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Stocks have finished the first half of the year and we are now embarked upon the second.

The Standard & Poor's 500 Index declined just over 20% in price terms during the first 6 months. News media around the world continue to print woeful stories so we need not rehash reasons for challenges: inflation, interest rates, oil, Ukraine war, supply chains, populism, and Covid.

Financial news have been highlighting that equities suffered the worst first-half performance in 50 years. That makes for eye-catching headlines as media compete for user views. However, it overlooks the fact that we have seen relatively more frequent poor second half performance periods during those same years.

The late 2018 and March 2020 downturns took a few short weeks and markets almost immediately then rebounded. Declines focused on a few market sectors. This one has lasted longer and involved all market sectors. That is closer to the norm for bear markets. We pointed out after the previous bounces that the technical definition of "bear market" was fulfilled by 20% declines, but a true bear typically takes more time and pulls down valuations across multiple sectors. Markets are cyclical and bear markets have a purpose: they purge excessive exuberance and reduce quality stocks to levels that are again cheap. We have gone a long way toward doing just that.

Growth stocks suffered more than value stocks. Here are some additional indexes from Oppenheimer's monthly client approved benchmarks report for June.

MSCI World .....	-20.5%
MSCI World Growth .....	-26.81%
MSCI World Value.....	-12.16%
Nasdaq .....	-29.22%
Russell 1000 Growth .....	-28.07%
Russell 1000 Value .....	-12.86%

The average bear market, depending on your data source, lasts 9 to 10 months. Some observers posit that this one actually began in first quarter 2021 with a break in leadership. Uptrending charts for the highest PE, high-revenue growth technology stocks first began to crack. Many such stocks since declined 50%, 70% and even 90%. In a bear market, past leaders are often the first to fall. It starts as a correction of a few sectors, but in its latter stages investors sell out of many more, even stocks with reasonable and low valuations.

Initially, bear markets cannot be distinguished from routine corrections--much as the first sneezes of a summer cold seem but a passing allergy. Only once a bear is well underway does it manifest its differences.

In the past, an allocation to bonds has proven a help to portfolios when stocks turned down. During the first half of 2022, bonds did not at all provide the performance cushion that they had provided in traditional asset allocations. Tightened policy from central banks around the world had a telling effect. Bond yields moved up sharply from the lows of 2021 and their prices declined. The Bloomberg Barclay's US Aggregate Bond Index dropped 8.8%, its biggest decline in 4 decades, with European high grade corporate bonds down 10% in the first five months.

The primary risk to bonds is inflation. Inflation, as no one needs be reminded, has increased dramatically since 2021. While inflation is still evident to us all when fueling a car or shopping for groceries, emerging signs of relief might be appearing on the horizon.

Increased interest rates could be having their desired effect on slowing inflation's severity. China Covid shutdowns and its real estate malaise add to the effect.

Commodity prices boomed because of supply chain disruptions when demand rose after Covid reopening. Exacerbating that came sanctions after Russia invaded Ukraine. Commodities from oil, to industrial metals, to agricultural goods spiked to multiyear highs.

Recently, as second calendar quarter transitioned to the third, key commodity prices halted their ascent. In recent weeks, industrial metals have dropped -20% to over -30% from recent highs. Agricultural commodities have also been coming down, despite sanctions and droughts. At this writing, here are some representative month-to-month commodity price declines:

Iron Ore .....	-14.15%
US Oil.....	-14.15%
Silver .....	-12.76%
Copper .....	-22.35%
Iron Ore .....	-21.72%
Wheat .....	-27.61%
Palm Oil.....	-35.83%

Source: tradingeconomics.com

These key inputs to producer price inflation are paid by manufacturers, bakers, bottlers, restaurants, etc.. Wheat prices, much a topic because of exports from Ukraine and Russia, after rising dramatically, have returned to pre-invasion levels. Higher energy prices are a significant issue, but even there prices have come off the highs—excepting of course in Europe. If the steam has gone out of the commodity rally, it would have a moderating effect on the pace of inflation to be reported in coming months.

These commodity price declines come too late to help profit margins to be discussed in this season's mid-year corporate profit reports. We will yet hear plenty of cautionary remarks with earnings reports. Input price declines do not provide immediate relief, but hold promise looking out a few months.

In developed markets, the consumer plays a large part in GDP—about 70% of the US economy—and consumer price inflation matters. Large retail chains like Target and Walmart are now heavily discounting consumer goods prices. Many retailers, in an effort to get ahead of supply chain difficulties, stocked up on goods consumers had been buying during Covid shutdowns. They overstocked just as consumers changed preferences. Shelf-clearing, lower prices can have a moderating effect on inflation looking out a couple of months. Inflation numbers are reported retroactively, so a continued moderation will not show up until the end of summer.

A decline in the rate of inflation will help bonds. Central banks will be able to slow the pace of rate rises. That is good for bonds and indeed all asset prices. In the last two weeks, longer dated bonds have stopped falling in price and risen on that possible outlook.

The lower income consumer is particularly affected by inflation and has shifted buying choices. This includes substituting cheaper brands and resorting to credit card debt to meet expenses. This is a much to be lamented problem for those individuals and for society. It will have an impact during coming elections.

In contrast, we have seen strong consumption

by middle- and higher-income consumers as post-Covid reopening ushered in changes in consumption habits. The Financial Times notes, “the split in spending patterns is showing up in survey data. Monthly spending among US adults making less than \$50,000 was down 8 per cent in May year on year, while spending among those making more than \$50,000 was up 25%”

Consumers shifted from the goods centered spending under quarantines to spending on services in reopening, more the prior norm. You only need look at internet news images to see the effect of renewed demand at airports and tourist destinations. The Financial Times again, “travel spending has surged, surpassing 2019 levels in April for the first time since the pandemic began, according to the US Travel Association.” The consumer is still generating economic momentum, providing revenue growth for some industries. We hear that Millennials prefer experiences to possessions, yet US Commerce Department figures quoted in the Wall Street Journal, “show that spending on long-lasting durable goods as of May was 18.8% higher than in February 2020, after adjusting for inflation and seasonal swings.”

The picture on corporate capital spending is still not clear. Earlier this year, there was considerable talk of investment in productive capacity in multiple industries. With concerns over a global economy slowing from higher interest rates, capex spending plans are being curtailed. The tech industry is considered relatively exempt from legacy encumbrances that weigh upon older industries during slow times, yet over the last month we have heard tech companies reduce hiring plans. Amazon has spoken of overcapacity in fulfillment and Tesla speaks of layoffs. Yet United Microelectronics, an important global microchip fabricator reports that June sales grew 43.2% over last year.

Rising rates will have had a damping effect on GDP. Recent GDPNow releases by the Atlanta Federal Reserve indicate that the US could print two quarters of negative GDP numbers, the technical definition of a recession. Yardeni Research have raised the odds for a shallow and short-lived

recession to 55% from 45%. But the Wall Street Journal counters, “with the economy nowhere close to anyone’s idea of normal, thinking a downturn is coming on the basis of what some model or rule of thumb says could be a mistake.” As in preceding examples, sources of economic growth show differing trends. There are still employment, consumption and investment tailwinds.

This bear market initially comprised the correcting of high PE ratios in some industries, and then began to incorporate an economic slowing. Analysts have been late to reduce earnings estimates, as recent weeks have shown. However, the correlation between stock performance and GDP growth is not 1:1. Stocks move in anticipation of future growth or future slowing. Stock prices started to move to encompass expectations of slowing well ahead of the analysts. Market sentiment is now coming to see economic slowing as leading to moderating central bank policy. Moderating rate rises and eventual interest rate declines tend to factor positively for stock market performance.

Bear markets end, one can never time exactly when. This bear market has gone a long way to reducing excess valuations in growth sectors—in other words, serving its purgative purpose.. One might look at the trailing PE ratio, which is to say that based on already reported earnings, not analyst forecasts. The S&P 500 trailing PE has declined from 28.8 a year ago to 17.75; a combination of increased earnings and declining prices has led to a correction in valuation of 38%. Nasdaq declined from 37.95 to 24.65.

Turning to the forward PE, which is based on the consensus of analysts’ estimates, Factset reported on July 1st a forward PE of 15.8. That is below the 5-year average of 18.6 and the 10-year average of 16.9. The last decade witnessed extraordinarily low interest rates, which justified anomalously high PEs, so it is worth considering a longer-term time frame: the 20-year average is 15.5 and 25-year 16.5.

On the above basis, the market looks reasonably valued to slightly cheap. This in itself is not yet an all-in buy signal. Analysts are still trimming earnings estimates to reckon for adverse events since their

earlier estimates were published. Still, it is worth reiterating that the bear market has already done a large part of its unpleasant but salutary work.

On a stock-by-stock view, we see more and more valuations that have actually become cheap as compared to a company's own history and market valuations. Value investors like Warren Buffett and Berkshire Hathaway colleagues have been stepping in, taking recent declines as an opportunity to accumulate.

For growth investors, the hit has been harder this year. The William O'Neill group provides quantitative screens based on data accumulated over 60 years which appear in Investors Business Daily. To paraphrase that newspaper, one might have wished "the stock market would move sideways

to allow more stocks to set up bases, while investors get more clarity on the Federal Reserve and the economy. But the market will do what it will. Investors should keep positions small and be ready to take quick profits and keep any losses small. When a sustained market rally takes hold, investors will have plenty of opportunities to ramp up exposure and letting winners run. For now the focus should be on preparing for that next bull market."

As to stories about the last 6 months being the worst first half in decades, it might be noted that after previous such declines, stocks rebounded in the second half, rising 15% in the final 6 months of 1962 and 27% in 1970. Past performance is never a guarantee of what might happen next, but that is useful counterpoint to the media headline flow.



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The Standard and Poor's (S&P) 500 Index is an unmanaged index that tracks the performance of 500 widely held large-capitalization U.S. stocks. Individuals cannot invest directly in an index.

performance of developed markets. As of January 24, 2014 the MSCI World Index consisted of the following 23 developed market country indices: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

MSCI World Growth Index captures large and mid-cap securities exhibiting overall growth style characteristics across 23 Developed Markets countries. The growth investment style characteristics for index construction are defined using five variables: long-term forward EPS growth rate, short-term forward EPS growth rate, current internal growth rate and long-term growth rate and long-term historical growth trend and long-term historical sales per share growth trend.

MSCI World Value Index captures large and mid-cap securities exhibiting overall value style characteristics across 23 Developed Markets countries. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield.

Bloomberg Barclays U.S. Aggregate Bond Index is an unmanaged index composed of securities from the Barclays Capital Government/Corporate Bond Index, Mortgage- Backed Securities Index and the Asset-Backed Securities Index. Total return comprises price appreciation/depreciation and income as a percentage of the original investment. Indices are rebalanced monthly by market capitalization. 4834009.1