Oakwood
FINANCIAL ADVISORS

Market Update & Comment - July 2022

The first six months of the year were challenging for investors with negative returns for nearly all asset classes. Global stock markets fell sharply, led by US stocks with the S&P 500 hitting a bear market in late May where it has remained. At close of business on June 30th the S&P 500 was down -20.5% YTD.

2022 Year To date (30th June)	
Index, Currency, Bond	**Gain/Loss**
FTSE World Index (€)	-21.0%
FTSE World Index (€) (x-US)	-19.5%
Dow Jones Industrial Average	-15.5%
S&P 500 Index (€)	-20.6%
FTSE Asia Pacific Index (€)	-17.7%
FTSE Emerging Markets Index (€)	-16.3%
Euro Stoxx 50 Index (€)	-19.9%
ISEQ (Irish Stock Exchange)	-25.2%
Gold Price (€)	-1.1%
Silver	-15.2%
Brent Oil	42.6%
Rogers Commodities Index (€)	23.1%
US 10-Year Bond Yield	2.87%
German 10-Year Bond Yield	1.22%

While there were a lot of moving parts in the markets picture, not least the war in Ukraine, the core narrative is very simple. The apparent persistence of high and rising inflation has spurred central banks to a hawkish stance, and sharp increases in interest rates are rarely welcomed by investors.

Interest Rate Increases (with more forecasted)

Markets have remained concerned after June's interest rate hikes from the Fed and Bank of England, with the former raising US rates by 0.75%. The ECB are planning a 0.25% rate rise in July 2022, the first since 2011.

Value v Growth
Within equity markets, the relative recovery of the value style continued in emphatic terms. The *MSCI World Value* index fell 4.5% compared with a 22.6% drop for its growth counterpart. Some of the divergence was related to sector-specific factors; the environment of strong commodity prices and prospective interest rate increases was supportive for a number of classic value sectors such energy, basic materials and financials.

Superior Return Potential
Growth stocks are those companies that are considered to have the potential to outperform the overall market over time because of their future potential. Value stocks are classified as companies that are currently trading below what they are really worth and will thus provide a superior return.

Our Clients Have Benefited
Our leaning in portfolios towards Value Stocks since the first half of 2021 benefited our clients, cushioning them from the brunt of the equity market drops in the first half of this year.

Bond Market Carnage
2022 has been a traumatic year so far in Fixed Income (Bond) markets. The benchmark Eurozone sovereign bond index is down 16.8% in the first half and fell 10.4% in Q2 alone. The yield on that index is now up to 2.2%, having bottomed at zero in 2020. Inflation-linked bonds were more resilient, but also produced negative returns in Q2. Investment-grade corporate bonds also held up better than sovereigns, mainly thanks to their lower average durations.

Safe Haven – Property
Among other asset classes, direct property was something of a safe haven while financial markets tumbled. The **Irish Life Commercial Property Fund**, a good representation of the Irish commercial market, returned a positive 2.3% for the first half of the year. Overall, the majority of Irish Commercial Property Funds returns circa 2% YTD.

Commodity Gains – Mixed Performance
The other asset class to register gains over the first six months was commodities, for obvious reasons. The Rogers *Commodities* index gained 23.1% in the first half. Within that, it peaked in early June, and retreated 13% from there as the Fed's mounting hawkishness raised recession fears.

Wall of Worry

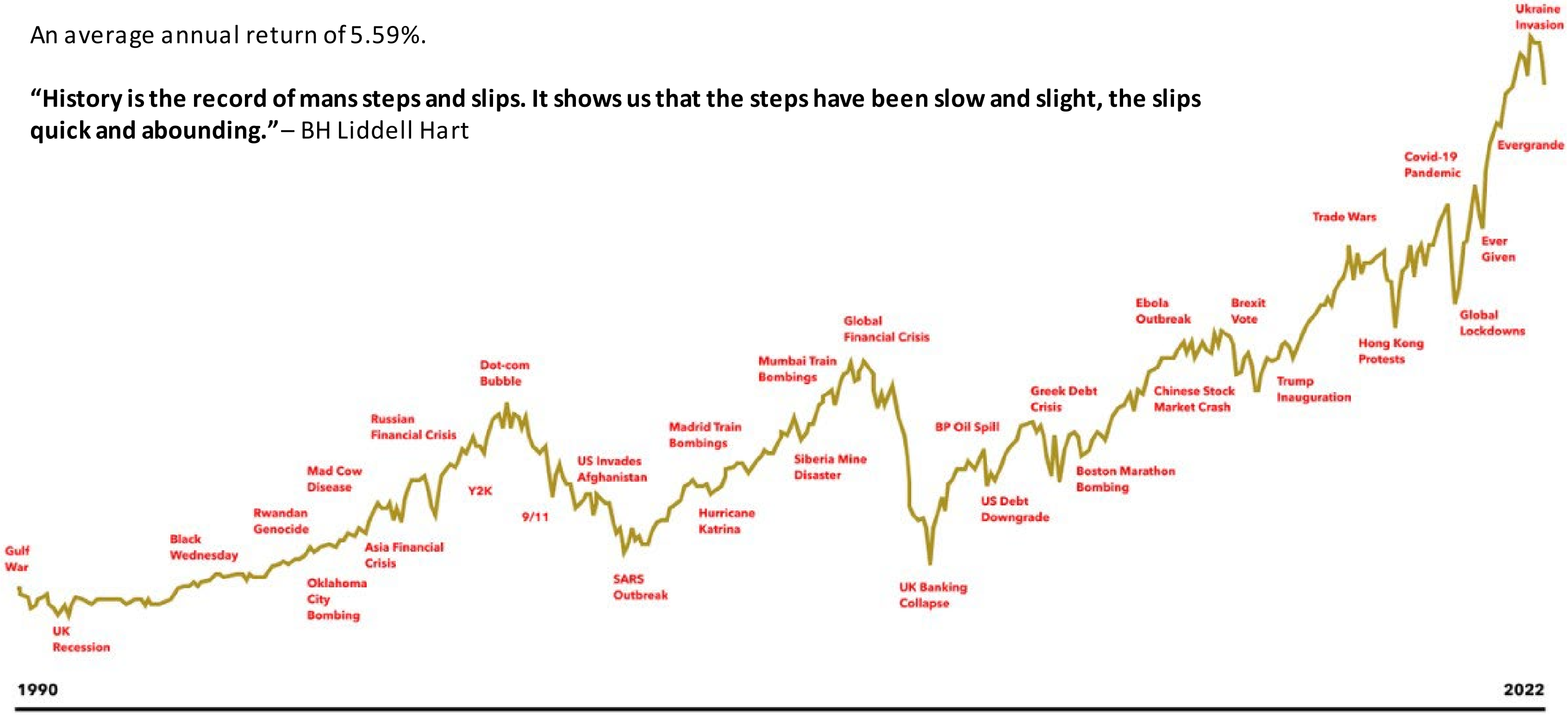
A Timeline of Negative World Events

The chart below shows the growth in world equity markets despite a never ending stream of negative world events.

Despite ongoing uncertainty, $1 invested at the start of 1990 grew to $5.70 by the end of 2021.

An average annual return of 5.59%.

"History is the record of mans steps and slips. It shows us that the steps have been slow and slight, the slips quick and abounding." – BH Liddell Hart



Source: Bloomberg, returns are based on the MSCI World Price Index from 1990 and do not include dividends.

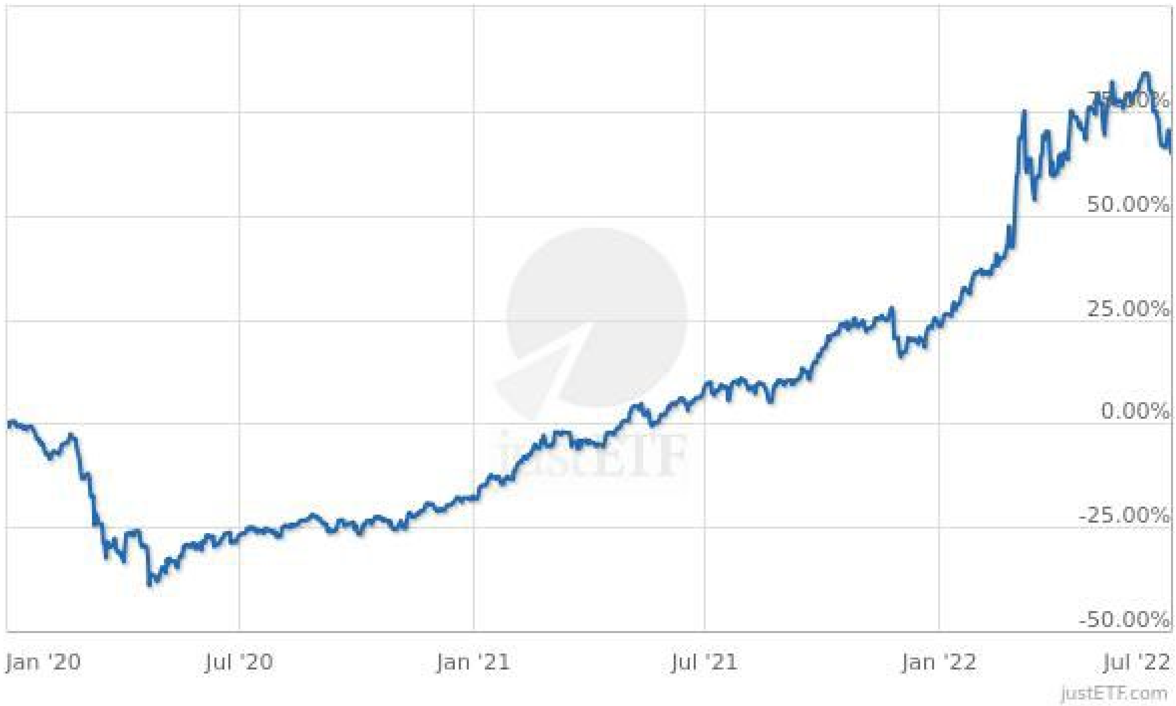
Inflation may have peaked

Developments in the commodity markets over the past few weeks are also interesting. General commodity prices, including oil and gas prices, have sold off sharply over the past fortnight. This may be an initial indicator that inflation peaked.

Following a bumpy passage

As the chart below highlights, the Roger's International Commodities Index had a significant decline at the onset of Covid-19. It recovered from mid-2020 onwards and broke out to new highs – reflecting the extra demand created by the various governments' stimuli in response to the pandemic and, more lately, the threat to oil and gas supplies following Russia's war against Ukraine.

Roger's International Commodities Index



Weakening commodity prices may well be reflecting an easing of demand as consumers curtail spending in the face of much higher prices, along with an easing of some supply constraints.

Credit availability in decline

In the context of equities, it is tempting to conclude that inflation moderating and a benign US interest rates could fuel a recovery in US equities, and hence global markets. But we must also recognise that the Federal Reserve is reversing its Quantitative Easing policy in place since 2009. An ongoing contraction of US credit is underway (with the reversal of quantitative easing), and the volume of credit available is going to continue to decline.

Looking Forward

This year's asset price declines have done much to restore valuations towards more reasonable levels when taking a longer-term view. Long-term average return expectations will have risen to reflect that adjustment.

Some equity markets offer good value

It was the explosion of credit since Covid that helped underpin much of the last two years' advance in stock markets. Its reversal is an additional headwind to any market recovery.

The main US stocks got to extreme values over this period on back of the FED Quantitative Easing programme and the correction looks like it may still to have a bit to go here. However, most equity markets outside the US are offering solid if not good value.

Speculative Bubbles Burst

It is also gratifying that extreme speculative bubbles evident in areas such as crypto-currency have been deflated without, thus far, any great contagion. As evidenced by Cathy Wood's ARK Innovation ETF, which is down 75% over the past 15 months, a lot of the speculative activity is being wrung out of US equity markets.

Equity uncertainty is a main concern

On equities, our main reservation relates to the corporate earnings outlook. Consensus expectations for profits growth look unduly optimistic in the face of cost pressure and economic uncertainty, and the necessary adjustment of those estimates may cause further volatility in the near term.

Bond Yields are Problematic

On fixed income, the picture is more nuanced than it has been for some time. Yields have certainly moved up to values which might be considered semi-reasonable. However, we believe there is a serious risk that inflation proves stickier than forecast, and the market's longer-term expectations will have to rise from current levels. This is likely to impact directly on benchmark bond yields and so we remain cautious on the asset class.

Cope with volatility by maintaining provident planning

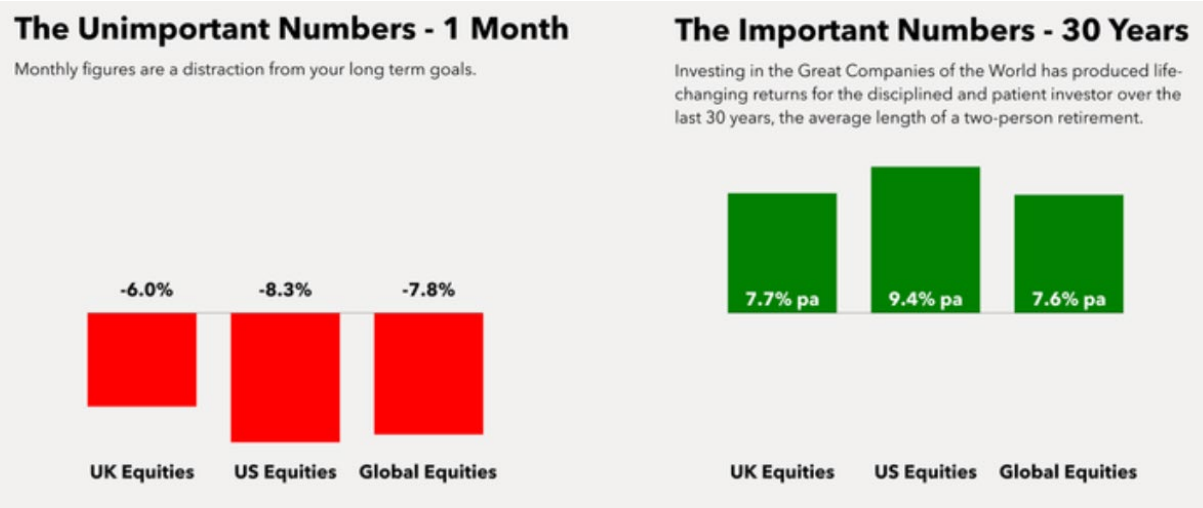
Whilst 2022 has been unsettling for investors, it does represent just 6 months over the lifetime of an investor's journey. Holding to core **investment principles**, remaining disciplined, and sticking with the plan continues to be age old, yet pertinent advice.

Stick to the plan

Success in investing is dependent on your appetite for volatility (the ups and downs of the market). The smooth stuff is not where you make money, especially with inflation running at over 8% year to date. You're not going to keep pace with inflation investing in government or corporate bonds. The ability to take a level of risk and have success depends on a set of human relationships just as much as it does on the mathematics of it. **Holding your nerve during these ups and downs produces the best results in the long term.**

Anytime volatility (fluctuation in asset price) picks up or the market makes a big move higher or lower, investors should remember that the market sets prices based off of ***the collective wisdom and foolishness from millions of decisions.***

The Stock Markets (updated June 2022)



Long term investment achieves your goals

If you are a long-term investor, if your fund will continue to be invested into perpetuity (ARF investor), then we must not overemphasize volatility. Your key benchmark should be to achieve all of your financial goals and not run out of money.

If you understand your tolerance for the worst days, you can build your portfolio to earn those higher returns and stay invested in stocks. That's the key. Compounding works best when it's uninterrupted. It also means you no longer have to concern yourself with the latest crisis and daily moves in the market.

Don't be misled

In many instances, volatility can be a friend rather than an enemy. Indeed, a focus on volatility leads to bad decision making. Individuals are directed to cash or lower risk assets (bonds) due to a risk score which doesn't take in to account their capacity for loss.

Opportunities to protect against inflation

The current volatility is offering up opportunities to invest in asset classes that protect against inflation. As mentioned previously in our note **Value based equities** have given a level of stability in the current market. For those with funds in cash or overly exposed to bonds then this may offer an opportunity to rebalance towards those **equity funds offering superior value**.

In addition, several Commercial Property funds have given a positive return in the first half of the year. While it may not feel like it due to the negative headlines, its not all doom and gloom. **Certain equity funds are now offering value which we haven't seen since before the Covid Pandemic.**

If you have any concerns with regard to recent markets falls please do let me know. As always, I welcome your comments, questions and concerns.

Ronan McGrath
Managing Director
Oakwood Financial Advisors

7th July 2022

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