not we have hit peak inflation remains an open question for now, but nevertheless, demand in the U.S. economy is still running above available supply. The adage remains true that If supply cannot rise to meet demand, demand must fall to meet supply. To that end, the Federal Reserve continued its monetary tightening by raising the federal funds rate in May by 50 basis points, and again in June by 75 basis points – the highest increase since 1994. June also saw the Fed start to reduce the size of its balance sheet by rolling over some of its bonds at maturity without replacing them with other assets – another form of monetary tightening which will impact financial market valuations.
- **Comments from the Fed emphasized its commitment to return inflation to its 2.0% objective,** and the July meeting could see another 50 – 75 basis point hike. However, some analysts have suggested that the Fed may eventually have to tolerate a higher level of inflation going forward. Since the 1970s, the Fed has only stopped rate hikes after the federal funds rate exceeded the CPI. But with the CPI at 8.6% and the federal funds rates between 1.5% and 1.75%, the Fed will be hard-pressed to raise aggressively enough before economic conditions make additional increases untenable. As of now, the expectation is that the economy will weaken so much that by 2023 the Fed will be forced to reduce the funds rate by 75 basis points.
- **Signs of slowing growth are appearing.** The Chicago Federal Reserve reported an eight-month low in its gauge of national economic activity, and weekly jobless claims came in above consensus at 229K, reflecting a labor market that has already peaked.
- **As discomforting as the idea of a recession may be, the result is always a pruning of economic excesses.** Our base case scenario right now is a (hopefully) shallow recession beginning in late 2022 or early 2023. We are hopeful that such an event would be enough to correct many of the imbalances in the economy today and reduce inflation to a more tolerable level.

EQUITIES

- **The S&P 500® Index struggled again during the second quarter with a -16.10% return.** The first quarter's return was -4.60%, and with back-to-back quarterly losses (something that hasn't happened since 2015) the Index tumbled into bear market territory, posting a drop of -19.96%, its worst first half of the year since 1970. For the most part, U.S. equity indices for every sector, size & style box experienced losses in the quarter. The dubious bright spot in equities was the energy sector as the rise in commodity prices – exacerbated by the Russian invasion of Ukraine – drove oil and natural gas prices higher.
- **International equities also fell due to weakening global growth, surging inflation, and the U.S. Dollar hitting a 20-year high.** Eurozone inflation accelerated to another record high of 8.6% in June, and business and consumer confidence slumped lower for most countries. The MSCI EAFE Index was down -19.57%, while the MSCI Emerging Markets Index fell by -17.63%. Much of the decline in emerging markets can be attributed to the economic slowdown in China, the world's second-largest economy, as its zero-COVID policies locked down big cities, grinding factory production to a sudden halt and further tangling logistics chains worldwide.
- **With the close of the second quarter, the S&P 500® also finished its most volatile half-year period since 2009.** Around 90% of the trading days of 2022's first six months had an intraday range greater than the 1%. The first half of 2009 saw 99% of its trading days surpass the 1% range.
- **Looking to the remainder of the year**, we expect to see the market trend lower, and volatility continue, especially as corporate profit expectations begin to fall, and price/earnings multiples continue to be squeezed in this high inflation environment.

	Market Performance (%)		
	QTD	YTD	3 Yr
S&P 500®	-16.10%	-19.96%	10.59%
Russell 1000® Value	-12.21%	-12.86%	6.86%
Russell 1000® Growth	-20.92%	-28.07%	12.57%
Russell 2000®	-17.20%	-23.43%	4.21%
MSCI EAFE	-14.51%	-19.57%	1.07%
MSCI EM	-11.45%	-17.63%	0.57%

FIXED INCOME

- **Volatility extended into the fixed income markets as well.** In a repeat of the first quarter, the second quarter saw the yield curve invert again as the 2-year U.S. Treasury yield exceed the 10-year U.S. Treasury yield for a brief period in June. This part of the curve is watched most closely by investors and often serves as a warning sign of potential recession, although it must remain inverted for some time before it is considered valid.
- **Rising short- and long-term rates pushed bond prices down**, causing the Bloomberg U.S. Aggregate Index to post a -10.35% decline. The Bloomberg Global Aggregate Bond Index finished the first half of the year down -13.91% as monetary tightening continued worldwide. June saw the 200th global rate hike and numerous central banks remain poised to aggressively pull back monetary support further. The U.S. dollar strengthened as global investors continued to seek a safe haven.
- **Since 1976, a negative quarterly return for both stocks and bonds has occurred just 20 times** and over that same time period, there have been only five instances in which both stocks and bonds were negative for two consecutive quarters (including this first half-year). For the last 20 years, investors could count on bonds to provide a measure of diversification to their stock holdings. However, studies show that stocks and bonds become positively correlated and thus, lose the benefits of diversification during times of high inflation such as the one existing today. Looking ahead, we expect bonds to once again cushion stock market losses as interest rate volatility subsides and fixed income becomes a better diversifier against equity risk.

	Market Performance (%)		
	QTD	YTD	3 Yr
U.S. Aggregate	-4.69%	-10.35%	-0.93%
U.S. IG Corporates	-7.26%	-14.39%	-0.99%
U.S. HY Corporates	-9.83%	-14.19%	0.21%
Global Aggregate	-8.26%	-13.91%	-3.21%
U.S. 90-Day Treasury	1.67%		
U.S. 2 Yr. Treasury	2.96%		
U.S. 10 Yr. Treasury	3.02%		

REAL ASSETS/ALTERNATIVES

- **Crude oil prices oscillated greatly over the past three months.** WTI began the quarter at $99.27/barrel and moved as high as $122.11 before ending the quarter at $105.76, an overall increase of 6%. Analysts believe – barring some type of supply shock – prices could slump significantly by the end of the year on growing concerns of a material economic global slowdown.
- **The war between Russia and Ukraine ground on, continuing to impact commodity prices.** We can expect continued volatility in this sector for the foreseeable future. While monetary policy can address inflation, it cannot address the shortages created by the war. Until recently, Russia was Europe's energy supplier. Now multiple countries, including Germany, Sweden, Denmark and Austria, have announced plans to further reduce their reliance on Russian gas. We currently believe that one of the key risks for this year is escalated protectionism as the world grapples with energy and food shortages stemming from the drastic reduction in primary commodity production due to the Russia/Ukraine war.
- **The increase in the federal funds rate quickly cascaded into a massive surge in mortgage rates**, leading to immense strain in the housing sector. Building permits fell 7% in May and housing starts sank 14.4%.

INTERESTING FACT

- **Tired of never-ending laundry?** Do you ever wish you could just pitch your washing machine? Then maybe you're ready to compete in the Guinness World Records Washing Machine Throw Showdown. Just know that you'll be up against 6'3", 326 lb. Johan Espenkrona who set the world record while going head-to-head with Dutch strongman Kelvin de Ruiter. The bodybuilders took turns throwing washing machines, attempting to scrub the old record of 13 feet, 6.6 inches set by Zydrunas Savickas. First, De Ruiter rinsed away Savickas' accomplishment with a 14-foot, 1-inch throw. But then Espenkrona, not wanting to be washed out, finally cleaned up by hurling his machine an astounding 14 feet and 7.2 inches. If you're not ready for that level yet, maybe you should settle for giving your hamper a good kick.

See next page for important disclosures

GuideStone® Capital Management

DISCLOSURES

Source: Morningstar

Performance greater than one year is annualized.

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S&P 500®: A market capitalization-weighted equity index composed of approximately 500 U.S. companies representing all major industries. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of its constituents.

Russell 1000® Value: A large-cap index consisting of those Russell 1000 Index securities with a less-than-average growth orientation. Companies in this index tend to exhibit lower price-to-book and price-to-earnings ratios, higher dividend yields and lower forecasted growth values than the growth universe.

Russell 1000® Growth: A large-cap index consisting of those Russell 1000 Index securities with a greater-than-average growth orientation. Companies in this index tend to exhibit higher price-to-book and price-to-earnings ratios, lower dividend yields and higher forecasted growth values than the value universe.

Russell 2000®: Measures the performance of the small-cap segment of the U.S. equity universe and is a subset of the Russell 3000 Index, representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. The index is completely reconstituted annually to ensure that larger stocks do not distort the performance and characteristics of the actual small-cap opportunity set.

MSCI EAFE: A free float-adjusted market capitalization index that is designed to measure equity market performance of developed markets, excluding the U.S. and Canada.

MSCI EM: A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

U.S. Aggregate: The Bloomberg U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate, taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency).

U.S. IG Corporates: The Bloomberg U.S. Aggregate Credit – Corporate – Investment Grade Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes U.S. dollar-denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.

U.S. HY Corporates: The Bloomberg U.S. Corporate High Yield Index – 2% Issuer Capped is an issuer-constrained version of the flagship Bloomberg U.S. Corporate High Yield Index, which measures the U.S. dollar-denominated, high-yield, fixed-rate corporate bond market. The index follows the same rules as the uncapped version but limits the exposure of each issuer to 2% of the total market value and redistributes any excess market value index-wide on a pro rata basis.

Global Aggregate: The Bloomberg Global Aggregate Index – Unhedged is a flagship measure of global investment grade debt. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.

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