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MARKET COMMENTARY August 20, 2022

Dow Jones Industrial Avg 34,678.35 Standard and Poor's 500 4530.41 2022 (YTD) -14.44% 2nd Qtr. -10.78% 2022 (YTD) -19.97% 2nd Qtr. -16.11%

"The first panacea for a mismanaged nation is inflation of the currency; the second is war. Both bring a temporary prosperity; both bring a permanent ruin. Both are the refuge of political and economic opportunists." - Ernest Hemingway

Economic Woes –After the decline in corporate earnings in this year's first quarter, investors were confronted with the possibility the economy might be faltering and how this might impact financial markets. Before most investors could adjust, the stock market registered its worst six month decline in at least 40 years. The Standard and Poor's 500 dropped 20 percent, while the tech-heavy NASDAQ plunged roughly 30 percent. Results in the fixed income markets were equally disappointing as bonds provided little in the way of shelter with a ten percent drop. Investors were rudely reminded stock and bond markets fall as well as rise. Needless-to-say, many market participants were in shock as they viewed their June statements. The surprise was the rapidity of the decline and the fact there were so few areas that were unaffected. Recent history inflated investor expectations as the stock market provided healthy double-digit gains in each of the previous three years.

Pain for Economy and Markets – This sudden reversal of fortunes was due in large part to a new, more virulent variant of the Covid virus and the many ways it impacted the economy. The Covid variant, BA-5, surfaced late in the first quarter of this year causing fear of another shutdown of the economy, which fortunately was not necessary. Nevertheless, consumers reacted to concerns of additional restrictions by beginning to cut back on consumption. This negative trend accelerated as inflation began to erode their purchasing power. Inflation rose from 1.9 percent in March of last year to a 9.1 percent annual rate in June – the worst in 40 years. To address this resurgence of inflation, the Federal Reserve announced a plan to steadily increase interest rates through the balance of the year. Their objective is to slow economic growth, which they believe will help subdue inflation. Although it may be difficult to assess the impact of these cross currents, one thing is clear neither stock market nor bond market investors felt comfortable with the outcome. There were only two safe places during the first half of the year – cash and energy stocks, yet each displayed weakness in the second quarter as inflation eroded the value of cash holdings and energy stocks retreated as higher prices reduced demand.

The economic outlook for the remainder of the year is a mixed bag, On the plus side, unemployment statistics have remained near record lows at 3.5 percent and there have been regular monthly gains in employment rolls, which has helped to lift total personal income. On the negative side of the ledger are rising interest rates and very high inflation (+9.1% annualized in June). Mortgage rate increases have brought about a turn in the market for both new homes and existing homes sales. In addition to adversely impacting the industries associated with housing, it will also affect the psychology of current homeowners, who will begin to see their home equity shrink after a extended period of increases.

Russia, Ukraine and the World Economy – Although this country's economy has been stronger than the other major world economies, the weakness of the last two quarters renders the U.S. vulnerable to problems elsewhere. One obvious development is the Russia- Ukraine war. Russia is a major supplier of

energy, natural gas and oil to the Eurozone, and President Putin uses Europe's energy dependence as leverage to achieve his political goals. There is considerable concern he will limit the flow of energy to Europe this winter, which will quite likely result in a recession in the region. Only Putin's pressing need for revenue to continue his war in Ukraine may prevent him from reducing the flow of gas and oil. Another major concern is the aggression being shown toward Taiwan by the People's Republic of China. China decided it could exploit the fact that the U.S. and its NATO allies are preoccupied with the Ukraine conflict to reassert its claim that Taiwan is a part of China, which mirrors Russia's view of Ukraine. Both situations can be linked to economic problems within the respective countries. Any escalation on either front would increase the possibility of a worldwide recession - or worse.

Possible Repercussions Here - On the home front, the economic outlook is clouded. In addition to the two recent consecutive quarters of negative growth are several worrisome trends. First is the increase in interest rates, which the Federal Reserve has been ratcheting up this year. The increases have resulted in a roughly two percent jump in mortgage rates since the beginning of the year. As a result, housing sales have crested due to the new rate level. One factor highlighted by the optimists is the persistent increase in consumer spending, yet much of that spending is paid for with credit cards. Higher interest charges will diminish disposable income. Finally, the elephant in the room – Uncle Sam (i.e., President Biden and the Congress) - borrowed three trillion dollars of "new" money last year, without any increases in revenue, and they recently added nearly a trillion more this year. Interest on this new debt will add approximately $100 billion annually to our national budget.

Energy pricing is creating challenges for countries around the world. Aggressive actions by Russia and the United States have resulted in the total dislocation of the world energy markets and has created instability for industries reliant on a steady supply of affordable energy. Europe will almost certainly experience a bleak winter because it allowed itself to become so heavily reliant on the flow of natural gas from Russia. Here in the U.S., the Biden administration enacted and signed legislation, which will reduce the country's reliance on carbon-based fuels (oil, natural gas and coal) in favor of green energy sources (wind and solar). This approach appears to ignore the magnitude of the shift since carbon -based now provides nearly two-thirds of our energy while green sources yield only 15 percent. These policies contributed to the spike in gas prices at the pump, which has since moderated. Consumers have already seen the severe impact on their electric bills and most certainly must prepare themselves for more pain when they receive their heating bills this winter. As a result, consumers will have less to spend and businesses will see sales and profits slide, which means a recession becomes more likely.

Defense! Defense! - The outcomes for the economy and the stock market are guarded at best. Starting the year with two quarters of negative growth combined with a Federal Reserve determined to limit inflation means it is difficult to see what factors will be able to spark growth in the near-term. As a result, a defensive posture is advised for most investors. It is recommended the focus be on strong, well-financed companies with dividends and capable of some growth during this trying period. An above-average cash position should take into consideration spending needs over the next 12- 18 months. Keeping some powder dry for an opportunistic purchase also makes sense.

A Change - Finally, I have had the assignment and the pleasure of providing my thoughts and comments about the financial markets, the economy, and even a sprinkling of politics, for the past 25 years. After due consideration, we have decided to replace my commentary with this more formal, professional quarterly report generated by Northern Trust, a Chicago-based bank whose services we have relied upon for quite some time. This will provide you with a much more comprehensive, detailed view of the economy and the markets. We felt this change would be more beneficial than my folksy, detail-light overview of the markets. Please let us know how you feel about this change as our goal is to provide you with the information you find most helpful. JML